CHÍNH PHỦ VIỆT NAM
THE GOVERNMENT OF VIETNAM

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VIETNAM PUBLIC EXPENDITURE REVIEW

# Fiscal Policies towards Sustainability, Efficiency, and Equity

OVERVIEW

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## OVERVIEW

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

Australian Aid

Global Affairs Canada

Schweizerische Eidgenossenschaft
Confédération suisse
Confederazione Svizzera
Confederaziun svizra

Swiss Confederation

Federal Departement of Economic Affairs,
Education and Research EAER
State Secretariat for Economic Affairs SECO

UKaid
from the British people

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| | |
|---|---|
| **ARP** | Agricultural Reform Plan |
| **ASEAN** | Association of South-East Asian Nations |
| **ATM** | Average Time to Maturity |
| **BOT** | Build-Operate-Transfer |
| **BT** | Build-Transfer |
| **CIT** | Corporate Income Tax |
| **DMEFD** | Debt Management and External Finance Department |
| **DoET** | Department of Education and Training |
| **DoF** | Department of Finance |
| **DFAT** | Department of Foreign Affairs and Trade of Australia |
| **DoHA** | Department of Home Affairs |
| **DRG** | Diagnosis Related Group |
| **EBFs** | Extra-Budgetary Funds |
| **FDI** | Foreign Direct Investment |
| **GDT** | General Department of Taxation |
| **GAC** | Global Affairs Canada |
| **GII** | Global Innovation Index |
| **GoV** | Government of Vietnam |
| **GFS** | Government Financial Statistics |
| **GDP** | Gross Domestic Product |
| **HCMC** | Ho Chi Minh City |
| **IDA** | International Development Association |
| **IMF** | International Monetary Fund |
| **IPSASs** | International Public Sector Accounting Standards |
| **MTFBP** | Medium-Term Financial and Budgetary Plan |
| **MTIP** | Medium-Term Investment Plan |
| **MoET** | Ministry of Education and Training |
| **MoF** | Ministry of Finance |
| **MoH** | Ministry of Health |
| **MoHA** | Ministry of Home Affairs |
| **MoLISA** | Ministry of Labor, Invalids and Social Affairs |
| **MoNRE** | Ministry of Natural Resources and Environment |
| **MPI** | Ministry of Planning and Investment |
| **MARD** | Ministry of Agriculture and Rural Development |
| **MoST** | Ministry of Science and Technology |
| **MoT** | Ministry of Transportation |
| **MDGs** | Millennium Development Goals |

| | |
|---|---|
| **NTPs** | National Target Programs |
| **O&M** | Operations and Maintenance |
| **OECD** | Organization for Economic Co-operation and Development |
| **ODA** | Official Development Assistance |
| **PIT** | Personal Income Tax |
| **PISA** | Program for International Student Assessment |
| **PER** | Public Expenditure Review |
| **PFM** | Public Financial Management |
| **PPP** | Public-Private Partnership |
| **PSDUs** | Public Service Delivery Units |
| **R&D** | Research and Development |
| **SAV** | State Audit of Vietnam |
| **SBV** | State Bank of Vietnam |
| **SECO** | State Secretariat for Economic Affairs of Switzerland |
| **SOEs** | State-Owned Enterprises |
| **TMS** | Tax Management System |
| **TABMIS** | Treasury and Budget Management Information System |
| **USD** | United States Dollar |
| **VAT** | Value-Added Tax |
| **VPSASs** | Vietnam Public Sector Accounting Standards |
| **VSSF** | Vietnam Social Security Fund |
| **VND** | Vietnamese Dong |
| **WBG** | World Bank Group |
| **WTO** | World Trade Organization |

# Foreword

Robust development transformation has placed Vietnam amongst the fastest growing developing economies in the world and achieved an impressive poverty reduction record. This process was supported by equitable and growth-friendly fiscal policies. 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 infrastructure to promote growth and poverty reduction. 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 to promote investment and growth have also resulted in slowing revenue growth in recent years.

Consequently, fiscal space has narrowed. Persistent fiscal deficits have driven rising public debt and raise concerns about the medium-term sustainability of the current fiscal position and the corresponding public debt path. Moreover, the rapid pace of expansion, openness and decentralization has made the economy more complex to manage. 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 while ensuring adequate fiscal space for investment and social spending. Achieving these objectives will require 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.

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 concrete options for fiscal reforms. This PER includes 68 specific policy measures aimed to: (a) achieve a gradual fiscal consolidation as a vital component to assist in embedding fiscal sustainability; (b) restructure budget allocations, including between central and local government, between capital and recurrent spending, and reallocation within sectors; (c) undertake institutional reforms to ensure that enhanced fiscal decentralization and autonomy given to public service delivery units be in line with functional devolution and capacities of subnational authorities and service units, as well as 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; and (d) strengthen capacity to successfully employ more advanced public financial 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.

This report is the result of collaborative process, with strong ownership of all related Government agencies and support by specialists from the World Bank. Going forward, as endorsed by the Prime Minister, relevant ministries and provinces will seek to implement the recommendations of this PER. 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.

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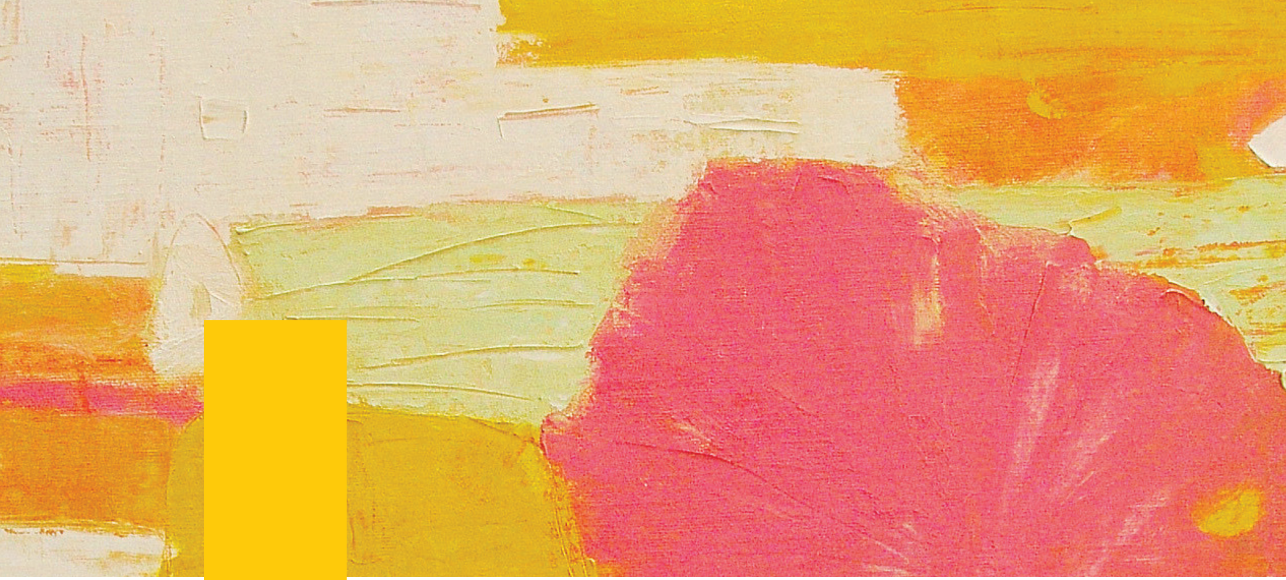

# INTRODUCTION

1. **Vietnam's reforms ("Doi Moi") initiated in 1986 have successfully transformed the country from one of the poorest in the world to lower middle-income status.** Since 1986, Vietnam's GDP has expanded more than fivefold, per capita income has quadrupled and the poverty rate declined markedly from 49 percent in 1993 to just 2.9 percent in 2014.[1] Whilst capitalizing on its gradual integration into the global trade and financial system, Vietnam, one of Asia's success stories, has also been transforming itself from a centrally-planned economy into a more market-oriented economy. Following its accession to the World Trade Organization (WTO) in 2005, Vietnam has emerged as one of the world's most attractive new investment destinations. Growth has been accompanied by a massive expansion in international trade and significant inflows of foreign direct investment and remittances. At around 180 percent of GDP, Vietnam's trade-to-GDP ratio is one of the highest in the world. Not only are income levels higher, but the Vietnamese population is better educated and has a higher life expectancy than most countries at a similar per capita income level. An impressive expansion of access to general education has been accompanied by quality improvements, such as in the basic cognitive skills of literacy and numeracy (PISA results 2012)[2]. There have also been significant improvements in health, reflected in Vietnam's entry into the top ten "high-performing" countries in its achievement of the Millennium Development Goals (MDGs) for health. The country also gradually improved its innovation ranking from 76$^{th}$ in 2012 to 71$^{st}$ in 2014, and is now placed in the middle of the 143 countries in the Global Innovation Index (GII).

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1 Under the poverty line of USD 1.90 a day, 2011 PPP.

2 The Program for International Student Assessment (PISA) is a worldwide study by the Organization for Economic Co-operation and Development (OECD) in member and non-member nations of 15-year-old school pupils' scholastic performance in mathematics, science, and reading.

2. However, Vietnam has also been encountering a number of difficulties in the wake of the global financial crisis, and the country will need to take determined reform and policy actions to meet its development agenda of restoring rapid, sustainable and equitable growth.

3. **GDP growth—a critical pillar of Vietnam's development record—has been on a noticeably lower trajectory since 2008.** Reversing this trend and returning growth to the earlier pre-global financial crisis peak is essential given Vietnam's aspiration of becoming a modern industrialized economy within a generation. An immediate policy focus is needed on preserving macroeconomic stability, whilst proceeding with structural reforms in public investment, state-owned enterprises (SOEs) and the banking sector. Key to this will be shifting away from a growth model that is capital investment-led (mainly by the state), towards one that is steered by the private sector and based on productivity and quality of growth. It will also be important to reallocate resources from less to more productive sectors; to improve productivity within the manufacturing and services sectors; to invest in science and technology; and to boost the innovation capabilities and skills of the workforce above and beyond its current proficiency in basic education.

4. **Despite Vietnam's good overall record, significant gaps remain in equality of opportunity.** Whilst income inequality remains modest, inequality of opportunity has emerged as a growing concern. Children from poor households and in remote areas are far less likely than their more fortunate peers to have access to education, sanitation and health care and are much more likely to be malnourished. Similar to its successful East Asian peers (Japan; Taiwan, China; and the Republic of Korea), Vietnam's main resource is its people. Investing in a universally strong human capital base is therefore a prerequisite for long-term growth. Whilst major gains have been made in reducing poverty, a significant proportion of the population lives just above the poverty line and is vulnerable to falling back into poverty as a result of economic or climate-related shocks, diseases and epidemics. They are also more vulnerable to the longer-term patterns of environmental and natural resource degradation.

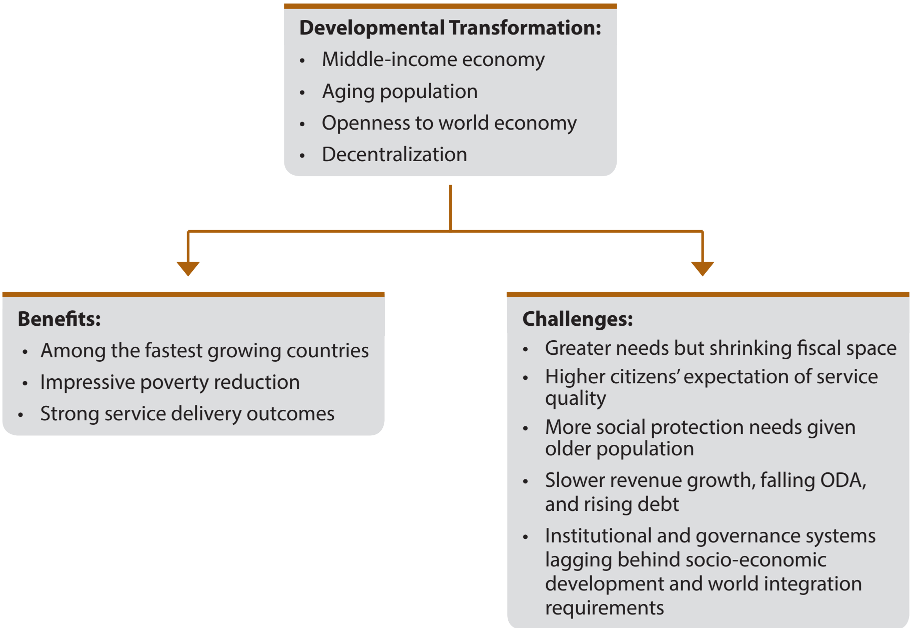
5. **Institutional reforms need to keep pace with economic development and continue to secure inclusive and equitable growth and social security.** Vietnam will face qualitatively different challenges in the coming years as a middle-income country. The country's strong track record in expanding the reach of basic public services reflects its rise from a low base as a lower-income country. Countries naturally fall into growth traps unless continual reform, especially in their institutional approach, takes place. In Vietnam's case, strengthening public resource mobilization and management, public services and their performance, and transparency and accountability will all be central to the institutional reform agenda.

6. **One of the main cross-cutting issues is that institutional reforms need to be continued if the state is to become a successful facilitator of the economy.** Private provision of public services should be encouraged as a means of fostering competition, with the objective of achieving higher levels of service delivery. However, this path of reform is fraught with risks as the boundary between public and private domains change. There is increasing use of public-private arrangements to obtain higher levels of service delivery and infrastructure development. For reforms to be successful, it is critical to review both policies and mechanisms and reduce rent-seeking behavior. Most prominently, there has been a significant movement of functional responsibilities on financing and human resources to sub-national governments. Sub-national spending now accounts for approximately 55 percent of all Government expenditure, nearly 70 percent of total public investment, 85 percent of education expenditure and nearly 80 percent of health expenditure. However, fiscal transparency and accountability have not kept pace with this high level of fiscal decentralization. In the longer term it will also be important to define an optimal level of decentralization to avoid fragmentation of resources in pursuing the higher level development objectives of the country.

7. **Vietnam's development transformation, characterized by graduation to middle-income status, an aging working population, greater openness and fast decentralization, has also brought about new fiscal challenges** (see Figure 1). The transformation has increased the demand for quality public services and social protection, thereby creating increased fiscal pressures. Vietnam, like many other East Asia Pacific countries, risks getting old before getting rich. Managing rapid aging is not just about caring for old people, but requires comprehensive and proactive policy responses on pensions, health care and labor markets. Rapid aging will also require careful monitoring of the social protection system to ensure that it is comprehensive whilst remaining fiscally and financially sustainable. As countries age, to maintain competitiveness their economies typically move from a labor-intensive structure towards a knowledge economy. In this context, it is particularly important to ensure that a significant part of the child population and especially those considered as being from poor and near-poor households, do not withdraw from education between the primary and secondary levels. The quality of education and promotion of technological upgrading also needs improvement. All of these policy responses will require greater fiscal space to finance the necessary spending.

8. **This transformation has resulted in increasing expenditure needs, causing a shrinking of fiscal space just when higher levels of spending are needed.** 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. This became evident in the global economic crisis in 2008-09. Fiscal policies, including 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.

**Figure 1. Vietnam's rapid transformation is reshaping fiscal policy choices**




9. **Consistently high budget deficits, rising public debt and falling overseas development assistance (ODA) have emphasized the importance of developing a sustainable fiscal strategy.** As a result of persistent budget deficits, the debt-to-GDP ratio has increased rapidly, reaching 58 percent in 2014 and 61 percent in 2015, leaving Vietnam with shrinking space for borrowing. Recent years have also seen a notable shift in the composition of debt with increasing use of domestic debt financing which is more costly and has shorter maturity than the concessional external financing that Vietnam has relied upon in the past. This trend is expected to continue as access to concessional financing dwindles as a result of Vietnam becoming a middle-income country.

10. **The rapid pace of expansion, openness and decentralization has made the economy more complex to manage.** Although Vietnam weathered the global financial crisis relatively well, excessive fragmentation of public resources (including extra-budgetary resources) and data insufficiencies impaired the authorities' ability to thoroughly assess the actual size of government operations. This not only affected the impact of these operations but also the longer-term influence of monetary and fiscal policies. Macro-fiscal and public financial and information management systems as well as coordination between the relevant parties need to be further strengthened if they are to keep pace with the demands generated by ongoing transformation as well as new types of challenges.

11. **The Government has undertaken a significant number of reforms in public financial management over the past 10 years.** The joint PER 2004 proposed 118 reform recommendations, with the objective of strengthening legal and management systems in an efficient and transparent manner and bringing them more into line with international best practice. To date, about 70 percent of the recommendations have been completed. Most notable have been: the strengthening of the legal ecosystem as the Government submitted for approval by the National Assembly of a series of laws on the State Budget (2015), Public Investment (2014), Public Debt Management (2009, and again under revision), Public Asset Management (2017), Accounting (2015), Auditing (2015), State Capital Investment in Enterprises (2014) and Enterprises (2014); and adopted their accompanying regulations. Organizational arrangements and management infrastructure have also been enhanced. In particular, the strengthening of institutional arrangements for a more unified planning and budgeting process in selected ministries and provinces and the enhancement of management information systems to support PFM operations (including tax administration, customs modernization and treasury and budget management). Some of the key improvements are summarized in Figure 2.

12. **However, following through on a number of simultaneous reforms has proved challenging and these reforms will require more gradual implementation.** These include: the introduction of the medium-term perspective in fiscal planning and budgeting; strengthening of results orientation in budget management; implementation of the socialization agenda; selective mergers of the planning and finance agencies; further decentralization for local legislatures to exert full authority over local budgets; and increased revenue autonomy for provincial governments. Overall, the lag in the development of financial systems in a rapidly decentralizing economy has reduced effective control over alignment and prioritization of spending to meet development objectives. As such, there is still an unfinished agenda that needs to be reconsidered in the new context. Above all, the Government, realizing the need to ensure fiscal sustainability, has set itself a target of gradually reducing the level of fiscal deficits. However, fiscal consolidation options still need to be further considered.

**Figure 2. Progress from the PER 2004**

| Fiscal policy framework | Fiscal transparency | Intergovern-mental fiscal relations | Budget execution | Budget oversight |
|---|---|---|---|---|
| Medium-Term Fiscal, Expenditure and Investment Plans introduced. | Approved budget proposal, final accounts and audit results disclosed. | Local borrowing thresholds set more in line with international practices. | Budget control rationalized and commitment management introduced. | Budget preparation calendar decompressed. |
| Budger balance definition updated reflecting fully central and local government bonds. | Budget proposal disclosed for public consultation, citizens' budget, mid-year review disclosed. | National Targeted Programs consolidated. | Classification and reporting of both recurrent and capital budget unifed. | Legislative ovesight strengthened. |
| Prudent debt thresholds introduced. Management of external-domestic debt unified. Debt situation monitored closely. | Extra-budgetary funds and gross accounting of charges integrated. | Exclusive assignments of central government clarified. | Treasury and Budget Management Information System (TABMIS) introduced. | Legal status and scope of external audit by SAV enhanced. Audit findings disclosed. Audit recommen-dations followed up. |

13. **The Government of Vietnam and the World Bank Group, supported by other development partners, therefore 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 of this PER. 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? (See Figure 3).

**Figure 3.** **The three main questions of the PER**


14. 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 (i) net contributors and (ii) net recipients), as presented in Figure 4.

**Figure 4.** **The structure of the PER**

| Cross-cutting | Sector | Subnational |
|---|---|---|
| • PFM institutions | • Education | • Lao Cai Province |
| • Macro-fiscal trends | • Health | • Hai Phong City |
| • General revenue | • Science & technology | • Quang Nam Province |
| • General spending | • Agriculture | • Ho Chi Minh City |
| • Capital spending | • Transportation | • Can Tho City |

15. **The PER is expected to begin a multi-year engagement on more regular thematic expenditure reviews as well as on technical assistance and financing to support reforms.** It aims to focus firstly on the most pressing policy issues within each area and then to identify other policy issues for further analysis and support in subsequent years.

16. **In the report, the rate of growth (e.g. of GDP and budget revenue and expenditure) is presented in real (or constant 2010) terms.** Real term value, excluding the effect of inflation, is used to calculate growth rate and to enable comparison of changes in volumes over time as if prices had not changed. This method is different to the nominal terms (or current price) method, which is not adjusted for inflation and therefore factors price increases into the value. The knowledge of real growth rate (inflation adjusted) is useful for economic and fiscal policymakers. Real growth rate is often used for one or both of two purposes: (i) comparing the real growth between periods, to understand real trends over time; and (ii) comparing the growth rates of different economies that have different rates of inflation.

