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MAKING PUBLIC INVESTMENT WORK FOR GROWTH

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ABBREVIATIONS

ASEAN	Association of Southeast Asian Nations
CIT	Corporate Income Tax
CPI	Consumer Price Index
EMDE	Emerging Market and Developing Economies
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GER	Gross Expense Ratio
GNFS	Goods and Non-Factor Services
GFCF	Gross fixed capital formation
GSO	General Statistics Office
GW	Gigawatt
ICOR	Iincremental capital output ratio
IGF	Intergovernmental fiscal
IMF	International Monetary Fund
Km	Kilometer
LCI	Law on Credit Institutions
MoF	Ministry of Finance
MPI	Ministry of Planning and Investment
MTIP	Medium-Term Investment Plan
NPL	Non-Performing Loans
NSA	Not Seasonally Adjusted
NTPs	National targeted programs
O&M	Operation and maintenance
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
PAM	Public asset management
PDML	Public Debt Management Law
PFS	Pre-feasibility study
PIL	Public Investment Law
PIM	Public investment management

PIT	Personal Income Tax
PPG	Public and Publicly Guaranteed Debt
RCC	Regional Coordination Council
REER	Real Effective Exchange Rate
SBIMIS	State Budget Investment Management Information System
SBL	State Budget Law
SBV	State Bank of Vietnam
SCBA	Social cost benefit analysis
SME	Small-to-Medium Sized Enterprise
SNG	Subnational government
SOE	State-owned enterprise
TOT	Terms of Trade
VAMC	Vietnam Asset Management Company
VAT	Value-Added Tax
VND	Vietnam Dong
Y/y	Year-over-year

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OVERVIEW

RECENT ECONOMIC DEVELOPMENTS, OUTLOOK, AND RISKS

Recent Economic Developments

The external environment remains challenging with downside risks prevailing in the near-term. Global GDP growth is projected to decline to 2.1 percent in 2023 from 3.1 percent in 2022, reflecting weakening demand in most advanced economies. In line with slower global growth, global trade growth is estimated to weaken from 6 percent in 2022 to 1.7 percent in 2023.

After registering 8 percent real GDP growth in 2022, Vietnam's economic growth decelerated sharply in the first half of 2023, reflecting a slump in external and weaker domestic demand. Vietnam's real GDP growth slowed to 3.7 percent year-on-year (y/y) during the first half of 2023,[1] well below growth posted during the same period in 2022 (6.4 percent, y/y). The slowdown was led by a sharp deterioration in external demand with exports contracting by 12 percent (y/y) in the first half of 2023. This in turn weighed on the performance of the export sector, which is estimated to account for 50 percent of Vietnam's GDP.[2] Simultaneously, domestic demand moderated due to fading base effects[3] from last year's post-COVID rebound and weakening consumer confidence. Growth in final consumption expenditure[4] slowed to 2.7 percent (y/y) in the first half of the year, compared with 6.1 percent (y/y) in the first half of 2022. Despite resilient foreign direct investment (FDI) and a slight pick-up in public investment, total investment growth also declined, driven by weak private domestic investment which slowed substantially to 2.4 percent (y/y) from 11.8 percent (y/y) during the same period last year.

The slowdown in aggregate demand is mirrored on the production side of GDP. Reflecting the contraction in export demand, the contribution of the industrial sector to growth fell to 0.4 percentage points during the first half of the year, compared with 2.8 percentage points during the same period last year. Exacerbating the effects of the export demand shock, recurrent power outages which affected northern Vietnam in May and June 2023 disrupted economic activities with losses estimated at 0.3 percent of GDP. Meanwhile, services sector growth contributed 2.8 percentage points to overall GDP growth in the first half of the year, compared with 2.9 percentage points during the same period last year, as stronger performance in the hospitality sector driven by the recovery of domestic and foreign tourism offset normalizing retail and wholesale trade. The contribution of the agricultural sector to growth remained stable but low at 0.3 percentage points.

Businesses and the labor market have been negatively affected by the economic downturn. In an April 2023 survey of 10,000 firms

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1 Real GDP grew by 3.3 percent (y/y) in Q1-2023, lower than other economies in East Asia except Thailand, but slightly improved to 4.1 percent (y/y) in Q2-2023.