17. **The main findings and recommendations of the 15 chapters** are presented in the remainder of this overview structured around the three questions that anchor the PER study.

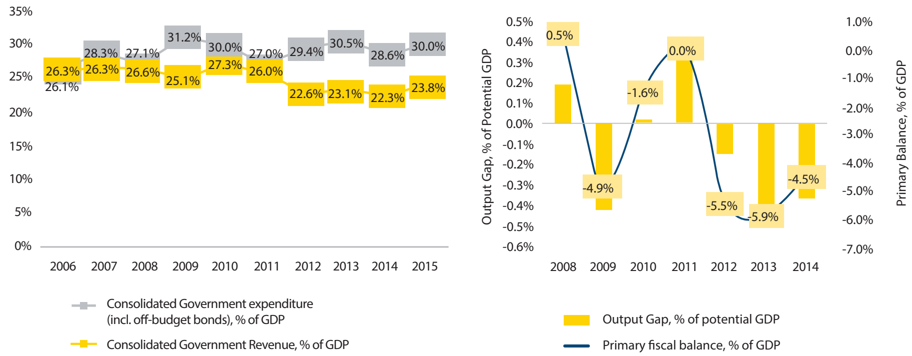
# 1 PURSUING FISCAL CONSOLIDATION, ENSURING FISCAL SUSTAINABILITY

## Ensuring fiscal sustainability and resilience to shocks

18. **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** (see Figure 5, right panel). 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 5.5 percent of GDP[3]; 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. A cyclical downturn in tax revenue-to-GDP was compounded by declines in oil revenue, trade revenue and land related revenue. In contrast, more recent expenditure expansion was driven largely by government consumption and social transfers (see Figure 5, left panel). In addition to the widening fiscal deficit, extra-budgetary borrowing has also contributed to rising public debt. The situation resulted in the recent surge in the debt-to-GDP ratio in Vietnam.

3 Using international definitions.

**Figure 5. Widening fiscal imbalances ... ...reflect countercyclical fiscal policy**

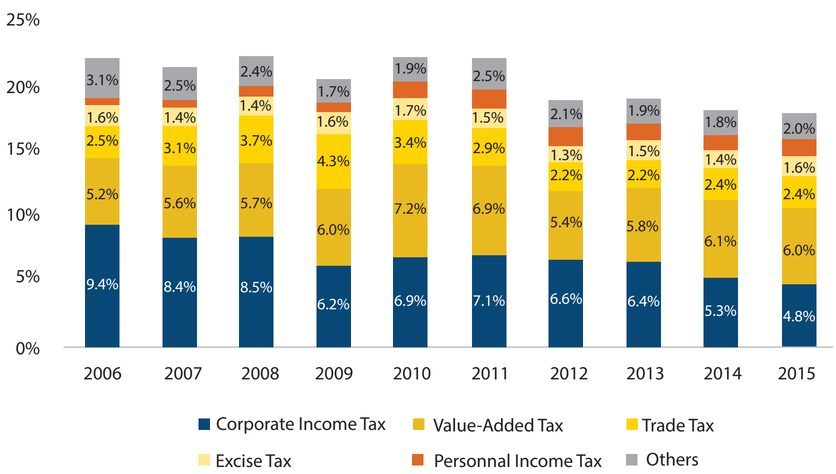



*Sources:* Vietnamese authorities and World Bank staff estimates.

## Revenue trends

19. **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 (See Figure 6).

**Figure 6. Tax revenue-to-GDP is on a consistent downward trend**




*Sources:* World Bank staff estimates based on MoF data.

20. **The main contributors to the lower revenue-to-GDP ratio include a decrease in oil revenue, land revenue, and tariff revenue.** The falling share of oil revenue in total GDP is due to the recent collapse in crude oil prices. From 2006-10 to 2011-15, the oil revenue-to-GDP ratio declined from 4.8 percent to 3.0 percent. Revenue from import and export activities to GDP fell from 5.5 percent to 4.2 percent and land-related revenue from 2.5 percent to 1.7 percent. The oil revenue decline was mainly due to the world oil price decrease coupled with Vietnam's declining oil production. Extensive global integration brings major benefits from increased exports and foreign investment, but reduces tariff revenue. Also, an increase in international transactions without strengthened administration capacity can risk transfer pricing and profit shifting by transnational companies. Land related revenue (which used to be nearly 10 percent of total revenue) also declined as the real estate market fell into its cyclical downturn. The overall declining trend in revenue will likely continue as free trade agreements that Vietnam has embarked upon gain momentum and the slowdown in land related revenue continues.

21. **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 in 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. Although CIT declined by 6 percent from the previous period, non-oil CIT between 2011-15 was still 3.8 percent of GDP, 0.3 percent of GDP lower than that between 2006-10. If the CIT collected from household businesses collected as PIT is taken into account, the CIT revenue in 2011-15 was essentially the same as that in 2006-2010. Despite a series of recent incentive policies, the share of VAT in GDP remained stable at 6.1 percent. In particular, domestic VAT rose slightly from 4 percent to 4.3 percent between the two periods. Personal income tax (PIT) increased significantly in the period from 0.8 percent to 1.3 percent of GDP.

22. **Vietnam has successfully managed its tax policy and administration system through a smooth transition towards one that is more market based and less reliant on external sources (oil and trade revenues).** Since 2005, the tax base has been broadened and tax rates have been gradually rationalized, making the tax regime more efficient. There have been positive structural changes in the composition of tax revenue towards more sustainable revenue sources. 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 68 percent (in 2011-15). In 2015, the share of domestic revenue to total revenue reached 75 percent. This increase partially helped to offset the decline in revenue from foreign trade due to economic integration and oil revenue.

23. **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 led to a considerable reduction in the time spent to pay taxes. This was particularly due to the simplification of tax compliance regulations[4] and the application of the Tax Management System (TMS) for core tax functionalities, such as registration, filing, return processing, taxpayer accounting, tax payment and arrears management.

24. **Despite achieving initial success, current business processes remain complex.** For the tax system to be effective, information based systems need to be supported by 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. Strengthening of the tax administration database and adoption of value-added IT applications is also required.

## Expenditure trends

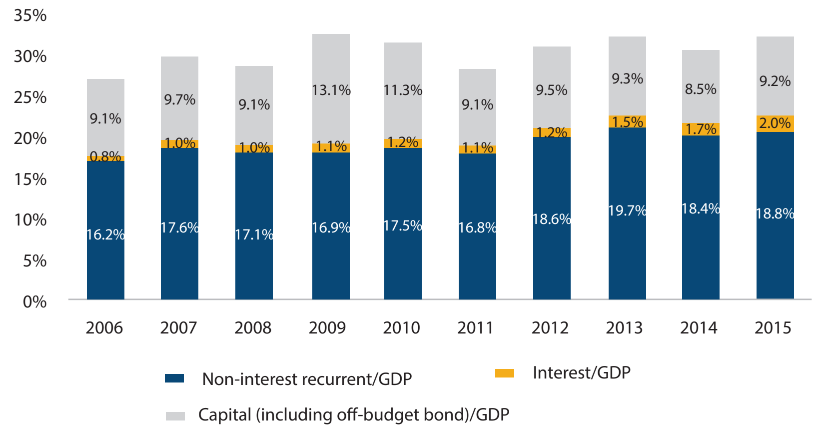
25. **Government expenditure, including capital outlays financed by off-budget bonds, has been maintained at a high level against GDP although the revenue ratio declined moderately in 2011-15.** From 2011-15, total State budget expenditure averaged 29.2 percent; rising moderately from 28.9 percent in the previous period. This was to accommodate civil service salary and social security increases. Growth in real state budget expenditure declined to 14.7 percent in 2011-15 compared with 21.7 percent in 2006-10.

26. **The composition of expenditure has changed with the rising proportion of recurrent expenditure (including interest payments).** In 2011-15, the proportion of recurrent to capital expenditure was 70:30, compared to 65:35 from 2006-10. The rise in the proportion of current expenditure has been driven by increased outlays on social security, salaries, wages and allowances and by interest payments. Expenditure on social security (excluding the wage bill) grew on average at 18 percent per year[5], faster than the growth of total revenue and expenditure. As a proportion of GDP the wage bill grew from 6.2 percent in 2009 to 7.3 percent in 2012. The growth in 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 a 12 percent increase in base and non-base salaries and allowances[6] and a 9 percent increase in the number of civil servants and government employees. The growth in the number of employees occurred between 2009-12 and was particularly at subnational government levels (20 percent). This was mostly due to the inclusion of commune officers and pre-school teachers into formal employment. The growth of public sector employment was much faster than population growth at 1.1 percent per year. International benchmarking comparisons indicate that the total wage

4 Government Resolution 19/NQ-CP dated March 18, 2014, and Resolution 19/NQ-CP dated March 12, 2015.

bill of Vietnamese civil servants is not overly high, but its rapid growth warrants caution. Additional analysis of the dynamics of the wage bill is recommended before considering further upward adjustments of the size of Government employment or increases in pay. Debt service payments are imposing an increasing burden on the budget. Interest expenditure has risen sharply both as a share of GDP and as a share of government revenue. In 2015, the Government spent about 2 percent of GDP and 8 percent of its total revenue (including grants) on interest payments; up from 1.2 percent and 4.3 percent in 2010 respectively. Debt service payments, including amortization, rose to 15 percent of government revenue in 2015 and continues to approach prudent thresholds, highlighting intensifying fiscal financing risks.

**Figure 7. The composition of expenditure is gradually moving towards recurrent spending**




*Sources:* World Bank staff estimates based on MoF data.

27. **The share of capital spending, although declining in total state budget spending, remains higher than the rest of the world and regional peers.** The state budget continues to make a significant contribution to investment in public infrastructure, contributing 29.1 percent of gross capital formation in the economy between 2011 and 2015. This was a moderate increase from 28.4 percent in the period 2006-10. Vietnam's government capital spending was on average 9 percent of GDP from 2011-15[7], lower than that of Mongolia (13.0 percent) but considerably higher than capital spending in Indonesia (3.3 percent), the Republic of Korea (4.2 percent) and Singapore (6.1 percent). Budgeted capital spending as a percentage of total spending is higher than for all these countries. The state budget continues to contribute nearly one third of gross capital formation to the economy, reflecting sustained investment in public infrastructure.

5 Real prices in the period 2011-15.

6 Since 2006, Government increased the base salaries and allowances 08 times, to cover inflation and to improve the living conditions of several target groups.

7 Inclusive of capital expenditure financed by government bonds and lottery revenue.

28. **Vietnam is a highly decentralized country and is becoming more so.** Between 2011 and 2015, sub-national spending, including expenditure sourced from central budget transfers, was 55 percent of total government expenditure. This was a rapid increase from 50 percent in 2006-10. Sub-national governments now account for 85 percent of education spending and nearly 80 percent of health spending. Capital spending is trending towards higher decentralization, whilst recurrent spending trends remain relatively similar (Figure 8 and 9). Over the period, the sub-national share of total capital spending increased to nearly 70 percent, which is high compared to international levels. Whilst there is no single correct mix between central and sub-national capital spending, this trend may constitute a special cause for concern, as discussed further in paragraph 68 below.

**Figure 8. Capital spending by level of government (% GDP)**

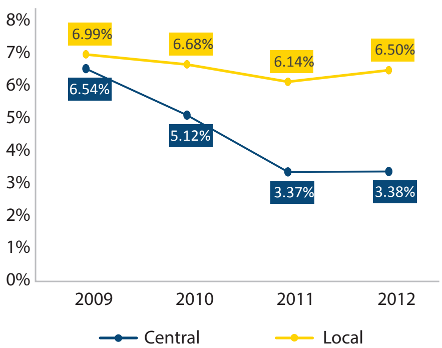
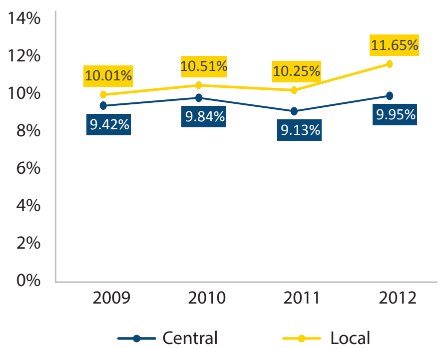



**Figure 9. Recurrent spending by level of government (% GDP)**

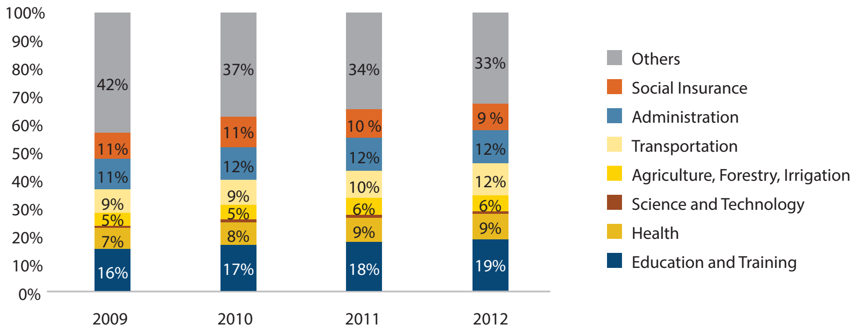



*Source:* MoF.

29. **The growth of spending on several key functions has been mixed.** Between 2009 and 2012 spending on education and health grew significantly above average, by 9.6 and 12.2 percent per year respectively. Public spending on education was 19 percent and health 9.5 percent in 2012. Spending on science and technology grew at an annual rate of 3.7 percent, which was below its average trend.[8] Spending on transport and agriculture was relatively stable at about 11 percent and 6 percent (see Figure 10). 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. This stronger emphasis in recent years on state budget spending on human capital development also reflects the government's expectation that the socialization agenda (i.e. mobilization of private investment) in the other sectors will advance at a faster pace.

8 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.

**Figure 10. Spending by government function (%)**




*Source:* MoF.

## Overall fiscal and public debt trends

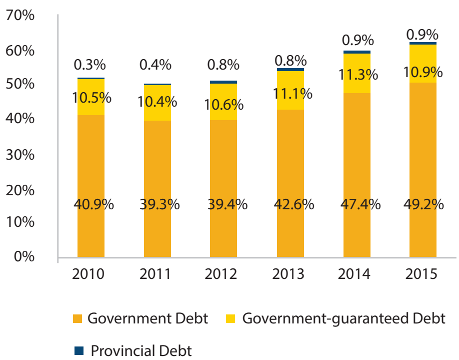
30. **Vietnam's public debt-to-GDP ratio has increased rapidly over the past few years as a result of a loosening fiscal stance.** Public debt[9] increased markedly from 51.7 percent of GDP in 2010 to 61 percent in 2015.[10] Of this public debt, 49.2 percent of GDP is debt directly owed by the central 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 (Figure 11, lelf panel). Excluding guaranteed debt and intra-governmental borrowing[11], 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 over the past five years), despite the country's impressive economic growth performance (Figure 11, right panel). If this trend continues, Vietnam is likely to face serious fiscal sustainability concerns.

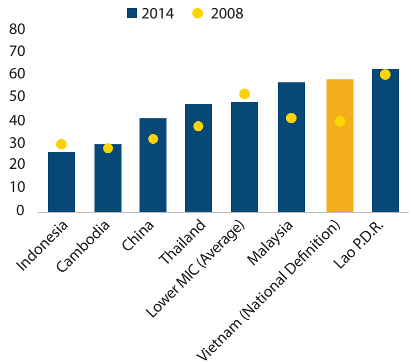
9 In this report, the scope of public debt as defined in the Public Debt Management Law (2009) includes central government debt, government-guaranteed debt and subnational government debt.

10 According to nationally reported public debt figures.

11 This includes advances from the Treasury balances and the Debt Accumulation Fund.

**Figure 11. Rising public debt (% GDP)**

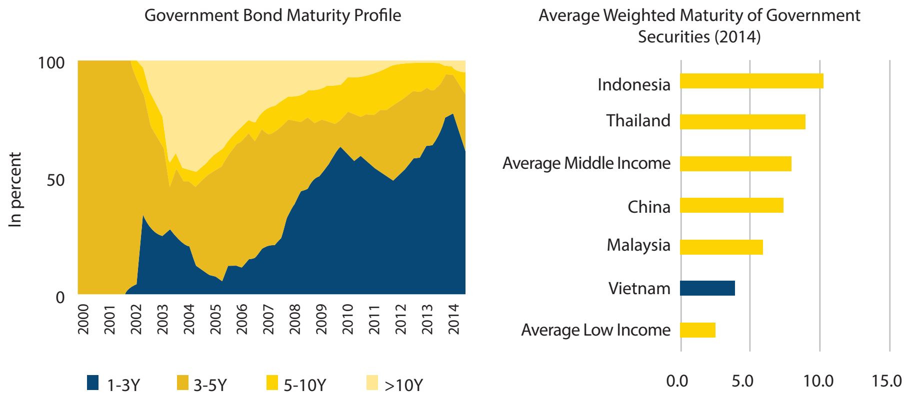



*Source:* MoF, IMF, World Bank staff estimates.

**31. 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 45.0 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 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. The Government has made significant efforts to lengthen the maturity of domestic Government bonds and 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, 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. The average maturity of government bonds in Vietnam compares unfavorably with those of other middle-income countries in the region (Figure 12).

**Figure12. Re-financing risks are increasing**




*Source:* ADB, Bloomberg, IMF, World Bank staff estimates.

32. **Whilst public debt is contained within statutory thresholds, it is greatly exposed to major risks.** Large fiscal deficits have prevailed.[12] Assuming that the budget deficit is retained and the existing government guarantee mechanism continues, Vietnam's public debt-to-GDP ratio will breach the permitted ceiling (65 percent of GDP) in future years despite high GDP growth and remaining benign costs of financing. Available fiscal buffers are now very limited. Even relatively moderate contingent liability shocks could render the debt trajectory unsustainable. Realization of explicit contingent liabilities and perhaps more importantly implicit contingent liabilities exacerbates the vulnerability of Vietnam's current debt path, even if headline fiscal balances[13] are managed prudently. Although the Government's policy is to enforce financial discipline in SOEs and in principle does not assume any responsibility for financial obligations unless explicitly guaranteed, it may have to consider stepping in to take over SOEs' contractual obligations in cases where defaults may have a serious impact on macroeconomic stability. Taking these risks into account when managing the Government's debt position and preserving sufficient fiscal buffers will enable the Government to absorb these shocks if they do materialize. It is therefore crucial that fiscal consolidation plans align with current government commitments and are consistently implemented to ensure that the public debt trajectory returns to a sustainable path, especially in the context of the prospective decline in concessional external debt.

12 Between 2011 and 2015, the budget deficit averaged 5.5% of GDP.

13 Headline fiscal balance is the difference between revenue and expenditure, excluding debt interest payments.

33. **Vietnam will benefit significantly from establishing a mechanism to systematically identify and analyze fiscal risks associated with contingent liabilities.** Collection of reliable and up-to-date information on implicit contingent liabilities is a first critical step, followed by analysis of their potential fiscal impact and their effective management. To this end, there is a need to improve the quality and timeliness of data in the SOE sector. Recently adopted regulations (such as Government Decree 61 (2013), Decree 81 (2015) and Decree 87 (2015)) have strengthened reporting and public disclosure requirements for the financial and operational performance of SOEs. Implementation of these requirements is now a key priority for the Government to enable more effective assessment of the efficient use of public resources and the analysis of implicit contingent liabilities of the Government.

34. **Going forward, Vietnam will need to rebuild its policy buffers before these risks materialize.** 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. Without adjustment of the current fiscal position, or without the fiscal deficit reduction roadmap, Vietnam's debt path will soon enter the territory of increased risk of distress and this will create impediments to growth and macroeconomic stability.

35. **In tandem with the concerted efforts to reduce the fiscal deficits, it will also be important for GoV to strengthen public debt management.** 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. In this context, prudent fiscal and debt management will result in bolstering investor confidence, sovereign creditworthiness and lowering the risk premium for Vietnam. Actions across several areas are needed:

a. ***Strengthening the debt portfolio:*** Efforts to optimize the cost and extend the maturity profile of public debt should be intensified. In the short term the use of less costly ODA sources including IDA should be maximized, working with donors to ensure ODA financing is closely aligned with Government expenditure priorities. Over the more medium and long term, Vietnam needs to open up alternative sources of affordable long term financing both domestically and externally.

b. ***Further development of the domestic debt market:*** The government has already taken important steps towards the development of the domestic debt market. The primary market has improved in terms of volume and maturity (average time to maturity (ATM) increased from 2.92 years in 2012 to 6.98 years in 2015), the number of primary dealers of government bonds expanded and the bond mobilization plan has been disclosed. However, there remain some factors limiting bond market development: a lack of liquidity in secondary markets; the absence of a solid institutional investor base (as of end of 2015, banks held approximately 77 percent of the stock of domestic government debt); and the absence of the necessary market infrastructure and support services. Building on recent progress, additional steps should be taken to further improve the functioning of both primary and secondary markets, diversify the investor base, and improve market infrastructure and support services.

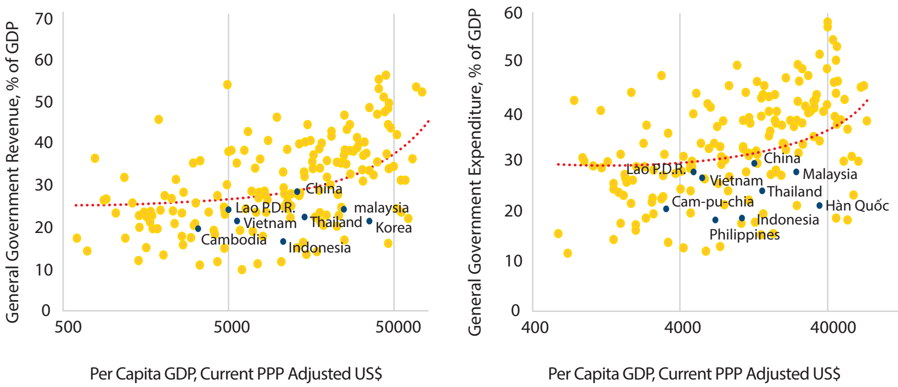
c. ***Further strengthening of debt management capacity:*** Whilst the government has adopted a coherent medium term debt management strategy, its implementation is hampered by the highly fragmented institutional framework for debt management. The Debt Management and External Finance Department (DMEFD) of the MoF has been established as the main debt management body, but in practice several activities are carried out by different agencies. Whilst the responsibility for external debt rests with the DMEFD, domestic debt is effectively managed by the State Treasury and the State Budget Department. MPI and SBV also play roles in the management of external concessional debt. This system has evolved in a context where external debt was mainly concessional, but increasing reliance on commercial debt may place different demands on the debt management function. Therefore, it is important to keep strengthening the system and coordination of debt management with the intention of consolidating all debt management functions into one office.

## Pursuing gradual and growth-friendly fiscal consolidation

36. **From an international perspective, both Vietnam's revenue and expenditure footprints are about average compared with regional and peer income level countries.** Whilst the levels of revenue mobilization and public spending are matters of policy choice for countries,[14] comparison with other countries suggests that Vietnam appears not to be an outlier in the sense that the Government does not seem to collect revenue or to spend excessively (Figure 13). However, it is of concern that the level of revenue mobilization as a proportion of GDP is on a declining trend, whilst the pressures for public spending for both capital and recurrent purposes are still high and debt thresholds are now close to their statutory safety limits.

14 Many governments opt to be *welfare states*, in which the state plays a key role in the protection and promotion of the economic and social well-being of its citizens. Overall, they tend to levy higher taxes and spend more on social protection, including provision of both cash welfare benefits (such as old-age pensions or unemployment benefits) and in-kind welfare services (such as health care, child care and education services), or through redistribution of taxation. Through these provisions, welfare states can affect the distribution of wellbeing and personal autonomy amongst their citizens, as well as influencing how their citizens consume and how they spend their time. Modern welfare states include the Nordic countries, such as Iceland, Sweden, Norway, Denmark, and Finland as well as a number of other OECD countries mostly in Europe.

**Figure 13. Revenue and expenditure footprints are broadly in line with Vietnam's income level**




*Sources:* World Bank staff estimates, based on the IMF World Economic Outlook (WEO) dataset of 150 countries.

37. **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.

38. **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).

## Strengthening revenue mobilization

39. **Although revenue mobilization as a proportion of GDP is currently not particularly low compared with other countries, it has been following a declining trend.** The World Economic Outlook of the IMF (2015) shows a declining trend in Vietnam's state revenue-to-GDP ratio compared with the more stable and upward trends of neighboring countries in the region, such as the Malaysia, Indonesia, The Philippines, Thailand, Lao PDR and Cambodia.

40. **In moving forward, strengthening revenue mobilization will be one of the core elements of the agenda** to bring about deficit reduction and to ensure that it does not come at the expense of critical public investment and social spending. It will require continued efforts to enhance further policy improvements and revenue administration.

41. **It will be important to continue to reform tax policies to strengthen domestic revenue mobilization.** Several specific policy options that could help bolster revenue performance include:

a. ***Broadening the value-added tax (VAT) base:*** International practice suggests the efficacy of one single VAT rate and very limited tax exemptions. In Vietnam, there are currently 26 goods that are exempt from VAT, 15 goods which are subject to a 5 percent rate and the remainder are subject to a 10 percent rate. This existing practice not only erodes the tax base but also breaks the integrity of VAT and complicates administration. To address this issue, a gradual phasing out of VAT exemptions and the 5 percent base list should be considered, leading to a single VAT rate. Measures such as gradually narrowing the list of exemptions, gradually moving items from the 5-percent to the 10-percent rate and finally applying a single VAT rate of 10 percent would lead to increases in revenue of 1.3, 0.4, and 11.1 percent respectively compared to the current rate structure.

b. ***Broadening the corporate income tax (CIT) base and reviewing tax incentives (tax expenditures[15]):*** Review and rationalization of tax incentives are necessary to promote their effectiveness and avoid irrelevance; avoid fragmentation and waste of resources; and ensure disclosure, transparency and equality in business competition. This needs to be undertaken without impacting the overall business environment in Vietnam where the CIT rate is currently significantly lower and competitive compared to its major competitors. The use of tax incentives and improvement of the business environment are important measures to attract further investment based on Vietnam's real competitive advantages. A systematic assessment of the impact of tax incentives in attracting investors and expanding the tax base would support fiscal policy decisions of the National Assembly and the Government in the future.

c. ***Increasing excise rates:*** In Vietnam excise tax rates on several non-merit goods remain relatively low (for example tobacco, beer and alcohol). Gradual excise rate increases for these goods could help to mobilize additional revenue and also deter unhealthy behaviors. Gradually increasing the applicable scope and rates of excise tax for selected goods will have positive fiscal impacts on revenue collection and reduce consumption levels and their health and environmental externalities. The World Bank has estimated that between 2014 and 2020 a radical increase in the current tobacco tax rate[16] would increase revenue from tobacco subject to the special excise levy by 12 percent, whilst the level of consumption of cigarettes per adult could decrease by 10 percent from 2016 to 2020.

15 Vietnam does not have a statutory definition of "tax expenditure", as tax incentives are not presented in State budget documentation.

16 The WB recommended to raise excise rate for tobacco products from 70 percent in 2016-17 and 75 percent in 2018 - 20 (per existing policy) to 85 percent in 2016 – 17, 100 percent in 2018 - 19, and 110 percent in 2020.

d. ***Expanding the personal income tax (PIT) tax base in line with international practice:*** Current legislation on different tax rates for taxable incomes remains complicated. Personal income tax policies do not cover all taxable income; for example, income from transfers of digital resources, e-commerce or income from major lottery prizes. In the future, personal income tax policies must be adjusted to expand the tax base and adjust the number of tax rates on taxable incomes and taxpayers, to improve compliance, encourage incorporation of business activities, increase transparency and facilitate tax administration.

e. ***Building a modern property tax system:*** It is important to consider a unified property tax to replace the existing agricultural and non-agricultural land tax policies. This will expand property tax to land related and other valuable assets relevant to the socio-economic development of Vietnam and be in line with international practices. Property tax will be an important and stable source of revenue to the State budget, especially at sub-national level. It could also improve incentives for the more efficient use of land and property.

f. ***Rationalizing the revenue policies on natural resources and the environment:*** (a) Natural resource tax policies should be revised to be relevant to each period of socio-economic development. This will ensure preservation and efficient use of natural resources and promote the link between natural resource exploitation and processing and environmental protection. It will also minimize the export of raw resources, encouraging sustainable, efficient, effective and economic natural resource exploitation in the nation; (b) Environmental protection tax policies should be reviewed to expand the tax base and period and adjust the tax rates and ranges. They should also minimize the extent of harmful impacts on the environment and align with current international practices. They should encourage the production, use and consumption of environmentally friendly goods as well as improve the collection of revenue to the State budget.

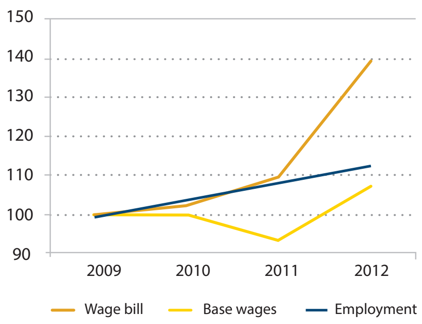
42. **In parallel with tax policy changes, tax administration reform remains a priority.** The next phase of tax administration reform should include a more systemic review and implementation of business process re-engineering. It should also move towards transparent information-based taxation operations and the application of risk-based audit for better compliance management. If implemented properly, these measures will help to strengthen the efficiency and effectiveness of tax administration to maximize revenue mobilization, help to reduce the compliance cost for taxpayers and improve the business environment in a fundamental manner. Other reforms that need to be undertaken include research into the feasibility of creating a self-sufficient large taxpayer office aligned with international best practice. Coordination between the General Department of Taxation (GDT) and social insurance funds should be strengthened with a view to transferring responsibility for collecting social security contributions to the GDT on behalf of the social insurance funds.

## Enhancing spending efficiency to free up fiscal space

43. 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:

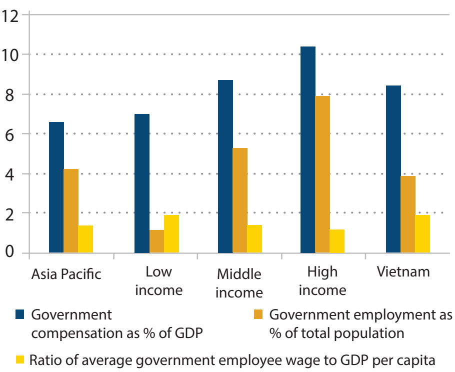
44. ***Public sector employment, compensation and deployment:* The administrative wage bill has been expanding significantly, accounting on average for 20 percent of total budget spending.** Although base salaries have increased by only 2.3 percent per year (below that of GDP at 6.2 percent per year), growth in non-base salaries and allowances have been the main drivers of salary increases (Figure 14). Growth in spending at both central and sub-national levels was especially strong in 2011 and 2012, when a large number of pre-primary teachers and commune administrative staff were formalized in the government wage bill. Vietnam's total government wage bill is high compared with other countries in the region, but similar to middle-income countries (Figure 15). Its share of GDP (6.5 percent on average during 2009-12) is about the same as that in Mongolia, but twice as high as that in Indonesia and the Republic. of Korea and three times higher than that in Singapore. On average, compensation is 6.6 percent of GDP in all Asia and Pacific countries and 8.7 percent in all middle-income countries (Figure 15).

**Figure 14. The government wage bill is growing quickly mainly due to non-base wage and headcount increases**




*Source:* MoF and Ministry of Home Affairs (MoHA).

**Figure 15. Vietnam's current government compensation and employment are between those of low-and middle-income countries**




*Sources:* Figures for Vietnam are for 2012 and from GoV; all others are for various years 2000 to 2008 and from IMF (2010).

45. **Public sector employment has increased rapidly over the period, contributing significantly to rapid growth in the wage bill.** The number of central government civil servants grew by 2.8 percent per year and public employees by 3.9 percent per year from 2008 to 2011. The number of provincial civil servants grew by 5.1 percent per year between 2009 and 2013. The increase in public sector employment appears to be much faster than population growth (1.1 percent) in the same period. This outcome seems inconsistent with the administrative and civil service reform agenda, which intends to pay for government salary increases by rationalizing employment levels. Currently, government employment in Vietnam is slightly lower than the average of other countries in the region and middle-income countries, but at present levels of growth there is a risk that it could reach and surpass middle-income averages within a few years.

**46. Average public sector wages in Vietnam do not seem particularly low compared with earnings elsewhere in the economy.** The ratio of average government employee compensation to GDP per capita in Vietnam is 1.9 times. For all countries in the Asia Pacific region, the ratio is 1.4. For low income countries the ratio is 1.9 and for middle income countries 1.4 (Figure 15). Whilst it is recognized that Vietnam's GDP per capita is relatively low given the large share of the population working in agriculture and the informal sectors, this outcome casts doubt on one of the main rationales for increasing civil service salaries, i.e. that they are paid significantly lower than those in other sectors. The caveat is that these wage and income averages may mask significant differences across sectors and job positions, for which data is unavailable. Further analysis is needed to benchmark government salaries with those in the private sector.

**47. Although the current size of the wage bill and overall public sector employment are not excessively high in comparison with other middle income countries, continued increases would not bode well for public finances.** A further increase in public sector employment will have a longer-term effect and once in place will be very hard to reverse. Based on current trends, Vietnam's wage bill could easily outstrip middle-income averages in a short period of time. Improving the performance of government employees has received insufficient attention. An in-depth review of the efficiency of public sector employment and compensation would be desirable before any further increases are made in the wage bill. Application of a forecasting model of future pay and employment would be helpful to illustrate the scenarios and provide full and reliable information to policymakers.

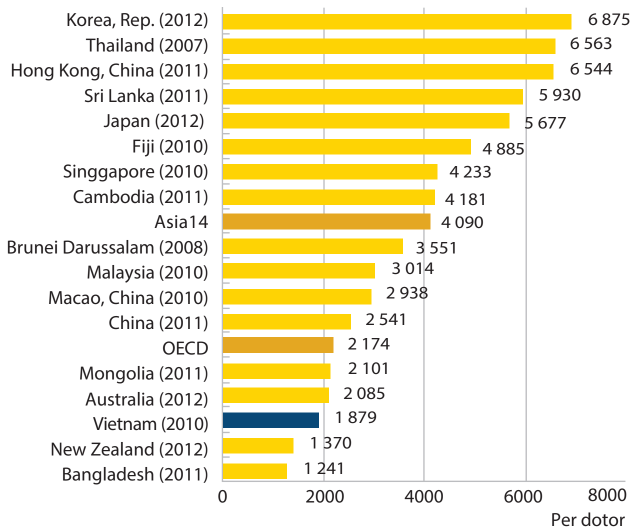
**48. The efficiency of deployment of human resources in several sectors of public service delivery is not satisfactory, most notably in education and health.** Average teaching time per teacher in general education is the lowest in ASEAN (and is 25 percent below the ASEAN average for primary schools) (Figure 16). As observed in general education and particularly in lower-secondary education, there is room to restructure teachers' working time and programs to increase the teaching load. More efficient use of education resources, especially teacher deployment, would increase access to education without affecting its quality by providing more services with the same resources. Similarly, on average a doctor in Vietnam sees far fewer patients per year than in other countries, suggesting possible scope for more efficient use of human resources (Figure 17). Patient visits at grassroots levels (districts and communes) are inefficient due to the poor quality of health provision at these levels. This results in under-utilization of resources at grassroots level and overloading at the central and provincial levels. Also, the ratio of nurses to doctors in Vietnam is the lowest amongst 12 comparator countries, suggesting that making greater use of less costly nurses would enhance efficiency.

**Figure 16. Teaching hours in Vietnam are the shortest in ASEAN**

| Country | Grade 3 teaching hours | ASEAN avg. = 12/ | Grade 5 Teaching hours | ASEAN avg. = 12/ | Grade 9 | ASEAN avg. = 12/ |
|---|---|---|---|---|---|---|
| Vietnam | 945 | 0.74 | 1,015 | 0.76 | 1,050 | 0.67 |
| Cambodia | 1,200 | 0.94 | 1,200 | 0.89 | 1,750 | 1.12 |
| Indonesia | 980 | 0.77 | 1,120 | 0.83 | 1,280 | 0.82 |
| Lao PDR | 980 | 0.77 | 1,160 | 0.86 | 1,620 | 1.04 |
| Malaysia | 1,380 | 1.08 | 1,320 | 0.98 | 1,560 | 1.00 |
| Myanmar | 1,200 | 0.94 | 1,400 | 1.04 | 1,400 | 0.90 |
| Philippines | 1,800 | 1.41 | 1,900 | 1.41 | 1,980 | 1.27 |
| Singapore | 1,470 | 1.15 | 1,470 | 1.09 | 1,600 | 1.03 |
| Thailand | 1,500 | 1.18 | 1,500 | 1.12 | 1,800 | 1.15 |
| ASEAN avg. | 1,273 | 1.00 | 1,343 | 1.00 | 1,560 | 1.00 |

*Source:* JICA (2013).

**Figure 17. A typical doctor in Vietnam sees fewer patients per year than in other countries in East Asia**




*Note:* Latest available year per country.

*Source:* OECD health statistics.

49. **There is still a mismatch between personnel quotas and qualifications and actual needs.** Personnel quota setting and actual employment are not well coordinated between the Ministry and Departments of Home Affairs (MoHA/DoHAs), line ministries and departments, sub-national People's Councils and public service delivery units (PSDUs). This results in mismatches between the quantity and composition of personnel made available and actual needs at both national and sub-national levels. Mismatches occur mostly in lower-secondary schools and are primarily due to a mismatch of teaching subjects and locations. As a result, many schools are left with little funding for non-salary recurrent spending. The revenue from school fees, though unevenly collected in different locations, has become an important source of non-salary spending.

50. **Better coordination between applicable agencies is needed for more efficient mobilization of civil servants and public employees.** Improved coordination is needed 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. This should include the possible sharing of staff between multiple units to make full use of their capacities; 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.

51. **The ongoing exercise to rationalize the size of public service staffing is a key action to improve efficiency.** This will help to restrain further growth of the wage bill, whilst protecting essential social sector spending and increasing its efficiency. A useful starting point would be to define sound job descriptions and corresponding employment needs. It would then be important to develop a pay and grading system that places more emphasis on actual job performance as opposed to the seniority criteria applied in the current rank-and-file system.

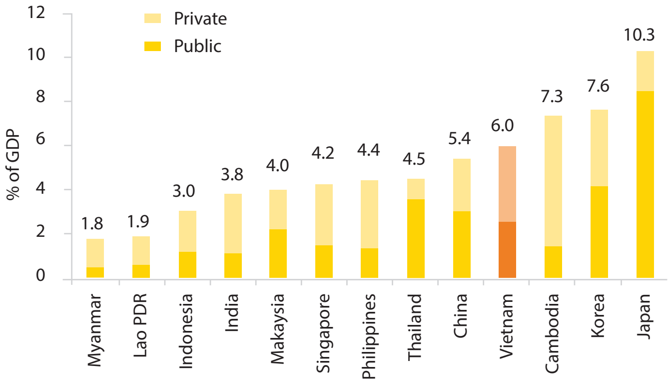
52. **There is significant scope for the rationalization of other inputs in public service delivery sectors, such as education, and health, without jeopardizing service quality:**

- ***In the education sector, there are signs of inefficiencies in the deployment of human resources (paragraphs 48-49).*** There should be a human resource adjustment plan to increase teaching hours per teacher linked to curricula reforms intended to achieve compatibility with international levels. Provincial Departments of Education and Training (DoETs) could play a greater role in developing a human resources plan that would include existing teacher profiles, future enrolment projections and the professional development needs of teachers. There could be financial incentives for schools to rationalize the teaching force. These measures would help meet the target of full-day school for 90 percent of students at the primary level and 50 percent at the lower-secondary level by 2020. It would particularly benefit disadvantaged students who cannot afford to pay for after-school classes. Furthermore, reforms in the curricula and improved textbooks and testing methods are also important to enhance spending efficiency and effectiveness in the sector.

- ***In the health sector, Vietnam has a very high level of health spending relative to GDP in comparison with its regional peers, but the outcomes are not optimal*** (Figure 18). The major drivers of inefficiency include provider payment mechanisms that do not offer appropriate incentives; an over-reliance on hospital centered service delivery at the central and provincial levels, instead of grassroots based and preventive health care; and high pharmaceutical spending. Spending on medicines in 2010 was 43 percent of total health spending or 2.7 percent of GDP, higher than in most countries in the region and well above the OECD average of 16 percent and 2 percent respectively (Figures 18 and 19). Pharmaceuticals consistently comprise 60 percent of total reimbursements from health insurance. Decentralized procurement has led to a variation in prices across provinces. For instance, claims data from the Vietnam Social Security Fund (VSSF) in 2010 indicated up to a fivefold difference in procurement prices for the same drug across public hospitals.

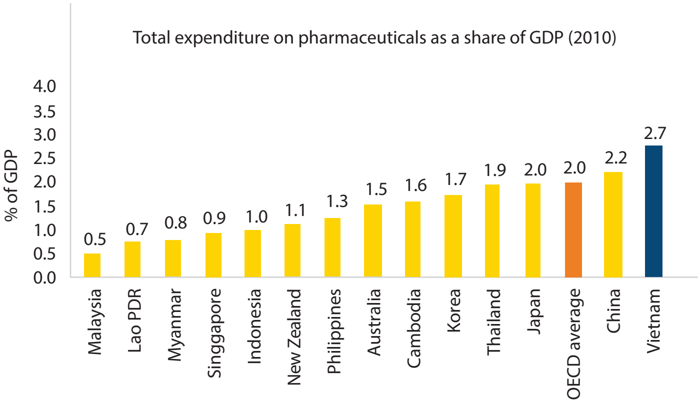
  ***Greater efficiency in health spending could be promoted through a number of measures.*** To reduce the cost of drugs, it is important to devise and carefully implement centralized procurement and price negotiations. For health services in general, the Government might consider enhancing the capacity of VSSF or a similar organization as an independent body to conduct robust cost-effectiveness analysis in the use of health services. Both of these measures would help improve spending efficiency in the health sector, through standardized and reduced prices for pharmaceuticals across provinces and health facilities and more robust controls on hospital spending. Experience from pharmaceutical procurement reform in Eastern Europe suggests that potential savings of more than 30 percent could be made in total pharmaceutical spending. Strengthening spending on preventive health care and health care delivery at the grassroots level could also be considered to improve patient examination and treatment. This could include a shift away from fee-for-service reimbursement to other health financing arrangements including relevant diagnosis related group (DRG) and case based payment.

**Figure 18.** **Vietnam's total health spending is higher than most countries in Asia**




*Source:* World Development Indicators (2010).

**Figure 19.** **Vietnam's pharmaceutical spending is high relative to peer countries and the OECD average**




*Source:* OECD (2014).

- ***In the agriculture sector, whilst investment in irrigation may continue to be prioritized (currently about 70 percent of total agricultural spending), the focus should be moved to measures to increase water productivity and promote other functions such as agricultural services.*** In the past public spending on irrigation in Vietnam focused on increasing rice production and less emphasis was placed on crop diversification to increase agricultural incomes. Irrigation continues to be prioritized and water productivity is still a relatively low priority in Vietnam compared with other countries. For instance, the rice output per unit of irrigation water in Vietnam is only half that of China and one-third that of India (Table 1). This suggests that increasing rice production is feasible with increased water productivity. It is also important to consider alternative strategic initiatives in the sector. They may include improving water productivity by reviewing the irrigation fee exemption policy to move to affordable irrigation fees; conditional fee exemption to improve water efficiency; and encouraging crop diversification to enhance agricultural incomes (Table 2). The performance of irrigation service providers can also be improved.

**Table 1. Water productivity is relatively low in Vietnam compared with other countries**

| Country | Cropping Pattern | Output Per Service Area (USD/ha) | Output Per Unit of Irrigation Water (USD/m$^3$) |
|---|---|---|---|
| Vietnam | Rice | 654 | 0.03 |
| | Rice and Vegetables | 1,051 | 0.11 |
| | Rice and Sugar | 3,603 | 0.34 |
| | Vegetables | 4,862 | 0.49 |
| China | Rice | 1,541 | 0.06 |
| | Rice and Rapeseed | 1,546 | 0.38 |
| | Wheat/Corn | 2,491 | 1.46 |
| | Apples | 4,163 | 1.20 |
| India | Rice | 988 | 0.09 |
| | Rice/Chilli/Cotton | 1,206 | 0.12 |
| | Sugarcane | 1,844 | 0.17 |
| | Coconut and Sugarcane | 2,165 | 0.12 |

*Source:* Burke et al (2015)

**Table 2. Alternative crops to rice could provide higher margins (Chau Phu, An Giang, Mekong Delta, 2012)**

| Crops | Gross Revenue (VND) | Gross Margin (Mil.VND) |
|---|---|---|
| Bean | 300.97 | 173.30 |
| Chili | 341.69 | 202.66 |
| Gourd | 159.94 | 133.84 |
| Lotus | 631.07 | 461.20 |
| Flower | 170.00 | 118.15 |
| Rice | | |
| WS season | 36.61 | 17.26 |
| SA season | 33.38 | 13.39 |
| AW season | 39.63 | 20.20 |

*Source:* Le Canh Dung (2012)

- ***In the transport sector, high unit costs of construction and maintenance are amongst the issues that have hindered the overall value for money of the road subsector in Vietnam.*** Whilst the initial unit cost of construction in Vietnam is generally comparable to other regions, there are two main elements that increase the costs: land acquisition and the spreading of limited funds over too many projects. The level of competition in construction and maintenance is much lower than in other regions of the world. Whilst local contractors dominate the market, the overall number of bids per contract is low and the lack of competition drives costs upwards. An increase in contract size is recommended to reduce overall road costs. Currently, the contract for a length of road is typically 2 to 10 times smaller than in Europe, Central Asia or Sub-Saharan African countries.

***Between 2009 and 2013 there was a 68 percent increase in the already high overall maintenance costs per km which led to under maintenance.*** Unit Maintenance costs are substantially higher than their equivalent costs elsewhere in the region. Routine maintenance costs are approximately USD 3,000 per km per year; 3 times higher than in Laos, 1.5 times higher than in Cambodia and closer to unit maintenance unit costs in OECD countries (e.g. USD 3,500 per km in the UK and approximately USD 4,500 per km in France). This increase in recent years was due to increases in the price of oil and cement based inputs for works construction, and an annual increase of 10 percent in the wages of workers involved in road construction. As maintenance activities are comparatively more labor-intensive in Vietnam than in other countries, the increase in workers' wages has had a greater impact on maintenance costs. This suggests that improvements should be made in maintenance practices and in the use of improved equipment. The PER therefore suggests a need to streamline and professionalize the maintenance of roads in Vietnam. This will be critical particularly in the context of a widening gap between the maintenance budget and estimated needs (currently approximately 50 percent) as discussed further in paragraph 73-74 below.

***In recent years, tremendous progress has been made in developing Vietnam's road network.*** The proportion of paved roads increased from 19 percent in 2004 to more than 50 percent in 2012 and paved road length increased by more than thirty percent in the period 2004-14. However, transport costs remain high for the level of development of the country. Road transport costs are comparable to China and Thailand in absolute terms. However, the costs compared with GDP per capita, are four times those of China, six times those of Thailand and three times those of India. Average road transport costs represented by trip time are the highest in the region after Indonesia and hold back Vietnam's competitiveness. This is because the density of expressways is lower than in most neighboring countries. Further analysis into the provision of freight services, tariffs and revenues of carriers is required.

- ***In the science and technology sector, although innovative financing mechanisms have been introduced with the promulgation of the Law on Science and Technology (2013) and Government Decrees in the science and technology (S&T) sector, implementation has been slow in practice.*** Funding for S&T organizations are mainly based on budget allocation norms instead of scientific work and projects. This practice undermines the dynamics and value-for-money motives of such institutions. The financing arrangements of the National Science and Technology Fund are not performance-based, nor does it attract additional resources for scientific and technological activities. Existing financial incentives are not sufficiently robust for enterprises and the private sector to participate in scientific and technological research and application.

***It is therefore necessary to 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. A set of performance indicators linked to the performance and quality of service delivery should be applied for S&T organizations to enhance their efficiency and accountability and to gradually align with international practice. It is also important to review, rate and restructure public S&T organizations. The regulatory framework should be revised to be more realistic and enabling for public S&T organizations to fully exercise their right to autonomy and organizational responsibility. A roadmap is needed to gradually reduce State budget recurrent expenditure in S&T organizations. Eligible S&T organizations should gradually adopt enterprise systems. To accelerate the implementation of the new financing mechanisms stipulated in the Law on Science and Technology 2013, it is important to strengthen the role of the National Technological Innovation Fund and the National Science and Technology Development Fund in the management of the budget allocation for national level scientific and technological mandates. This will also attract additional budgetary resources for investment in science and technology and encourage enterprises to establish their own S&T development funds.

53. **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. For instance, competitive bidding has helped in recent years to save 20 percent of spending on medicines (overall), more than 20 percent of maintenance costs for national roads and 10 to 15 percent of the budget for contracting solid waste collection and transportation services in Ho Chi Minh City. 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).

## Enhancing performance in the management and use of public assets

54. **Public assets are the largest source of wealth of the nation.** Good management and exploitation of public assets not only contribute to the battle against corruption, waste and leakage of resources, but also yield resources for capital improvement and socio-economic development. They also reduce fiscal risk especially in the context

of fiscal difficulties and rapid change in the use of assets and their ownership. International good practice suggests that every dollar generated from an increase in the yield from assets is a dollar less to find from budgetary cuts and/or increases in taxation and debt. Improvements in performance are also an important factor in accelerating the process of restructuring the economy towards a more market orientation, encouraging investment and boosting the confidence of the public and international community in state management capacity.

55. **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 VND 1 million billion, equivalent to USD 46 billion, or about 25 percent of the GDP. However, the actual value of public assets in Vietnam may be much higher as the coverage of the public asset 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).

56. **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. There have been fundamental changes since then: (i) For the first time the State was able to assess and compile data on three types of assets: land, property and motor vehicles and other assets at or above the value of VND 500 million; (ii) The right to manage and use assets was transferred to agencies and units in association with the expansion of financial autonomy; and (iii) New asset management mechanisms were adopted which are more transparent and market based. These include market valuation of land and property; piloting of centralized asset procurement; restructuring of State owned housing; and enhanced autonomy for budgetary units to boost maintenance and financing for asset development.

57. **However, the above changes are not sufficiently robust and comprehensive.** Coordination between State administrative agencies and organizations using assets has not been simplified and are inefficient; and the waste of assets and leakage of resources are not determined in a timely fashion. As such the value of assets has not yet been maximized. The Constitution of 2013 stipulates more comprehensive coverage of public assets including 3 major components: land, sea and other natural and special resources; assets in the State sector and State capital investment in enterprises and other entities; and socio-economic infrastructure invested in and managed by the State.

58. **To produce the stipulations on public assets in the Constitution, the National Assembly amended the law in 2017 in order to improve the management of public assets towards:** (i) More comprehensive and holistic management of public assets; (ii) More efficient use of assets by adoption of professional management practices

and market disciplines; (iii) More public disclosure, transparency and community scrutiny of the management and use of public assets. The activities detailed below will contribute to the above objectives.

a. ***Classify public assets as a basis to formulate appropriate management policies to improve and professionalize their management:*** Many countries have classified public assets into policy and commercial assets by their core function. Policy assets mainly support State administration and public service delivery. Commercial assets mainly support productive and commercial purposes. This separation serves as the basis to design appropriate management policies. For example, policy assets are mainly managed by the use of norms and standards whilst commercial assets are mainly managed on the basis of cost and profit analysis. Although Vietnam is in transition, and many assets can be regrouped from one category to another, the Government should consider this distinction as international good practice. Although the separation cannot always be clear cut, relative separation is needed to adopt appropriate management, utilization and accountability mechanisms. The management and use of policy assets should be linked to the quality of public services, whilst the management and exploitation of commercial assets should be linked to maximization of asset value. The delegation of powers over assets is linked to strengthened accountability on value for money in the use of public resources.

b. ***Professionalize management, especially of commercial assets:*** A market economy requires commercial assets of the public sector to be managed under the same legal and institutional framework as those assets of other sectors in the market. The vehicle undertaking the ownership of public assets should be reasonably independent from the State agencies responsible for the sectors or industries. This is especially important for assets such as State capital in enterprises (including State owned economic groups, corporations and commercial banks) as well as land and property and commercial infrastructure. It is important to adopt appropriate pooling of commercial assets and agree proper professional stewardship of the assets.

c. ***Establish consistent legal and institutional frameworks as the basis for improvement and professionalization of asset management:*** The consistent "eco-system" of legal and institutional frameworks also covers accounting, auditing and valuation standards, performance-based appraisal and rewards and sanctions. The State Budget Law (2015), Accounting Law (2015) and Land Law (2013) introduced basic principles to follow. The amended Law on Management and Use of State Assets (2017) also adopts these principles in public asset management. As a next step, it will be important to: (i) make a full inventory and market valuation of all public assets; (ii) allocate the costs of assets on an accrual basis, and; (iii) establish a highly professional public asset management body.

d. ***Link the delegation of powers and strengthening of accountability for value-for-money in the use of public assets:*** A mechanism needs to be established for annual debates and oversight of public assets by the National Assembly together with budget revenue, expenditure and public debt. The debates should emphasize value-for-money in asset investment, maintenance and operations (quality of public services), infrastructure maintenance and development, budget revenue generation and state asset improvement. It is important to develop mechanisms to discuss and reach consensus on the purpose of public assets at multiple levels (between the National Assembly and Government, between sub-national People's Councils and sub-national governments and between government at all levels and asset using organizations, aligned with decentralized structures. These discussions should form the basis of performance indicators and corresponding mechanisms for monitoring, evaluation and reporting. Public asset information should also be presented in a transparent, comprehensible and public manner to promote effective community scrutiny.

e. ***Improve and strengthen public asset management and reporting information systems:*** Several statistical and reporting systems are already in place for important types of assets, for example, the asset registry system (covering public assets as defined in the 2008 Law); the road asset management and supervision system (covering national and provincial roads); and the land management information system. It is important that next steps be taken to: (i) expand the coverage of the public asset management information system; (ii) modernize the system's functionality and better link the databases of the system with the budget and accounting management information system (for the assets created through the use of budget and other State finance) and GIS systems (for land and infrastructure); develop the set of templates of the public asset reporting system; and (iv) strengthen the timeliness and regularity of reporting on public assets and strengthen information disclosure and transparency.

## Promoting private financing and rationalizing citizen contributions

59. **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. 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 and a gradual easing of subsidies from the state for these services. Progress has been most notably documented in:

- **Increased private participation in the delivery of essential public services and development of infrastructure:**

  ***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.

- **Increased client payment component in the financing of services delivered by government:** User charges in social sectors have gradually increased in relation to budget spending, which is also on an upward trend. In HCMC, average user charges amount to 30 percent of budgetary spending, of which 'out of pocket' (OOP) expenses for health provision are twice as high as budgetary spending.

60. **However, this important reform agenda is facing a number of challenges.** *Firstly*, 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 USD 150,000), and most (75 percent) are concentrated in diagnostic and testing equipment. The first attempts to equitize two hospitals in HCMC failed to progress as expected. *Secondly*, there is a risk of excessive charges being imposed on service users. For instance, in the health sector the share of OOP payments (including indirect costs for access to health services) has declined but is still equivalent to budget spending. This is devastating, especially for the poor. Also, a number of cases were reported of excessive charging of travelers on roads built under PPP arrangements. 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. There is a risk of widening inequity in access to basic services, as discussed in more detail in Section 2. *Thirdly*, although the quality of services has improved, this improvement is considered insufficient to meet citizens' increasing demands. There is considerable scope for potential increase in performance and accountability in service delivery as discussed in further detail in Section 3.

61. **It will be critical to pay closer attention to an appropriate division between public and private financing of public services.** It will be critical to develop appropriate policy criteria to guide the imposition of user charges for services provided by PSDUs. Decree No. 16 (2015) sets out a roadmap for PSDU operational and financing reform by (i) moving away from direct budget financing of service providers to financing by payment for services, which will gradually be fully costed; (ii) providing direct support for policy targeted service users instead of offering service fee exemption by service providers; (iii) providing on-going budget support for PSDUs operating in selective sectors. There is therefore a need to develop lists of public services that are fully or partially financed by the State budget. The World Bank acknowledges this direction of reform of the Government, noting that international practice, even in the most advanced countries, is that education and health care continue to be prioritized for government funding to achieve equity. For example, in most countries tertiary education is considered to provide benefits not only to the student (especially a higher future income), but also benefits society as a whole (an "external" benefit), principally by stimulating faster economic growth. For this reason, it is widely considered that it is appropriate for government to pay part of the cost of tertiary education for students in general, in addition to larger subsidies for disadvantaged students. Due to the quasi-public nature of tertiary education, failing to provide such a general subsidy and obliging the majority of students to pay the full cost will result in a level of tertiary education below that which would provide maximum social benefit.

62. **Finally, while there is clearly potential for more PPPs in various infrastructure sectors, tapping into this potential will require robust legal and risk management frameworks.** The motivation for PPP perhaps should not be primarily about reducing financial burden but rather about better quality of services and more efficient delivery of infrastructure. Experience from around the world has shown that core public infrastructure still needs some form of public subsidy. Finance needs to be well managed and PPPs need to be assessed carefully, including how risks are shared between government and private sector partners. 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. These risks need to be understood and managed well to avoid unwanted fiscal consequences.

# 2 BETTER ALIGNING PUBLIC SPENDING WITH NATIONAL PRIORITIES

63. **It is important for public spending to be better aligned with national priorities to maximize its impact.** Vietnam's national priorities are for development to be characterized by rapid, equitable and sustainable growth underpinned by modern industries; a knowledge-based economy; a universally strong human-capital base; and modern state and governance institutions. Aligning spending to these priorities involves linking the budget with socioeconomic planning; linking sub-national allocations with government priorities; and ensuring that the transformational role of the state in the economy is taking place on the ground. This section examines and makes recommendations for improving the alignment between spending and national priorities in a decentralized context and turning the budget into an effective tool for strategic decision-making and implementation.

## Spending for sustainable growth

64. **Robust economic growth supported by sound macroeconomic and pro-growth expenditure policies have lifted Vietnam from being one of the poorest countries in the world to a lower middle-income country.** In the period 2011-15, total State budget spending accounted for 29.2 percent of GDP, increasing from 28.4 percent in the period 2006-10. Capital spending was highly prioritized towards infrastructure development. Indeed, it was an important contributor to the high economic growth. Recurrent spending was prioritized for human development,

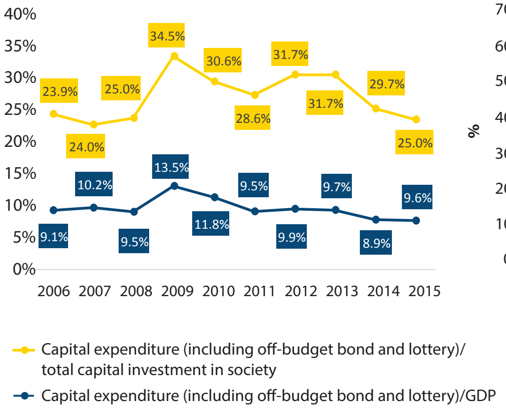
social protection and security and poverty reduction. Average per capita incomes more than doubled from 2000 to 2014, placing Vietnam amongst the fastest growing developing economies with the most impressive poverty reduction record in the world.

65. **In the future Vietnam will still be faced with strong demand for sustained spending on infrastructure and human resource development.** This requires maintaining adequate levels of public investment, strengthening spending efficiency and making full use of existing assets as well as developing a highly skilled workforce and improving innovative capacity.

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

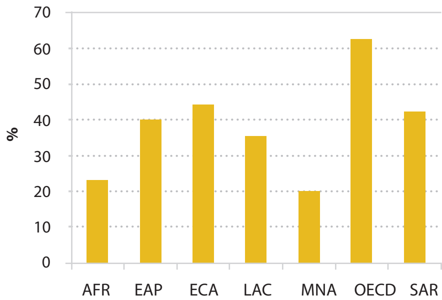
66. **State budget capital spending, including investment financed by off-budget government bonds, fees and charges, has moderated as a share of total government spending.** However, it remains an important driver of investment in society. Capital investment from the state budget accounted for 29.1 percent of total investment in the economy in the period 2011-15, slightly higher than the 28.4 percent in 2006-10 (Figure 20).

**Figure 20. The share of capital spending has decreased slightly**




*Source:* MoF.

**Figure 21. Vietnam's level of decentralized capital spending is amongst the highest in the world**




AFR: Africa
EAP: East Asia and Pacific
ECA: Europe and Central Asia
LAC: Latin American and Caribean
MNA: Middle-East and North America
SAR: South Asia Region

*Source:* WB.

67. **There has been a change in the proportion of central and local investment budgets.** The proportion of central and sub-national total capital investment moved from 33:67 in the period 2006-10 to 27:73 in 2011-15.[17] 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. This contrasted to the 2003-08 period, when capital from government bonds focused mainly on investment in transport and irrigation projects led by the central government. The 2009-14 period saw the targeting of mostly local priorities (66 percent in 2010) such as rural roads, small hydro-electric works and other social programs. Sub-national public investment now represents about 40 percent of provincial budgets. The level of decentralization of capital spending in Vietnam is amongst the highest in the developing world (the average proportion for 2001-10 in developing countries was 38.4 percent, see Figure 21). This has provided strong incentives for development at sub-national level, as well as contributing to the development of rural infrastructure such local roads, clean water systems and the improvement of local education and health services; together contributing towards poverty reduction.

68. **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.

## Enhancing investment efficiency through better project prioritization, selection and management

69. **Priority should be given to improving the allocation of capital spending and its efficiency, rather than increasing capital spending.** The emphasis moving forward may be better focused on retaining the current level of capital spending, but giving increased attention to improving its efficiency. There should also be stronger incentives for the non-state sector to increase the proportion of private investment in total capital investment.

17 Following receipt of balancing transfers and target transfers from the central government.

70. **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. For example, the average project size in 2009 was VND 4.4 billion for provincial level projects and VND 8 billion for central projects. Financial availability is sometimes not taken into account in project approvals. For instance, between 2001-08 the budget allocation only met 61 percent of the total cost of projects approved by the central government. Consequently, the annual allocation for each project was too low and many medium and small sized projects (groups B and C) were only allocated around VND 1 billion a year, resulting in planned implementation periods of 2 or 3 years stretching out to 5 or 6 years before completion. Local authorities also accumulated payment arrears to construction companies, which in turn prevented them from servicing their debts and led to growing levels of non-performing loans in local banking systems. 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[18]. 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.

71. **A large number of projects are driven by weak appraisal and selection processes.** Until 2015, when the Public Investment Law was enacted, many projects were included in the budget without being subject to adequately detailed costing or appraisal. In many cases, appraisal was only undertaken after a project had already been included in the budget and at this stage a negative assessment would not result in its rejection. The screening and formal appraisal of projects, which in many cases were a formality, was carried out by the agencies that are responsible for completing the projects. Increased decentralization and limited oversight has resulted in unrealistic investment portfolios and insufficient project preparation. Consequently, in the past, many projects had longer implementation periods than initially anticipated and needed to have their allocations adjusted accordingly, ultimately incurring losses and creating inefficiency.

72. **A number of steps are essential to strengthen fiscal discipline, allocative efficiency and technical efficiency to improve the credibility of the capital budget and help to reduce arrears.** 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 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

18 Map of capital arrears is from: http://tuoitre.vn/Kinh-te/567953/giat-minh-voi-91-000-ti-dong-no-dong.html

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).

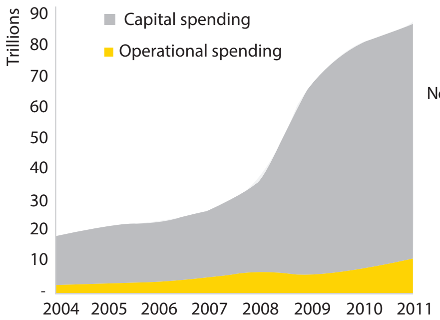
## Ensuring proper maintenance of assets to maximize their value and enhance investment efficiency

73. **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. In the transport sector over-spending on capital and under-spending on maintenance at both national and provincial levels have long been a concern. Preserving a road in good condition is less costly than neglecting it and having to rehabilitate or reconstruct it. Underspending on maintenance reduces the lifespan of infrastructure and thus increases the lifecycle costs of assets. It is estimated that 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 $km^2$), the full potential of such a network is hindered by its poor condition due to low levels and financing of maintenance.

74. **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 2012, maintenance expenditure represented only about 18 percent of total transport expenditure (Figure 22). 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.

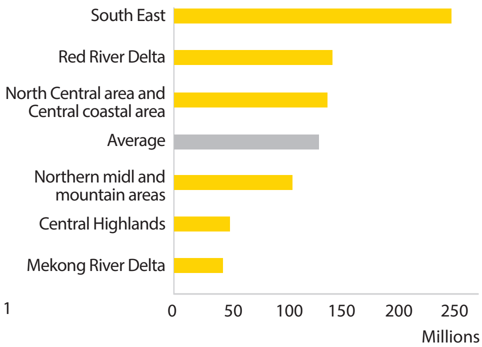
75. **The misallocation between capital and recurrent expenditure is also apparent in the agriculture sector.** In past years the Government invested heavily in building infrastructure in the agriculture sector, particularly for irrigation. This led to agricultural growth, ensuring food security and reducing rural poverty. Investment in irrigation was not only for agricultural production but also for residential purposes. Now that the irrigation network has been well established a key challenge is that the condition of irrigation canals is deteriorating and affecting their potential operational capacity. This is due to irrigation spending being focused more on capital spending than on O&M. The allocation of recurrent expenditure for O&M activities is substantially lower than the need and has brought about negative impacts on the operational capacity and performance of irrigation systems.

**Figure 22. The transport sector favors capital expenditure over operational expenditure (in nominal values, VND trillion)**




*Source:* MoF.

**Figure 23. Wide gaps in transport recurrent expenditure compared with population by region (2011, VND million per population)**




*Source:* MoF.

76. **This situation and its challenges are similar in almost all other sectors.** In the education and health sectors, maintenance budgets are not increased when new capital projects are planned and implemented, resulting in shortfalls in maintenance spending and a shorter life of education and health physical assets. There are also cases where new schools and hospitals have been built without sufficient funds being allocated for the recruitment of teachers and doctors.

77. **The misallocation between capital and recurrent expenditure is also present at the sub-national level.** From 2009-12, there was a modest improvement in the transport sector, where maintenance spending grew by 25 percent per year, twice as fast as capital spending. However, progress is uneven across provinces. There have been positive signs in HCMC and Lao Cai[19]. However, in Hai Phong capital projects of all kinds continue to be planned and implemented without estimating the resulting additional maintenance costs. Maintenance spending therefore appears to be inadequate.

78. **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.

19 The maintenance-to-road construction expenditure ratios in Lao Cai and HCMC were 22 percent and 23 percent on average between 2010-13 respectively .

- ***In the transport sector:*** it is recommended to re-allocate 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 it). 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. The Roads Maintenance Fund may help to support increased O&M spending in the roads sector. However, there is scope for improvement in legislation to improve transparency and efficiency of the Fund. O&M spending in other transport subsectors such as railways and inland waterways should also be re-prioritized.

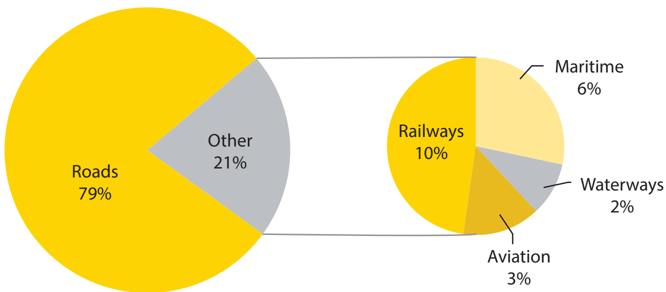
- ***In the agriculture sector:*** it is recommended to move some resources from capital to recurrent O&M spending, particularly for irrigation, whilst simultaneously adopting sustainable strategic agricultural initiatives to reduce the cost burden on the State budget. Some irrigation O&M costs should be shared between the state budget and water users.

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

79. **Rationalization of the composition of public spending within each sector could help to strengthen the alignment between spending and Vietnam's comparative advantages and development strategy, better meeting opportunities for higher growth.** This suggests the need to reconsider sub-sectoral spending allocations to create better alignment with sectoral development strategies and a more optimal balance between the subsectors; that is, one more consistent with Vietnam's comparative advantages. In the past transport and agriculture spending has been prioritized to support growth and poverty reduction. It is time to review the intra-sectoral allocation to take into account their advantages and development potential.

- ***In the transport sector, road transport represents approximately 89 percent of the overall public transport budget.*** There is relatively low spending on maritime, waterway and rail transport despite their transport costs per kilometer being considerably lower than for roads (Figure 24). Whilst road transport remains the most important method in terms of volume, between 2009-12 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. Inland waterway and maritime transport are advantageous to Vietnam, have the lowest transport costs for domestic freight transport and the most efficient budget-to-volume ratios. Optimizing the alignment of capital expenditure with current volumes and potential demand would improve the value for money of investments across transport types. It will also be important to improve infrastructure intermodal connections for better logistics, especially between maritime, inland waterways and railway connections.

**Figure 24. Public expenditure by mode of transport (2012)**




*Source:* MoF.

- ***In the agriculture sector, given the continued emphasis on irrigation as a driver of agricultural growth, it 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 (Table 3). The bulk of public spending in agriculture continues to be occupied with a food security strategy that generates ever increasing levels of rice. However, this policy results in a low value addition and an over-emphasis on investment in the development of large irrigation schemes for land dedicated to rice cultivation. This increase is a concern if it indicates the crowding-out of public resources for other priority areas such as cultivation, agricultural services, forestation, veterinary care and other priorities outlined in the Agricultural Reform Plan (ARP). It is recommended that some public spending be reallocated away from irrigation to other areas such as cultivation and agricultural services. This reallocation will be important to increase agricultural productivity and to promote agricultural diversification and exports.

  **Another efficiency issue in the agriculture sector is the regional allocation of resources.** 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 Mekong River Delta, the South East and the Central Highlands. Overall, total agricultural spending is 1.86 of GDP, whilst that for the Mekong Delta is 8.92. In the future, it will be important to consider whether the current distribution of public resource allocations to regions is optimal in meeting the objectives of the ARP. This will require assessment of the comparative advantages and role of each region in contributing to the vision of sustainable agricultural transformation. For instance, more spending for the Mekong River Delta will be likely to increase the volume of higher value-added products, such as marine products and fruit. Increased spending is also recommended for agricultural services, particularly for farming and processing.

**Table 3. A continued large share of agriculture expenditure is on irrigation (2009-12)**

| | % of GDP | | | | % of Total Agriculture Expenditures | | | |
|---|---|---|---|---|---|---|---|---|
| | 2009 | 2010 | 2011 | 2012 | 2009 | 2010 | 2011 | 2012 |
| Cultivation | 0.06 | 0.07 | 0.13 | 0.07 | 4.27 | 4.18 | 7.65 | 3.95 |
| Breeding | 0.03 | 0.04 | 0.05 | 0.03 | 1.98 | 2.31 | 2.62 | 1.97 |
| Cultivation and mixed husbandry | 0.04 | 0.03 | 0.03 | 0.03 | 2.62 | 2.11 | 1.95 | 1.69 |
| Agriculture services | 0.09 | 0.10 | 0.08 | 0.10 | 5.86 | 5.92 | 4.82 | 5.53 |
| Veterunary works | 0.04 | 0.06 | 0.05 | 0.05 | 2.89 | 3.55 | 2.74 | 2.80 |
| Irrigation | 0.96 | 1.04 | 1.12 | 1.22 | 64.64 | 64.43 | 63.92 | 70.21 |
| Forestation | 0.10 | 0.12 | 0.09 | 0.09 | 6.85 | 7.57 | 5.17 | 5.03 |
| Forestry services | 0.02 | 0.02 | 12.15 | 0.02 | 1.60 | 1.50 | 1.32 | 1.19 |
| Resettlement and new economic zones | 0.06 | 0.06 | 0.06 | 0.06 | 4.06 | 3.90 | 3.29 | 3.35 |
| Fisheries | 0.08 | 0.07 | 0.11 | 0.07 | 5.08 | 4.35 | 6.40 | 4.06 |
| Timber and other forestry products | 0.00 | 0.00 | 0.00 | 0.00 | 0.16 | 0.16 | 0.14 | 0.21 |

*Source:* MoF.

## A gradual shift between spending on infrastructure and human development

80. **In recent years Vietnam has been placing a strong emphasis on human capital development, which should support growth in the long run.** Spending on education and health grew significantly above average (4.4 percent per year) over the 2009-12 period, at 11.1 and 12.6 percent per year, respectively. This suggests a strong and accelerating promotion of human capital. Between 2009 and 2012 spending on human capital increased from 23 percent to 28 percent of the total national budget. National spending on education and training increased especially rapidly from 15.1 percent in 2000 to approximately 20 percent in 2012 and was much higher in some provinces such as HCMC (25 percent) and Can Tho (30 percent). Spending on education and training was on average approximately 5.7 percent of GDP in the period 2009-12. This was the same level as in Thailand, higher than the Rep. of Korea and double that of Indonesia. Health spending rose on average by 12.2 percent per year in the same period, resulting in its share of GDP being amongst the highest in East Asia.

81. **However, spending on science and technology (S&T) has been less than robust, despite the supportive policies and the resource prioritization given to the sector.** Innovation, which is fueled by S&T, is a key determinant of growth in productivity and can help Vietnam attain a higher growth trajectory[20]. This has been clearly identified in policy. Since 2000, the annual state budget allocation for S&T has met the stipulated 2 percent of total state budget expenditure. However, spending was only about 50 percent of the allocated budget. This suggests room for improvement in the structure of its allocation between capital investment and recurrent spending; between central and local levels; and between provinces. Lack of information on actual state budget spending on S&T and in particular capital spending, was cited as a challenge for the Ministry of Science and Technology (MoST) to monitor spending in all sectors and at all government levels. The allocation of funding was also mismatched with research and development (R&D) capacity. Even the actual budget utilization has not been allocated for the intended purposes and categories in some units especially at local level.

82. **To improve the effectiveness of state budget spending on S&T, it is important to focus on the priorities established in the S&T development strategy,** especially in basic research, strategic research and research for policy and public services as stipulated by the State. It is critical to implement new financing mechanisms as stipulated in the Law on Science and Technology (2013). Coordination between the MoF, MPI, MoST and sub-national governments in the allocation, execution and oversight of the state budget for development of S&T needs to be strengthened.

83. **The relative level and growth rates of per capita spending on human capital shows a reasonably consistent pattern across regions.** Spending on education especially and health to a lesser extent predominates everywhere in local budgets. The State has been prioritizing more budget resources to support poor and other disadvantaged groups in society to improve their access to basic social services through increased coverage and benefits[21] and thus improve social equality. Growth rates in education and health expenditure were strong across all regions especially between 2011 and 2012. The relative importance of local spending on science and technology is low in all locations and expenditure has remained essentially flat (Figure 25).

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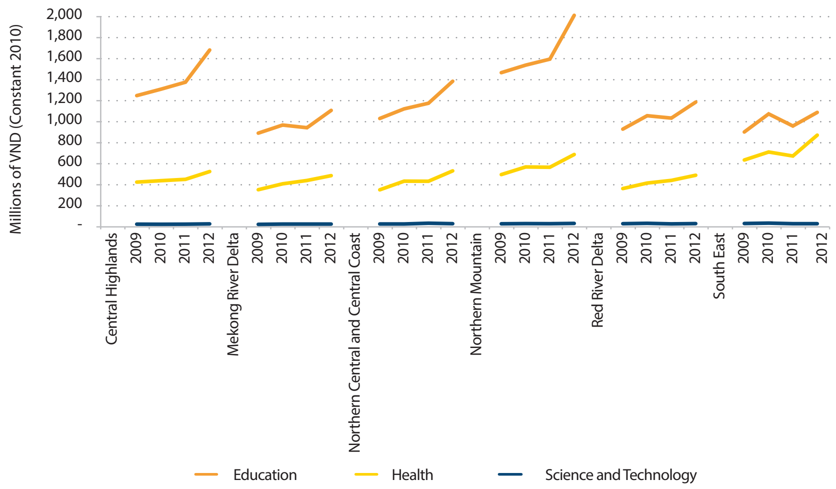
20 Vietnam 2035 Report (2016).

21 Spending on social security is allocated and accounted for in several functions (education, health, social protection, etc.) and through multiple social programs, making it difficult to report the actual outturn.

**Figure 25. Per capita sub-national spending on human capital by region (2009-12)**

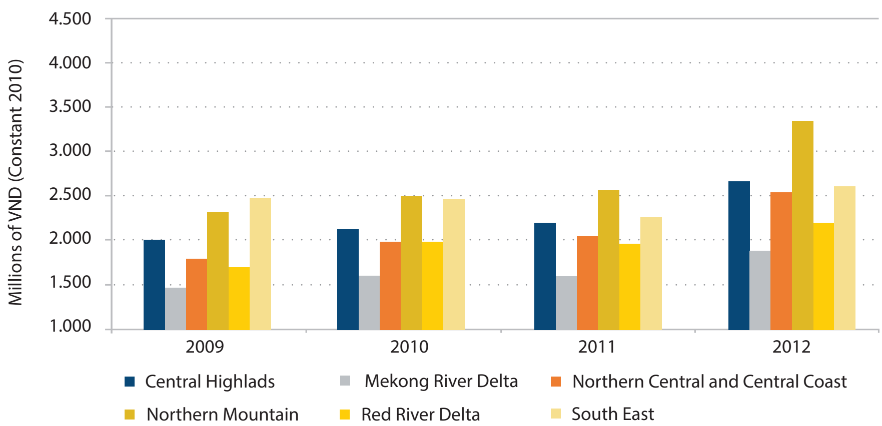



*Source:* MoF.

## Spending for equitable growth

84. **On an aggregate basis total spending of regions appears to be generally consistent with the Government's human capital equity objectives.** In broad terms, poorer regions (i.e., the Northern Mountains, Central Highlands and Northern Central and Central Coast regions) tend to have higher levels of expenditure on core functions such as education and health. The richest region (i.e., the South East) also has a high level of spending on human capital, however, spending is comparatively low in the middle range of regions (i.e., the Mekong River Delta and the Red River Delta regions) (Figure 26).

**Figure 26. Per capita sub-national human development spending by region (2009-12)**




*Source:* MoF.

## Enhancing equitable resource allocation to promote development across provinces

85. **Intergovernmental fiscal arrangements in Vietnam have helped to promote greater equity in resource distribution, both across and within provinces.** These arrangements define those areas with higher spending needs and then channel 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. These arrangements also enable richer provinces, which have higher revenue potential, to continue to have higher relative levels of spending. The incentives provided by the mechanism aim to stabilize 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.

86. **Central government has also influenced sub-national spending to address poverty reduction through targeted transfer systems.** Between 2011-15 there were 61 target transfer schemes[22] and 16 National Target Programs (NTPs). Nearly 75 percent of spending on NTPs went into four programs: Job Creation and Vocational Training (12 percent); Sustainable Poverty Reduction (15 percent); Education and Training (17 percent); and Development of a New Rural Life (29 percent). During the period approximately 56 percent of funding for all NTPs came from central authorities; 26 percent from local authorities; 5 percent from external donors; 4 percent from borrowing; and 9 percent from community contributions.[23] In addition, there were 28 other targeted programs.[24]

87. **The transfer systems have demonstrated clear redistributive benefits between provinces (as demonstrated in Figures 27 and 28).** It can be seen that the poorer provinces, located in the Northern and Western mountainous areas, have benefitted significantly from the transfers. The systems include balancing transfers and targeted transfers which account for 16 percent and 19 percent of total budgets respectively.

22 This includes an investment program in the 62 poorest districts; specific infrastructure investment (e.g. dykes, research and development centers); economic development programs in the East Sea islands and border areas; and investments in provincial and district hospitals.

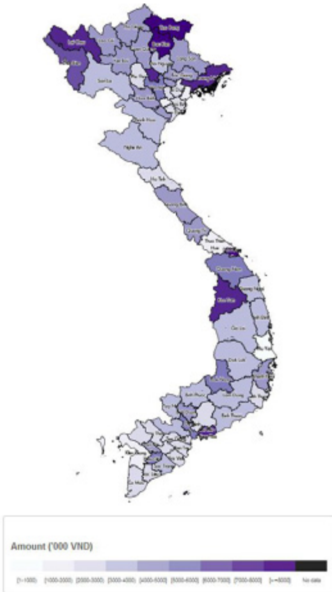
23 GOV report to the National Assembly on implementation of NTPs (2011-13).

24 The number of non-NTP target transfer schemes has fallen from 50 in 2007-11, to 28 in 2011-15.

**Figure 27. Per capita spending before central transfers is higher in the wealthier eastern-coastal provinces**


*Source:* WB staff estimates based on MoF data.

**Figure 28. Per capita spending after central transfers is higher in the poorer northern mountainous and central highlands provinces**

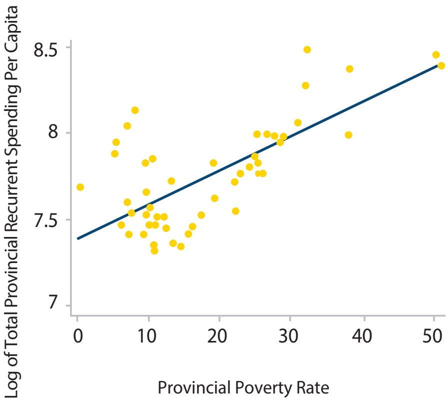



*Source:* WB staff estimates based on MoF data.

*Note:* The boundaries, colors, denominations and other information shown on any map in this work do not imply any judgement on the part of The World Bank concerning the legal status of any territory or the endorsement or acceptance of such boundaries.

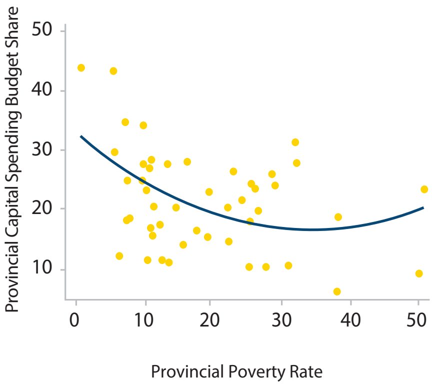
88. **These arrangements have made recurrent spending largely pro-poor and equitable and capital spending more balanced between equity and efficiency considerations.** Sub-national recurrent spending is strongly pro-poor in the sense that recurrent spending is higher the higher the poverty rate of the region (Figure 29). Sub-national capital spending is comparatively significant at either low or high levels of poverty (Figure 30). As a result, sub-national capital spending drives total sub-national spending outcomes related to poverty. Total spending by province is only pro-poor at the higher levels of poverty (Figure 31), contributing to the impressive record of poverty reduction. However, it may be observed that efficiency is not a priority consideration in budget allocation to sub-national governments. When Vietnam has entirely escaped poverty and become a fully middle income country, efficiency considerations should have greater priority in budget allocation. One example of this is the regional budget allocation for agriculture as analyzed in paragraph 79 above.

**Figure 29. Higher recurrent spending in poor provinces**



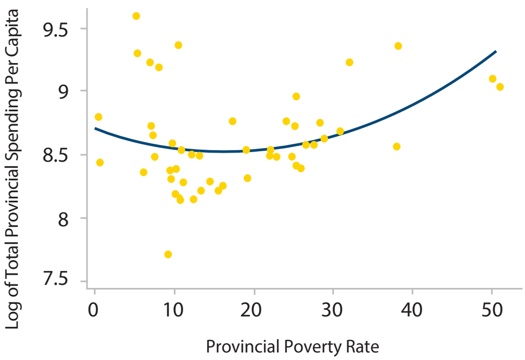

*Source:* WB staff estimates based on MOF data.

**Figure 30. Relatively large capital spending at low and high levels of poverty**




*Source:* WB staff estimates based on MOF data.

**Figure 31. Total sub-national spending is pro-poor**




*Source:* WB staff estimates based on MOF data.

89. **In the future it will be important to nurture growth in decentralized revenue and strengthen the operation of the transfer systems.** Drivers of growth should be renewed by prioritizing investment in prospective sectors (as discussed above). These actions should help to sustain the drivers for the country's equitable growth, as well as assist the positive impact of redistribution policies across provinces. There is a risk that the gap between the poorer provinces and the more prosperous ones could widen as the poorer provinces are generally less economically advanced and consequently tend to yield fewer public revenues. Unless proper incentives are put in place, these poorer provinces may over time become relatively more dependent on central transfers.

90. **An alternative is the promotion of the revenue potential and autonomy of provinces.** From 2011 to 2015, given the then existing decentralization arrangements, only 13 of the 63 provinces were self-financing and net contributors to the central budget. The remaining 50 provinces, whilst being allowed to fully retain local revenues (except oil and import-export related revenues), still required balancing transfers from central government to cover their expenditure. This accounted on average for 40 percent of total expenditure of these provinces.

91. **Consideration should be given to possible additional revenue tasks and a more equitable revenue-sharing arrangement.** More opportunities should be considered 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. The distribution arrangements of major taxes also warrant review to improve their transparency and equity. More equitable revenue-sharing arrangements have been internationally proven to promote local economic performance and revenue performance equally across local areas. According to the State Budget Law (2015), indirect taxes (e.g. VAT and excise) are currently credited to the provinces where they are produced. As this source of revenue is contributed by consumers from many different provinces, it is recommended that it be shared in a more equitable manner. 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.

92. **Vietnam's system of balancing (or unconditional) transfers is relatively transparent, rule-based and highly predictable.** The key principle in determining spending needs (for both capital and recurrent expenditure) is through the use of allocation norms based on population and other criteria such as school-age population, geographic location, etc. Thus, the greater the population, the higher the budget expenditure allocation. Higher expenditure allocation is factored in for the population in disadvantaged areas, subject to its development level and higher costs of service delivery. The State Budget Law (2015) also allows the adjustment of annual balancing transfers for inflation. This is an important principle to ensure equity in budget spending as spending needs are more fairly determined and are not dependent on local revenue capacity. 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 resourceful in making apparent progress in socio-economic development due to the fiscal transfer system.

93. **However, there are some limitations in population-based allocations.** The current budget allocation formula for education is not based on the number of students but on the school-age population. This is similar to health, training, culture, information, sports and athletic services, etc. The population based allocation is

therefore not linked to the amount of available facilities that should be invested in and their utility. This budget allocation practice provides little incentive for provinces to enroll more students, rationalize the teacher/doctor workforce and initiate administrative reforms to achieve human resource efficiency gains. The allocation norms seem to favor sub-national governments with higher revenues, allowing them to adopt higher population-based allocation norms. Nevertheless, this practice is a way to provide additional resources for the sub-national governments in key economic hubs to address additional costs (e.g. in response to the needs for education, health care, infrastructure, social order and safety services) of non-residents or temporary immigrants.

94. **It is critical to 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 example, the number of graduates, number of treated patients, and volume of public services delivered, etc. As a next step, it is recommended that provinces gradually move towards applying an intra-provincial budget allocation system taking into account the output indicators (students/patients) as a stepping-stone towards future nationwide application. The allocation of capital investment should be linked with the medium-term public investment plans agreed on the basis of development and infrastructure gaps. Program budgeting can be an appropriate approach and can be phased in through an appropriate roadmap. To retain the key principles of cost and population base of the budget allocation system, it is recommended that the costs of extraneous factors and provision of compensating transfers be taken into account, instead of increasing spending norms for provinces according to their revenue capacity. This will encourage infrastructure development and enrichment of the revenue base in potential high growth provinces.

95. **Too many targets and programs may inevitably lead to overlapping, lack of predictability and lower management efficiency.** NTPs are 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. 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.

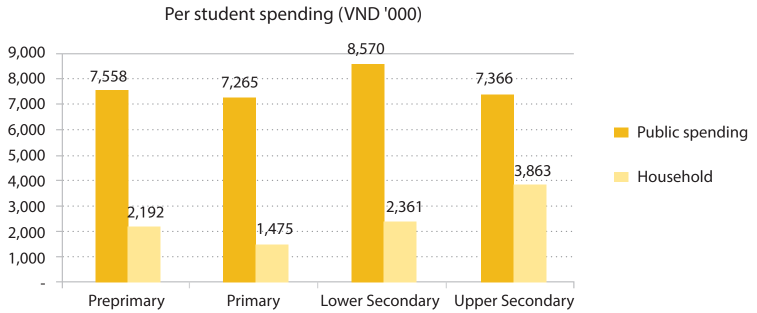
96. **Although sub-national spending is largely pro-poor, its impact on poverty reduction is not thoroughly understood.** It is therefore recommended that a benefit incidence analysis be conducted for each social security policy. This should include analysis of the burden and adverse impacts (if any) of the mobilization of personal contributions for basic services amongst low-income groups. This could be a priority area of research in the near future.

## Addressing the risk of widening inequities in access to essential services

97. **Whilst intergovernmental fiscal relations appear to be working well overall, there is a risk of widening inequities in access to basic services.** Despite the proactive efforts by Government to support the poor and the near-poor this constitutes a risk in the current environment of expanding socialization policies.

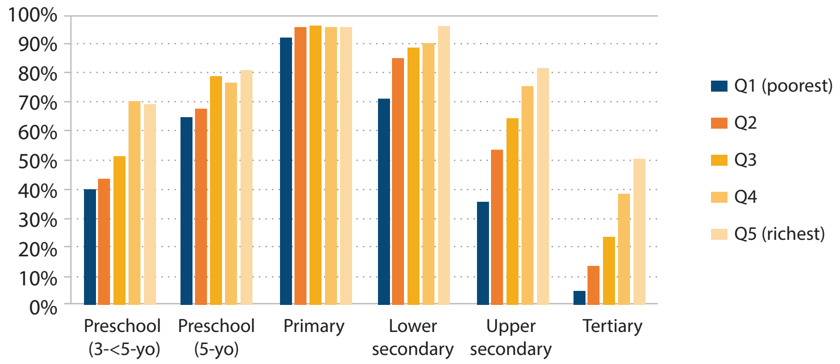
98. **In recent years, the proportion of household spending on pre-primary and general education has been very high relative to public spending** (highest for upper-secondary at 34.4 percent and lowest for primary at 16.9 percent (Figure 32). It is a matter for concern that the proportion of private spending on pre-primary and general education is amongst the highest in both the OECD and some non-OECD comparator countries (Figure 33). Access remains inequitable at pre-school and post-primary levels. There are wide gaps in the enrolment rates at all levels (except for primary education) by location (urban and rural), region, income quintile and ethnic group (Figure 34). More than half of the population aged 15 years and over in the poorest 40 percent have attained only primary education or less and none of the poorest and only 1.3 percent of the second-poorest groups have attained tertiary education. Evidence shows a drop in enrolment to secondary education amongst children of the poor, partly due to costly additional contributions required beyond school fees. Access to full-day schooling (FDS) depends to a high degree on parents' ability to pay school fees (to finance additional sessions, lunch and other extra-curricular activities), which widens the gap between the rich and poor in accessing learning opportunities. Consideration should be given to providing additional funding for disadvantaged primary and lower secondary schools that are unable to move to FDS because of parental financial constraints.

**Figure 32. The proportion of household spending on pre-primary and general education relative to public spending is very high in Vietnam**



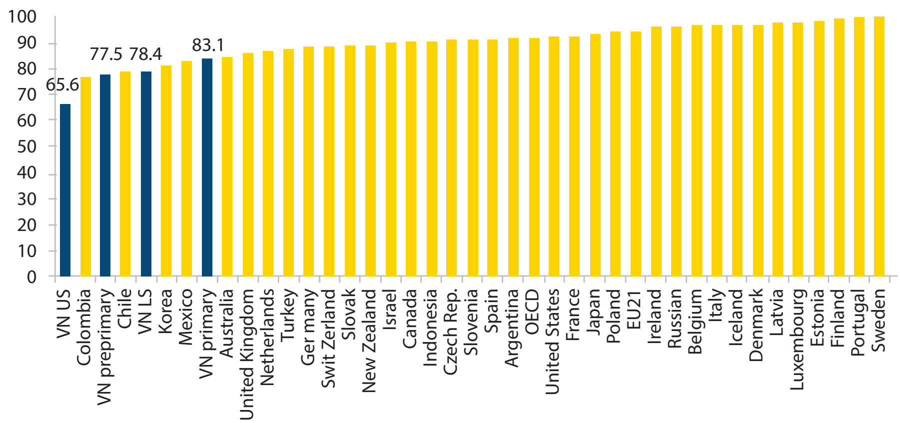

*Sources:* VHLSS 2012 for private spending; authors' estimate for public spending based on data from MoF/GSO.

**Figure 33.** **Access remains inequitable at pre-school and post-primary levels: Net enrolment rate by income quintile (2012)**




*Source:* VHLSS 2012.

**Figure 34.** **The proportion of household spending on educational institutions (at primary, secondary and post-secondary non-tertiary level) is very high relative to other countries (2011)**




*Source:* OECD Education at A Glance 2014, Table B3.2b for all data except for Vietnam; author's estimates for Vietnam (2012).

*Note:* According to the OECD's definition, "private spending" includes all direct expenditure on educational institutions, whether partially covered by public subsidies or not.

99. **In the health sector, there are various concerns about equity.** Health financing policy in Vietnam in principle favors poorer provinces and the poor.[25] 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 outside insurance coverage or 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. Vietnam has higher out-of-pocket (OOP) payments than in most Asian countries, which makes the poor and the near poor more vulnerable when facing catastrophic health problems. 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.

100. **There are shortcomings in the allocation of resources from Vietnam Social Security Fund (VSSF), which also result in inequality in access to health services by the poor and the near poor.** The system of provincial VSSF health financing to health facilities is based on differential capitation rates by insurance category (e.g. the poor, retired population, workers, etc.) on the basis of past utilization patterns instead of the actual demand for health services and the supply capacity of health facilities. This arrangement suggests that health spending is equalized for different categories of the population. However, the capitation rates are differentiated across beneficiary groups in the same province. For instance, in a surveyed province in 2012, the capitation rate for the poor was only one third of that for civil servants and other employees, because the poor have used fewer services in the past. Similarly, the capitation rates for the same category of people differ across provinces. For instance, in 2012 the capitation rate for the poor and near poor in the Northern Mountains region was only half that of the Red River region. Under these arrangements, health facilities are reluctant to apply highly technical services which may exceed the ceiling for the poor and the near poor lower capitation rates. This is especially true at provincial level hospitals where the number of referred patients (those with serious diseases with a higher cost of treatment) is likely to exceed the capitation ceiling.

101. **To improve equity in health spending, it is recommended that the Government continue to pursue their policy of universal health insurance policy and full coverage of health insurance cards for the poor.** This requires strengthening communication about entitlements, improving quality of health services, improving support to policy targeted groups. It is important to strengthen the quality of services available at grassroots level, where most of the poor seek care. This can be done by prioritizing investment in medical equipment for mountainous provinces where health services are underdeveloped and those with health insurance

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25 The state now fully covers the health insurance premiums of children under six, the elderly, those identified as poor, ethnic minorities and 70 percent of premium rates for the near-poor.

have less access to modern services than those in the plains and urban provinces. It is also recommended that provider payment reforms be introduced, including by gradually shifting away from fee-for-service to other health financing mechanisms such as rationalized capitation and case-based (DRG) financing.

102. **As Vietnam moves further towards market-based service pricing, improved and timely targeting practices should be adopted to mitigate the risk of increasing inequity in access to basic services.** The Government has prioritized support to the poor and near-poor, either through overall budget allocation mechanisms or targeted transfer and subsidy programs. However, evidence suggests that any expansion of socialization policies should be conditional on having in place effective mechanisms to protect access to basic social services by the poor and near-poor. The impact on the poor and near-poor will depend on how good the targeting programs are and as learned from experience across the world and in Vietnam targeting errors are not insignificant in their effect.

## Strengthening institutions and processes for better alignment between plans and budgets

103. **Selectivity and alignment of budget spending with national priorities remains weak.** Currently, strategies and plans are expanding and are too broadly defined, allowing almost any project to fit within them, and thus limiting prioritization. There are more than 19,000 plans and master plans and there is a need to ensure consistency and synergy between them. Development strategies and plans are often also excessively optimistic in their assumptions about the amount of finance that can be mobilized for their implementation. The problems of insufficient integration of planning and budgeting, and of budgeting for capital and recurrent expenditure (identified in the PER 2004) remain.

104. **An opportunity to address these longstanding issues is provided by the introduction of the Medium-Term Investment Plan (MTIP) in the Public Investment Law (2014) and the Medium-Term Financial Plan (MTFP) in the State Budget Law (2015).** The MTIP will potentially help link sectoral and sub-national priorities with national priorities within a resource framework and improve fiscal discipline. These benefits ultimately depend on other subjective factors, including coordination between the planning and finance authorities. Experience from the sectors under review also emphasizes the need to devise clear sector strategies and a consolidated investment framework with clear sector priorities. This is for public spending to contribute towards sectoral development and reform objectives and avoid inefficient spending in the sector, especially due to a high level of decentralization. The establishment of clear prioritization principles and guidelines will help enhance the selection of projects in each sector on the basis of both economic and social cost-benefit analyses.

105. **It will be important to limit the ambition of plans within financial affordability.** The MTFP should establish the level of overall investment spending that is fiscally affordable. The MTIP should then focus on the prioritization of different investment projects within that constraint and across multiple years. It is crucial that the two plans are considered in parallel by the Government and the National Assembly to ensure consistency between them. It is also important that the MTFP should not only be a forecasting tool but a fiscal policy planning tool. For example, if the Government sees that investment needs exceed available resources, then this raises important questions about mobilizing additional resources. This might be done by considering changes to tax policies or by creating fiscal space for investment through improved efficiency in recurrent spending. The establishment of a macro-fiscal advisory unit within the MoF should be considered to help introduce more flexible fiscal policies and a better alignment with investment and monetary policies.

106. **Vietnam is making progress towards unifying the budget process as a way to tackle the shortcomings of the existing dual-budgeting system**[26]. This involves making changes across several dimensions. Unifying the budget presentation is often the first step. Even if there are separate processes for capital and recurrent spending, budget documentation can be consolidated to show overall allocations for each function or program. The State Budget Law (2015) requires the presentation of a unified budget which will help to improve understanding of both overall allocations and the links between recurrent and capital spending. The second aspect is procedural integration. The Prime Minister will authorize the MoF and the MPI to prepare, agree upon and issue unified budget guidelines. Line ministries will prepare unified budget submissions covering both capital and recurrent spending and negotiate jointly with the finance and planning and investment authorities. The final aspect, and probably the most challenging, is institutional changes. Vietnam is not the only country with dual budget processes; as observed internationally, the roles of the related institutions tend to change as governments move towards a unified budget process.

107. **It is not only important to align the 5-year MTFP and 5-year MTIP at the time of their approval.** It is equally important to ensure they remain aligned over time. Even if the financing gap is closed, there is a high chance that gaps (positive or negative) will arise in the future. Vietnam is a dynamic economy and it is very challenging to produce forecasts that will hold for as long as five years. It will be important to provide for sufficient flexibility in the planning process to accommodate these changes when they occur. As such, the MTFP and MTIP should also provide guidance on priorities in the event that more or less resources become available during the period. Whilst the 5-year MTFP and 5-year MTIP are both conceived as fixed-term plans for the coming five years, the rolling 3-year Medium-Term Financial and Budgetary Plan (MTFBP) supports the annual budget process

26 A dual budgeting system is a system with separate capital and recurrent budgets.

and offers an opportunity to create the type of flexibility needed and ensure that plans and budget allocations remain realistic over time.

108. **It is critical to shift the focus of budget negotiations from bidding for more resources to debating the purposes and expected results of proposed spending.** Such procedures will enhance more comprehensive and strategic management of budgetary resources. Simultaneously, it will capitalize on the respective strengths of both the MoF (which has a strong focus on aggregate fiscal discipline) and the MPI (with a strong capacity in sectoral policy). One approach would be to have a cabinet meeting at the beginning of the budget cycle to decide the fiscal resource envelope for both capital and recurrent spending and for all ministries and provinces in a transparent manner. The subsequent budget negotiation can then focus on outcomes. This is a relatively common approach in many countries. However, the new approach requires radical change in both the MoF and amongst budget users. It should therefore be adopted with caution and planned with a detailed roadmap.

109. **More generally, the traditional input-based method of financing does not incentivize efforts towards creating results.** To improve support to targeted beneficiaries, it is recommended to move from providing support to service providers to providing support to end beneficiaries. For instance, the model of provision of bus subsidies could be reviewed to improve its targeting directly to low-income passengers rather than providing them through bus companies. A gradual move towards output-based financing is also envisaged in the legal framework as stipulated in the State Budget Law (2015). This process can be started in some sectors where outputs can be readily measured, such as in higher education and S&T. In all cases, to adopt the new budget management approach, a required first step is to develop a robust set of criteria for performance monitoring and evaluation (M&E) systems.

# 3 STRENGTHENING ACCOUNTABILITY FOR RESULTS

## A longer-term vision[27]

110. **Vietnam has made considerable progress over the past two decades in achieving economic growth and using that growth, in part, to increase the resources being mobilized and deployed to key public service provision.** A key part of the transition from low-income to middle-income public finance systems involves establishing controls over daily delivery tasks such as issuing payments, paying salaries, commitment controls, procuring goods and services, and ensuring that the budget calendar is adhered to. This is a reflection of the urgency of these matters because without control it is hard to maintain basic fiscal discipline and macroeconomic stability. To do this, the Government has put in place basic public financial management (PFM) systems governed by a comprehensive legal framework, standardized business processes, far-reaching administration apparatus and functioning management information systems. These cover almost all of the fundamental PFM building blocks from revenue mobilization to expenditure and asset management and accounting and auditing.

111. **The previous phase of reforms has resulted in significant achievements.** *Firstly*, Vietnam has established and maintained a system of aggregate and detailed fiscal controls, which are similar to those which many other countries use to maintain basic fiscal discipline. Overall, there is a strong basis in place for fiscal control, albeit with many opportunities for improvement. This is crucial for the maintenance of fiscal

27 A Capable Public Finance Sytem for Vietnam in 2035, background note for the "Vietnam 2035" report, prepared by Philipp Krause, Sierd Hadley, and Quyen Hoang Vu (2016), in consultation with leaders and staff of the NA, MoF, MPI and other ministries.

sustainability, including episodes of stress. *Secondly*, Vietnam has moved towards an arrangement involving systems of mutual accountability between executive and legislative branches with the support of audit institutions and the judicial system. The structure has, by and large, changed in a step-by-step evolution that has upgraded and adapted the system of plans and strategies as well as the organization of the core executive. *Thirdly,* Vietnam has implemented a wide-ranging decentralization of public finance. As a result, there is now considerably more space for lower-level and service unit managers to work towards their objectives, although inevitably there is a debate over the pace and extent of these changes. Notably, as discussed above, it is assessed that the current intergovernmental fiscal relationships err on the side of equity, rather than performance. *Fourthly*, fiscal transparency and accountability have increased significantly. 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 data leave room for improvement, but the step-change improvement made in accountability institutions is profoundly important.

112. **Each of these four achievements raise their own set of corresponding challenges as the country sets its sights on its next series of growth and reform objectives.** *Firstly*, how can the Government maintain fiscal discipline in the face of increasing demands on the public purse, and as the complexity and size of the public sector increases at least in absolute and most likely in relative terms? *Secondly,* how can the Government transition away from having a central bureaucracy that is focused on maintaining compliance and processing transactions, towards a developmental and service providing government? *Thirdly*, how can the Government properly redefine the role and size of the state administration and strike a balance between what to do within government and what to leave to others? *Fourthly,* as Vietnam integrates further into the world economy, how can the Government maintain and enhance its position and gain the trust of related stakeholders? The reform trajectory will have to strike a balance between how to address immediate pressures and how to make fundamental changes to allow Vietnam to become a sustainable high-income country.

113. **It cannot be expected that the same PFM institutional approach will continue to serve the country well as Vietnam becomes a full middle-income country.** Above all, institutions in Vietnam should reflect and meet the changing demands of the country's citizenry, who are growing increasingly affluent. State institutions will have to be driven by internationally accepted rules to which Vietnam has already committed itself. Strengthening public resource mobilization and management, public services and their performance and fiscal transparency and accountability will be central to the institutional reform agenda. Information systems will play a crucial role. The Government is well aware that improving the comprehensiveness, quality and timeliness of financial and performance reporting for management and analytical purposes will be a critical backbone underpinning all the efforts discussed in this report.

## Strengthening fiscal comprehensiveness and transparency

114. **Accountability cannot be achieved without timely and accurate information on the resources consumed and the outcomes achieved from the use of those resources.** It is therefore important to improve the system of budget classification. *Firstly*, more consistency should be pursued in budget formulation, implementation and final accounting. *Secondly*, there is a need for the functional classification of expenditure to be consistently applied across both recurrent and capital expenditure to enable better analysis, including for sectors and functions. *Thirdly*, critical economic aspects of expenditure (in particular the wage bill across government and by sector given the level of autonomy currently provided to the spending units) should be reported on a regular basis for both authorization and oversight purposes. The information will be important for efficiency analysis, i.e. how best to use various inputs to achieve the expected outputs.

115. **It is also important to improve fiscal reporting in the following areas.** *Firstly*, fiscal reporting should be enhanced to keep better track of finances to inform the Medium-Term Expenditure Framework. *Secondly*, it will be important to present and analyze budget data in a form that meets the standards of international best practice. For example, the Government Financial Statistics (GFS) standards. *Thirdly*, future consideration should be given to a further revision of the State Budget Law to shorten the period of final accounts reporting (currently 18 months after the close of the fiscal year) to inform budget approval for the subsequent year. International good practice suggests 6 months and 10 months as the optimal and maximum good practice period. However, as it is challenging to shorten the period because of the "nested" budget system[28], it is important to improve the quality of budget execution reviews by strengthening the use of management information (including those captured in the Treasury and Budget Management Information System – TABMIS) and the capacity of the State Audit of Vietnam (SAV).

116. **The issue of budget carryover remains a concern.** In executing the budget, some unspent finances are allowed to be carried over without being shown in the budget of the following year. The amount is accounted for as carryover in the year it is appropriated and again as actual outturn for the following year. The same amount is therefore double counted. The same treatment is applied on the revenue side (i.e. carried over revenue and actual revenue).

28 In Vietnam, the budget system and the State Budget Law cover all levels of government. Budgets of local authorities are prepared and submitted through a bottom up process, in which local legislatures review and appropriate the local budgets before submitting these to the upper tier of government. The national legislature ultimately adopts a State Budget for the entire country, being the consolidation of the central and local budgets.

117. **Improvements in the management, accounting and reporting of carryover budget provisions in a more transparent and consistent way are needed to help 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.[29] Budget accounting must follow the principle that revenue and expenditure incurred in one year must be accounted for in that year so as to truly reflect the fiscal balance. Improved quality of budget preparation and timely budget allocation may help restrain the amount of revenue and expenditure carryovers. Therefore, it is recommended that over-realized revenues only be used sparingly to resource additional expenditure and are instead used to reduce the deficit. Transparent and consistent accounting and reporting of carryover makes it possible and more meaningful to compare reports on budget execution with the original budget (including the amounts of in-year expenditure allocation). Increases in within-year expenditure allocations, including from over-realized revenue, should be approved by the Standing Committee of the National Assembly as per the State Budget Law (2015) and should be formally appropriated by a supplementary budget (which should also be presented consistent with the original budget and final accounts).

118. **Currently, a consolidated budget execution statement is prepared annually, whereas whole government financial statements are not yet available.** Information on public sector entities such as extra-budgetary financial funds and SOE operations are reported but not yet consolidated. Financial reporting also lacks comprehensive information from spending units, including information on service revenues, assets and debts.

119. **To have an accurate and comprehensive picture of public finance to support policy formulation and assessment of fiscal outcomes and sustainability, it is important to prepare whole government financial statements aligned with international standards.** The Accounting Law (2015) requires the preparation of annual financial statements (starting in 2020) including full information on revenues, expenditures, assets and liabilities (including expenditure commitments) and explanatory notes. This will be a major change but may face a number of challenges in the medium-term. As a first step, it is recommended that the adoption of the Vietnam Public Sector Accounting Standards (VPSASs) be implemented on a phased basis with limited adaptation from the International Public Sector Accounting Standards (IPSASs). State accounting bodies are applying different accounting systems for different types of public entities. This significantly undermines the interpretation of information on the financial performance and use of financial resources by

29 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.

public service units. The situation also undermines their accountability. The agenda therefore also includes the development of financial statement templates for public sector units, including explanatory notes, in compliance with the standards.

120. **There are more than 30 central extra-budgetary funds (EBF) in the central government and provinces.** Between 2007-09 expenditure from EBFs was equivalent to almost 8 percent of total budget expenditure. The State Budget Law (2015) introduced the requirement that the operation of all EBFs' be reported to the National Assembly alongside state budget proposals and out-turn. Nonetheless, the lack of any focal agency at both central and local level to monitor EBF operations, coupled with limited capacity to analyze the performance of and risks incurred by EBFs is a source of concern. It is therefore recommended that the MoF and the Departments of Finance (DoFs) be assigned as the agencies to monitor and assess all EBF operations. EBFs with similar functions to those financed by the state budget should be closed to avoid fragmentation of resources. More could also be done to promote private participation in EBFs to increase their size and make them more suitable for large projects, such as those in science and technology.

121. **Whilst the State Budget Law (2015) mandates more comprehensive documentation of budget proposals and final accounts reports, there is still a need for complementary information on a more systematic and regular basis to support budget authorization and enhance management and oversight.** This could include reporting on arrears of revenues and expenditure; explanation of tax reductions and exemptions (possibly through annual quantified 'tax expenditure statements'); pre-financing (additional capital spending in the current year, accounted for in the following year's budget); information on the collection and use of service charges by PSDUs and their linkage to their performance and service quality; and performance and fiscal risks of SOEs and EBFs. This additional information could help to further improve budget decision-making, monitoring, fiscal sustainability, spending effectiveness and efficiency, transparency, and accountability.

## Strengthening performance management and accountability frameworks

122. **The Government has taken a series of initiatives to promote increased effectiveness and efficiency of government expenditure as well as better performance on the part of government agencies.** Some of the agencies will in future operate largely outside the budget, being financed mainly by full-cost charging for their services. Performance enhancing reforms that apply to government agencies that will remain within the budget, such as the development of output-based budgeting, will have ramifications across all three stages of the budget cycle.

123. **The autonomy extended to administrative and public service delivery units (PSDUs) has achieved some positive results.** *Firstly*, autonomy appears to have prompted PSDUs both to cut waste in their operating expenditure and to steadily increase their own revenue mobilization. *Secondly*, the remuneration of public employees has been raised to more satisfactory levels. *Thirdly*, budget allocations to PSDUs have been increased although slower than the general budget expenditure growth rate. Finally, there is anecdotal evidence to suggest that financial autonomy may have at least in some instances promoted the upgrading of plant and equipment as well as the expansion of the quantity and quality of services delivered.

124. **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. It is not clear if the increase in user fees and prices imposed by PSDUs has led to improved service quality. There is a risk that the degree of emphasis placed on increasing salaries may have led to insufficient attention being given to the need to improve the quality of service delivery to clients rather than to increase the volume of services. In the absence of informed consumers and competition between providers of specialized services such as health, there is a risk that greater freedom to impose user charges may not be sufficient to create incentives for PSDUs to deliver good quality services to clients. International experience suggests that a significant government role in subsidizing some PSDUs is likely to remain in some sectors. Additionally, State regulatory agencies have not put in place quality measurement systems for each type of service. Autonomy and socialization reforms must be complemented by a strong performance accountability framework including mechanisms to support citizens' opinions (especially in the health and education sectors). It will be important to restructure S&T research institution financing on the basis of enhancing their accountability and performance. It is important that all PSDU revenue and expenditure is transparent and the accountability of PSDU managers for fee revenue and the link between fee collection and quality of services is strengthened.

125. **The Government has embarked on a major step concerning the implementation of output-based budgeting**[30] as demonstrated by the legal provisions on performance budgeting stipulated in the State Budget Law (2015) and some steps towards its introduction in Decree 16 (2015). However, the roadmap established by Decree 16 for the development of output-based budgeting may be too ambitious.[31] A key question is which public services should apply output-based

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30 Output-based budgeting in this context means funding which is linked by formula to the volume of services (outputs) which agencies deliver.

31 The price increase roadmap (in Article 10) provides for a three-stage development of the pricing of public administrative services that are funded by the state budget. In the first stage, which is scheduled to take place by 2016, direct costs (including salaries) of services will be calculated as the basis for pricing. In the second stage, by 2018, "managerial" costs will be included in the price. Finally, in the third stage, by 2020, depreciation will be included in service prices, thus ensuring that prices will be based on the full cost of production.

budgeting. Output-based budgeting is not suited to all government agencies and services[32] and, even where it may work it is conceptually and administratively complex. There are three major challenges in introducing output-based budgeting. First, is the complexity and time required to apportion service costs as it is difficult to allocate costs between services within agencies. Second, is the relationship between price and cost. Although prices should broadly reflect costs, they do not necessarily fully reflect and recover the costs of individual public service agencies. Third, is how to formulate policy to ensure vulnerable groups have access to services. The complexity of the undertaking therefore suggests that there should be a roadmap for each sector.

126. **Given that output-based budgeting can only be applied selectively, consideration should be given to the introduction of a comprehensive government-wide program budgeting system.** For instance, this could work well in sectors such as environmental protection, preventative health and secondary education. Good performance information on effectiveness and efficiency should also be developed to inform the budget preparation process. However, the development of a robust program budgeting system is a wide-ranging reform that can only be successful if undertaken in a gradual and carefully sequenced manner.

127. **Overall, there is scope for strengthening internal controls as well as making constant improvements in management.** One option in the longer term is to introduce internal audit functions in all government agencies. This would require the adoption of a legal framework for internal audit and the phasing in of the establishment of the function and operation with other existing types of inspection and external audit activities.

## Enhancing external audit and oversight

128. **The status and capacity of the SAV has been strengthened over the past few years.** The 2013 Constitution and the State Audit Law (2015) together give the SAV the legal status of an agency established by the National Assembly that operates independently of government. There is now a clearly defined process for the supervision and monitoring of the implementation of audit recommendations. In recent years the average rate of implementation of audit recommendations is estimated to be around 70 percent and will increase when the quality of audit is improved; cooperation between the SAV and central and sub-national governments tightened; and the oversight of the National Assembly and provincial People's Councils strengthened.

32 Currently, there are more than 40,000 PSDUs at all levels of government.

129. **The scope and coverage of the SAV external audit process has steadily increased over the past five years.** However, the SAV still has some way to go before it is able to complete annual audits of all the public sector organizations within its mandate. Additional to auditing the budget execution accounts, SAV also conducted audits of the management and use of public finance and public assets in enterprises and financial institutions. SAV audits are primarily financial and compliance-based but there is an increasing focus on performance auditing and good progress has been made in enhancing its performance audit capacity. The SAV is in the process of aligning its auditing standards to Level 4 ISSAI standards (the most detailed guidelines on auditing principles).

130. **Efforts are underway to strengthen SAV staff numbers and their qualifications.** 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. It will be important for the SAV to 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. This will assist in ensuring that the SAV has sufficient human resources to deliver on its full extended legislative mandate under the State Audit Law (2015).

131. **The SAV Development Strategy 2020 was prepared based on a capacity needs assessment and provides a comprehensive development strategy for strengthening the SAV's capacity over the medium term with detailed activities under eight objectives.** These objectives address key areas for development, such as human resources, training, compliance with ISSAI standards (including a risk-based audit methodology) and IT. The strategy is ambitious and it will be challenging to successfully implement all the proposed activities within the timeframes proposed, especially given the SAV's increasing amount of audit work, capacity constraints and the limited financial resources it has available. The activities within the strategy will therefore probably need to be further prioritized and sequenced.

## Strengthening management information systems

132. **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. 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.

133. **Consistent efforts will be needed to support improvements made in the production and supply of high quality financial information to wider groups of data users.** The Prime Minister's Decision No. 1803 (2011) and MoF Decision No. 3036 (2014) required the strengthening of databases, applications and capacity to improve fiscal analysis and forecasting. The Prime Minister's Decision No. 34 (2014) required the strengthening of public disclosure and transparency of financial and statistical information. However, more needs to be done to put this into operation. The MoF is still working to enhance the data depository and decide upon appropriate ways to grant wide and interactive access to government agencies, other organizations and the general public.

134. **All efforts to strengthen management information systems in PFM should be included in a comprehensive Government Financial Management Information Program (GFMIP).** The objective of this program is to develop linked management information systems on revenue, expenditure, assets and liabilities covering all stages of the budget cycle and general public finance cycle. It is also intended to integrate the various systems databases and develop the analytical tools required for the consolidation of statements to meet the management needs of the Government (G2G), businesses (G2B) and the public (G2C). This program will assist in raising the level of public confidence in the modern, developmental and service oriented government of the middle to high-income country that Vietnam aspires to become.

# CONCLUSIONS

135. **Given the tightening fiscal position, this PER recommends a gradual, growth-friendly fiscal consolidation as a vital component to assist in embedding fiscal sustainability.** This will require strong polices and measures to lower budget deficits, contain further accumulation of public debt and rebuild policy buffers to allow for potential shocks. The recommendations are founded on consideration of a concerted effort to boost revenue mobilization, curb expenditure growth and restructure expenditure whilst protecting social spending and investment, realizing potential efficiency gains, professionalizing public debt and public asset management and strengthening risk management and monitoring.

136. **To promote high and equitable growth in Vietnam, the PER recommends a suitable restructuring of the budget.** The PER has identified areas for potential restructuring of the budget allocation between central and local government, between capital and recurrent spending, and reallocation within sectors. The PER suggests strengthening the effectiveness and efficiency of public investment as a major driver of growth, ensuring proper maintenance of assets to maximize their working lives, enhancing equitable resource allocation to promote development across provinces and addressing the risk of widening inequities in access to essential services. It also suggests that the arrangements to ensure a positive impact of fiscal decentralization are equitably distributed between the most fortunate and the least fortunate groups in society.

137. **Vietnam has made considerable progress over the past decade, but as a middle-income country it also faces a different set of significant challenges in the future.** The policy reforms that the Government has embarked upon are highly commendable, but for these reforms to realize their full potential there needs to be effective complementary measures to counter potential adverse impacts. For instance, enhanced fiscal decentralization should be complemented by arrangements to ensure the ability to influence national policies and accountability for results. Financial autonomy given to PSDUs needs to be accompanied by improvements in the quality of services. Service price increases should only be implemented at an appropriate pace and together with proper targeting of support to the poor and

near-poor, to avoid potential impoverishment and catastrophic incidents. A realistic phased approach is also recommended for the successful implementation of complex reforms (e.g. accrual accounting and output-based budgeting).

138. **The PER suggests a possible mix of incentives that would be key to any reform.** This is even truer in the case of PFM, which is connected to the essential financial incentives. Various instruments could be used to generate "rewards-and-sanctions" incentives in the public sector, including budget projections (e.g. through reforming the budget allocation norms criteria), managerial flexibility of financial and human resources and pay and career prospects; as well as applying competitive and market pressures and enhancing oversight. As Vietnam adjusts itself more towards policy, results and performance, the types of commitments made by the executive, the legislature, and the SAV should be changed accordingly. It will be critical to develop public service performance management and accountability frameworks taking into account feedback from public service users.

139. **Finally, the PER envisages that the shift towards strengthened policy and regulatory functions will place a range of institutional, organizational and staffing skills demands upon agencies carrying out these functions**. Hence the stress placed on organizational and individual capacity development and the need to reinforce institutional arrangements. The increasing efforts to achieve a greater degree of results orientation will require considerable and ongoing staff time and effort as well as skills that are not necessarily traditionally found within government. For instance, skills in contract specification and management, the development of performance indicators for administrative and public service delivery units, the verification of unit cost measures, risk management, SAV performance auditing capacity, etc. The increasingly complex challenges will require capacity to successfully employ more advanced PFM management tools such as fiscal forecasting, debt sustainability analysis, medium-term budgeting, medium-term debt strategy, performance and results-oriented budget management, and integrated financial management information systems.

140. **During the course of this PER, a number of issues have been identified that would benefit from further analysis, policy development work, capacity-building and implementation support.** For example, (i) additional analysis of the wage bill, allowances and employment dynamics is highly recommended before considering further upward adjustments of pay scales and the size of Government. This could include work on a public-private comparator survey in key sectors; (ii) in-depth analysis of the policy on socialization and on public service price increases effecting vulnerable groups; and (iii) incidence analysis of sectoral spending on the population. The World Bank and other development partners stand ready to continue jointly working with the Government of Vietnam in some of these areas as a follow-up to this PER. The chapters in this report identify a number of issues that could be considered for such a follow-up. The form, nature and extent of any such follow-up will be determined in close dialogue with the Government and will depend on the specific needs of the Government in the future.

# Summary of proposed policy options

| No. | Policy actions | Timeframe/ Lead(s) | Expected Impact |
|---|---|---|---|
| 1. | Enact 5-year Financial Plan 2016-20 with clear annual budget deficit reduction targets through a combination of measures to strengthen revenue mobilization, curb expenditure growth, restructure expenditure and create gains in efficiency. | Short Term (MoF, MPI) | Improved fiscal discipline and sustainability. |
| | **Creating fiscal space whilst ensuring fiscal sustainability** | | |
| | Improving tax revenue mobilization | | |
| 2. | Expand VAT tax base (by narrowing VAT exemptions and the 5 percent base list), leading to a single higher VAT rate. | Medium Term (MoF) | Revenue gains. Ease of burden on tax administration. |
| 3. | Review and rationalize tax incentives (tax expenditures) policies. Conduct a full diagnosis of the impact of tax incentive policies in attracting investment and tax base expansion. | Short–Medium Term (MoF) | Stabilized level of CIT revenue/GDP. Improved transparency in tax administration. |
| 4. | Increase the rates of excise tax for non-merit goods (e.g. tobacco and alcohol). | Medium Term (MoF) | Revenue gains. Change in consumer behavior. Reduced consumption of unhealthy goods, resulting in indirect positive fiscal impact. |
| 5. | Adjust personal income tax (PIT) policies to expand the tax base and adjust the number of tax rates on taxable incomes and taxpayers. | Medium–Long Term (MoF) | Revenue gains. |
| 6. | Consider a unified property tax to replace the existing agricultural and non-agricultural land tax policies, expanding property tax to land related and other valuable assets. | Medium–Long Term (MoF, MoNRE, MARD) | Revenue gain. Strengthened tax administration and transparency. |
| 7. | Expand tax base and adjust tax rates of natural resources and environment taxes to (i) contain sale of raw resources; (ii) encourage sustainable, efficient, effective and economic natural resource exploitation; and protect the environment. | Medium–Long Term (MoF, MoNRE) | Improved fiscal sustainability and transparency. |

| No. | Policy actions | Timeframe/ Lead(s) | Expected Impact |
|---|---|---|---|
| 8. | Continue to review and re-engineer business processes for the move to transparent risk based tax administration. | Short–Medium Term (MoF) | Increased taxpayer compliance. Reduced tax evasion and avoidance. Reduced time in paying taxes. |
| 9. | Strengthen the Large Taxpayer Office (LTO) in the GDT to be a full-fledged LTO with all functions as in international practices (policy, administration, inspection, auditing). | Medium–Long Term (MoF) | Revenue gains, reduced time to pay taxes. Strengthened risk based compliance management in revenue administration. |
| 10. | Strengthen the partnership between the GDT and VSSF in the collection of taxes and social security contributions. | Medium–Long Term (MoF, VSSF) | Improved efficiency of revenue administration. Reduced time taken in paying tax and social contribution by businesses and citizens. |
| Achieving efficiency gains in major sectors | | | |
| 11. | Contain the growth of the wage bill by right-sizing and restructuring public employment. Move towards performance based remuneration. | Short–Medium Term (MoHA, MoF, ministries, provinces) | Efficiency gains and fiscal sustainability. |
| 12. | Review teachers working hours and consider increasing them to an internationally comparable level in association with education and curricula reforms. | Short–Medium Term (MoET) | Fiscal savings thanks to increased teacher working hours. More balanced salary and non-salary structure in total recurrent expenditure. |
| 13. | Simplify salaries and allowances schemes for teachers to reduce over reliance on seniority as a pay factor. | Medium–Long Term (MoET, MoHA) | Efficiency gains for education spending and fiscal sustainability. |
| 14. | Strengthen coordination between ministries and departments of education and health, home affairs, and finance in the recruitment and deployment of teachers and doctors. Provide financial incentives for schools and hospitals to rationalize their work force. | Short–Medium Term (MoHA, MoET, MoH, provinces) | Fiscal savings due to rationalization of teacher and doctor staffing at central and local levels. Improved services by addressing the mismatch between staffing quotas and needs. |

| No. | Policy actions | Timeframe/ Lead(s) | Expected Impact |
|---|---|---|---|
| 15. | Carefully implement nationally centralized procurement and price negotiations on pharmaceuticals. | Short–Medium Term (MoH) | Fiscal savings due to reductions in pharmaceutical prices. |
| 16. | Enhance the capacity of Vietnam Social Security Fund (VSSF), or another organization, to provide independent supervision and cost-effectiveness analysis in the use of health services. | Short–Medium Term (MoH, VSSF) | Harmonized prices for pharmaceuticals and health facilities across provinces. More robust controls on health spending. |
| 17. | Gradually move from the fee-for-service system to other health financing methods (including case based payment). | Short–Medium Term (MoH, VSSF) | Improved access to health services at grassroots level, especially for the poor. Assists in moving from input-based budget transfers to output-based payment by the VSSF through supporting targeted groups to purchase health insurance cards. |
| 18. | Increase water productivity and consider measures to charge irrigation fees to improve water productivity. Improve the performance of agro-irrigation service companies. | Medium Term (MARD) | Enhanced spending efficiency and agricultural incomes. |
| 19. | Consider reducing unit costs in road sector, including via (i) adopting innovative construction and maintenance techniques and technologies; (ii) professionalizing road maintenance. | Medium–Long Term (MoT) | Fiscal savings and/or increased quantity due to reduced road construction and maintenance costs. |
| 20. | Strengthen the independence of complaints handling and conflicting instructions in contract implementation. | Short–Medium Term (MPI) | Fiscal savings and/or increased quantity due to reduced costs, improved competitiveness and transparency in the bidding process. |

| No. | Policy actions | Timeframe/ Lead(s) | Expected Impact |
|---|---|---|---|
| Strengthening the management of public debt and fiscal risk | | | |
| 21. | Strengthen public debt management by (i) reinforcing the debt portfolio by optimizing the maturity and risk profile of public debt (ii) develop the domestic debt market, and (iii) continue to develop debt management capacity. | Medium Term (MoF, MPI, SBV) | Lowered cost of financing for a given level of risk. |
| 22. | Better coordination between debt and cash management and public asset and financial fund management. | Short–Medium Term (MoF) | Better liquidity management and lowered cost of financing. |
| 23. | Enhance fiscal risk management including monitoring of major contingent liabilities in the SOE sector. | Short–Medium Term (MoF, MPI, SBV) | Mitigated fiscal risks. |
| **Improving alignment between public spending and national priorities** | | | |
| Improving allocative efficiency for sustainable growth and development | | | |
| 24. | Roll out and improve the quality of medium-term finance-budget plans. | Short–Medium Term (MoF, MPI, line ministries, provinces) | Strengthened fiscal discipline, improved quality of revenue forecasts and medium-term ceiling setting; improved alignment between socio-economic and budget plans and between recurrent and capital budgets. |
| 25. | Promulgate specifications on decentralization of socio-economic mandates for each sector aligned with the mandates and powers of each government level as the basis to determine fiscal decentralization. | Short–Medium Term (MoHA) | Improved allocative efficiency. |
| 26. | Consider moving away from ringfencing budget allocation for several categories of expenditure e.g. education and training, science and technology, environment and budget contingency provisions; and allow sub-national governments to have discretion to determine realistic allocations. | Medium–Long Term (MoF) | Improved allocative efficiency. |

| No. | Policy actions | Timeframe/ Lead(s) | Expected Impact |
|---|---|---|---|
| 27. | Rationalize the regional allocation of state budget spending on agriculture to align with the comparative advantages and roles of each region n sustainable agricultural restructuring as set out in the Agriculture Reform Plan (ARP). | Medium–Long Term (MARD, MPI, MoF) | Improved allocative efficiency. |
| 28. | Review the extent of decentralization of capital expenditure to sub-national governments to align with the decentralization of socio-economic arrangements; create incentives to promote connectivity between major projects; align investment with provincial accountability and implementation capacity. | Medium–Long Term (MPI) | Improved allocative efficiency. |
| 29. | Introduce project appraisal methodology on the basis of social and economic effectiveness analysis; improve investment project costing and budgeting; in the medium-term disallow contracting without verification of resource availability; improve contract recording and monitoring. | Short-Medium Term (MPI, MoF, line ministries, provinces) | Improved project selectivity and alignment; better investment and development objectives. |
| 30. | Consider the nationwide expansion of the full day schooling program through a roadmap taking into account state budget affordability (in terms of physical facilities, teacher resources and support for students from disadvantaged households) and levels of contribution from parents. | Medium Term (MoET, MoF, MoHA, provinces) | Improved allocative efficiency. Increased student instruction time particularly for disadvantaged students. |
| 31. | Strengthen investment in health preventative care and health care delivery at grassroots level. | Short–Medium Term (MoH, provinces) | Improved incentives for preventative care as against treatment services. Improved quality of health care. |
| 32. | Maintain the level of budget allocation for S&T of 2 percent of total state budget expenditure; focus on the priorities established in the S&T development strategy, especially in basic research, strategic research and research for policy and public services as stipulated by the State. | Short–Medium Term (MoST) | Improved effectiveness of state budget spending on S&T. |

| No. | Policy actions | Timeframe/ Lead(s) | Expected Impact |
|---|---|---|---|
| 33. | Strengthen coordination between the MoF, MPI, MoST and sub-national governments in the allocation, execution and oversight of the state budget for development of S&T. | Short–Medium Term (MoST, MoF, MPI) | Improved effectiveness of state budget spending on S&T. |
| 34. | Restructure transport spending by expanding the proportion of spending on non-road transport (e.g. inland waterways, maritime); increase public investment by 1.5 times and maintenance by 1.3 times for inland waterways. | Short–Medium Term (MoT, MPI, MoF) | Movement towards more efficient, low-carbon and sustainable logistical methods aligned with Vietnams' comparative advantage. |
| 35. | Focus investment on key road corridors, expressways and bottlenecks. | Short–Medium Term (MoT, MPI) | Reduced supply chain issues. Reduced burden of road transport costs on the economy. |
| 36. | Restructure spending on roads to double road maintenance expenditure informed by medium-term financial, budget and investment plans and road asset management information system, so that maintenance reaches 20 to 25 percent of total spending on roads. | Short–Medium Term (MoT, MPI, MoF) | Maximization of value and investment efficiency by proper maintenance of assets in accord with international good practices. |
| 37. | Improve the legal framework and strengthen multimodal transport connectivity, especially between sea, inland waterways and railways. | Short–Medium Term (MoT) | Investment efficiency gains and development of logistical services. |
| 38. | Improve regulatory framework to crowd in more private sector financing for transport sector, aligning the framework better with international good practices (including on management of guarantees and foreign exchange rate risks). | Short–Medium Term (MoT, MPI, MoF) | Increased private sector investment and improved investment efficiency in transport sector. |
| 39. | MARD responsible and authorized to take the lead in coordinating with other ministries and provinces in consolidate, monitor and evaluate the investment framework for agriculture sector, ensuring consistency and alignment with sectoral development masterplan and plan; assess whether the current spending both in absolute and relative terms are adequate and aligned with the ARP. | Medium–Long Term (MARD, MPI, MoF, provinces) | Improved allocative efficiency. |

| No. | Policy actions | Timeframe/ Lead(s) | Expected Impact |
|---|---|---|---|
| 40. | Reallocate agriculture spending by (i) shifting a part of irrigation capital expenditure to recurrent expenditure; (ii) reallocate expenditure from irrigation to other sub-sectors, such as aquaculture, cultivation and agricultural services and adopt crop diversification to increase agricultural incomes. | Short–Medium Term (MoT, MPI, MoF) | Improved allocative efficiency. |
| 41. | Utilize resources for agriculture R&D through: (i) clarify R&D strategices/ priorities; (ii) strengthen institutional management of R&D activities; and (iii) strengthen cooperation between universities and public and private institutions. | Medium Term (MARD, MoST) | Facilitating sustainable agricultural transformation and green growth agenda. Improving agricultural innovation and productivity and facilitating a platform for greater private sector participation. |
| Strengthening revenue and expenditure policies and arrangements for equity and development | | | |
| 42. | Improve the budget allocation norms by (i) combining population based norms with other criteria; (ii) linking capital expenditure allocations to medium-term public investment plans founded on development level and infrastructure gaps; (iii) incorporate additional costs due to exogenous factors and targeted support into the spending norms for sub-national government instead of increasing spending norms. | Short Term (MoF, MPI) | Improved incentives for stronger performance and public services delivered by local governments, by linking spending with outputs such as the number of graduates, number of patients treated, volume of public services delivered; development of infrastructure and enrichment of the revenue base. |
| 43. | Adjust the mechanism of using over-realized revenues for salary reforms to create more flexibility between groups at sub-national government level. | Medium–Long Term (MoF) | Improved fiscal discipline and efficiency. |

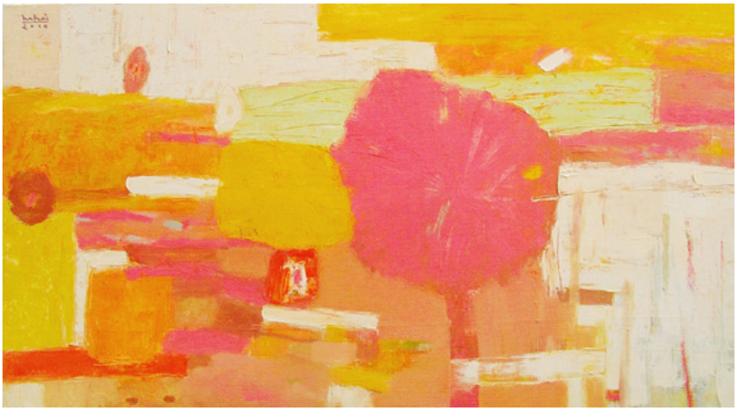
| No. | Policy actions | Timeframe/ Lead(s) | Expected Impact |
|---|---|---|---|
| 44. | Enhance local government autonomy over the determination of user fees at local level. | Medium–Long Term (MoF) | Increased sources for local revenue and improved quality of services. Strengthened public scrutiny of government performance and quality of public services. |
| 45. | Consider moving towards a formula-based approach (e.g. using local population, GDP or per capita consumption) to enable the sharing of VAT revenues in a more equitable manner. | Medium–Long Term (MoF) | Promotion of stronger and more even local economic performance. |
| 46. | For provinces that are heavily affected by climate change, consider: (i) incorporating complementarity criteria in the budget allocation systems; (ii) priortizing their access to external concessional financing; and (iii) undetaking risk-sharing policies such as participating in disaster risk and asset insurance. | Medium–Long Term (MPI, MoF, provinces) | More sustainable development. |
| 47. | Ensure timely and better targeted support to disadvantaged people to ensure that a majority of the population have access to basic services such as education, health, electricity and clean water. | Short–Medium Term (MoF, MOLISA) | Enhanced equity in access to basic services. |
| 48. | Continue to pursue universal health insurance policy and ensure full coverage of health insurance cards for the poor by strengthening communication, enhancing health service quality, ensuring sustainable financing and supporting priority groups. | Short–Medium Term (MoH, MoF) | Improved access to health services at grassroots level, especially for the poor. Assists in moving from input-based budget transfers to output-based payment by the VOSS through supporting targeted groups to purchase health insurance cards. |
| 49. | Consider shifting VSSF financing to health facilities away from capitation to better align with local health care needs. | Short–Medium Term (VSSF, MoH) | Improved equity in public spending for health services. |

| No. | Policy actions | Timeframe/ Lead(s) | Expected Impact |
|---|---|---|---|
| | **Strengthening accountability for results** | | |
| | Enhancing fiscal comprehensiveness and transparency | | |
| 50. | Substantially reduce budget carryover by (i) enhancing the quality of budget estimates (including revenue forecasts); (ii) prioritizing the use of over-realized revenue for deficit reduction; (iii) accelerating the speed of budget allocation; (iv) managing and strictly monitoring budget execution to make timely adjustments. | Short–Medium Term (MoF, MPI, line ministries, provinces) | Improved fiscal discipline. |
| 51. | Improve the practice of accounting and reporting on budget carryover following international practices, including moving away from double counting of revenue and expenditure permitted to be carried over. | Medium–Long Term (MoF) | Improved fiscal transparency. |
| 52. | Reform budget classifications, accounting and reporting to allow consistency in budget preparation, execution and final accounting, between recurrent and capital expenditure. | Short Term (MoF, MPI) | Improved fiscal transparency; a contribution to strengthening fiscal discipline and spending efficiency; improved simplicity, workability and capacity for monitoring. |
| 53. | Adopt public sector accounting and auditing standards in line with international standards. | Medium–Long Term (MoF, SAV) | Improved fiscal transparency. |
| 54. | Consolidate accounting data from public sector bodies into whole-of-government financial statements in compliance with the International Public Sector Accounting Standards (IPSAS) cash-based standards first, and then gradually moving towards accrual-based. | Medium–Long Term (MoF, other ministries, provinces) | Improved fiscal transparency and mitigated fiscal risk. |

| No. | Policy actions | Timeframe/ Lead(s) | Expected Impact |
|---|---|---|---|
| Strengthening fiscal discipline, performance monitoring and outcome | | | |
| 55. | Reduce capital construction arrears through: (i) allocating budget and targeted transfers to lower tiers in a more timely manner; (ii) improving ex ante assessment, execution monitoring and ex post evaluation of the implementation capacity of contractors; (iii) recording arrears transparently; and (iv) enhancing accountability on arrears at all levels of government. | Short–Medium Term (MPI, MoF, line ministries, provinces) | Strengthened fiscal discipline; reduced carry overs and capital construction expenditure arrears. |
| 56. | Develop an accountability framework that enables the measurement of the results achieved by public service delivery units (PSDUs) and administrative agencies, including mandatory performance indicators. | Medium–Long Term (MoF, line ministries, provinces) | Improved spending efficiency and quality of public services. |
| 57. | Develop competitive financing systems whereby the State will contract out on the basis of economic-technical norms and quality standards for several types of education and training services (irrespective of ownership), to ensure that payments correspond to training quality, qualification and levels. | Medium–Long Term (MoF, MoET, MoHA) | Improved spending efficiency and quality of education. |
| 58. | Establish (i) performance-oriented mechanisms that provide financial incentives for universities to improve quality of education and research services; and (ii) quality assurance systems for education services. | Long Term (MoET) | Improved spending efficiency and quality of higher education. |
| 59. | Improve technical and professional processes to strengthen public disclosure and transparency in the assessment of hospital quality. Strengthen the accountability for performance of sub-national governments and health facilities on service delivery. | Short–Medium Term (MoH, provinces) | Improved accountability in health spending. |
| 60. | Take steps to move away from budget allocation for regular operations to more competitive methods of contracting out and block grants for the delivery of S&T mandates. | Short–Medium Term (MoST) | Improved efficiency of spending on S&T development. |

| No. | Policy actions | Timeframe/ Lead(s) | Expected Impact |
|---|---|---|---|
| 61. | Develop performance indicators linked to the extent and quality of delivery of their mandate by S&T organizations to gradually improve their performance and accountability, gradually aligned better to international standards. | Medium–Long Term (MoST) | Improved efficiency of spending on S&T development. |
| 62. | Take stock, review and re-organize public S&T organizations. Develop a roadmap to reduce recurrent public expenditure to S&T organizations which have applied research activities. Gradual incorporatize eligible S&T organizations. | Short–Medium Term (MoST, MoF, MoHA) | Improved efficiency of spending on S&T development. |
| 63. | Accelerate the implementation of new financing mechanisms stipulated in the Law on Science and Technology 2013. Strengthen the operation of the national technology renovation fund, the national venture capital funds and encourage the development of S&T Development Funds in enterprises facilitate enterprises' investment in R&D activities. | Short–Medium Term (MoST, MoF, MoHA) | Improved mobilization of resources for S&T activities and efficiency of public spending on S&T development. |
| 64. | Provide financial incentives for enterprises in enhancing S&T activities and establishing S&T development funds. | Medium–Long Term (MoF, MoST) | Improved mobilization of resources for S&T activities and efficiency of public spending on S&T development. |
| 65. | Strengthen SAV's auditing methodology and capacity for performance audit. | Medium Term | Strengthened accountability for results. |

| No. | Policy actions | Timeframe/ Lead(s) | Expected Impact |
| --- | --- | --- | --- |
| Ensuring timely and accurate information to meet management needs and increased transparency | | | |
| 66. | Strengthen information systems and expand access to financial management information systems (especially TABMIS) to ministries, provinces, and the SAV. | Short Term | Improved fiscal transparency (for reporting and analysis purposes) and accountability. |
| 67. | Enhance public investment project monitoring system and database to improve quality of pubilc investment reporting and timely inform decisions; first, record multi-year commitment and investment execution information through the Treasury and Budget Management Information System (TABMIS) and the Invsetment Project Monitoring System. | Medium Term | Improved allocative efficiency and fiscal transparency. |
| 68. | Develop and improve other important information systems to support budget preparation, public investment project management and asset and liability management. Integrate in phases the databases of public finance related systems. | Medium–Long Term | Improved fiscal transparency and public services to businesses and the public. |



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