2 The size of the export sector is measured by the domestic value-added -direct and indirect- from exports as a share of GDP. Source: Martins Guilhoto, J., C. Webb and N. Yamano (2022), "Guide to OECD TiVA Indicators, 2021 edition", OECD Science, Technology and Industry Working Papers, No. 2022/02, OECD Publishing, Paris, https://doi.org/10.1787/58aa22b1-en. The value 50 percent is for 2019.

3 In 2022, economic growth in Vietnam benefited from low-base effects associated with the strong impact of the COVID pandemic on economic activity in 2021.

4 Final consumption expenditure refers to the sum of household final consumption expenditure (formerly private consumption) and general government final consumption expenditure (formerly general government consumption).

by the Private Sector Development Committee, 60.1 percent of firms reported a reduction in revenue of at least 20 percent during the first four months of 2023 and 59.2 percent reported reduction in orders. 71.2 percent reported a cut of at least 5 percent of their labor force in the first four months of the year.[5] At the national level, growth in employment slowed from 2.2 percent (y/y) in the first quarter of 2023 to just 1.4 percent (y/y) in the second quarter of 2023, well below an average pre-covid level of about 4 percent. The external demand shock has especially affected export-oriented manufacturing firms and workers with some export hubs such as the Southeast region (which includes Ho Chi Minh City and surrounding provinces)[6] experiencing an almost 62 percent jump in the number people approved to receive unemployment benefits in the second quarter of 2023 compared to the first quarter of the year.[7]

The current account surplus widened (1.5 percent of GDP) in the first quarter of 2023, despite a contraction in exports. The positive external position was the result of a solid inflow of remittances, resilient foreign direct investment, a narrowing deficit in the services trade balance as foreign tourism continued to recover, and a surplus in the merchandise trade balance. The surplus in the merchandise trade balance was caused by the fact that the contraction in imports (-15.3 percent, y/y, in Q1-2023) outpaced the contraction in exports (-11.7 percent, y/y, in Q1-2023). Despite declining commitments, foreign direct investment (FDI) disbursement remained resilient (US$10 billion) in the first half of the year. Consequently, the overall balance of payment position improved with the State Bank of Vietnam (SBV) accumulating additional US$1.6 billion in foreign reserves by the end of the first quarter of 2023, bringing the total to US$88.7 billion, equivalent to 3.3 months of imports.

Headline inflation declined quickly thanks to the slowdown of fuel prices in global and domestic markets and a slowing domestic consumption, while core inflation decelerated more slowly. The CPI fell from 4.9 percent (y/y) in January 2023 to 2 percent (y/y) in June 2023. Meanwhile, core inflation (which excludes food, fuels, and government administered prices) slowed from 5.2 percent (y/y) in January to 4.3 percent (y/y) in June, as second-round effects of the 2022 commodity price shock persisted, including through higher costs of construction materials and subsequently of housing.

Amid decreasing inflationary pressures and slowing growth, the SBV loosened monetary policy to buttress the economy. The SBV reduced discount and refinancing rates by a cumulative 150-200 bps through a series of four policy rate cuts between March and June 2023 to 3 percent and 4.5 percent, respectively. Despite these cuts, credit growth slowed from 16.8 percent (y/y) in June 2022 to 7.8 percent (y/y) in June 2023, reflecting weaker credit demand from businesses. Asset quality has been deteriorating with nonperforming loans (NPLs) rising from 1.9 percent in December 2022 to 2.9 percent in March 2023, compelling the SBV to re-introduce regulatory forbearance measures.[8]

Accelerated public investment supported the slowing economy, but implementation challenges remain. The 2023 mid-year fiscal balance registered a smaller estimated surplus (1.5 percent of GDP) than a year ago (5.2 percent of GDP)

[5] Private Sector Development Committee, April 2023.

[6] The Southeast Region includes Ho Chi Minh City and Provinces of Dong Nai, Binh Duong, Ba Ria – Vung Tau, Binh Phuoc and Tay Ninh, contributing about 32 percent of GDP. The region is home to 18.7 million people or about 19 percent of Vietnam population.

[7] Ministry of Labor, Invalids and Social Affairs, June 2023

[8] Circular 02/2023/TT-NHNN allows banks to restructure loans and stagger provisions over multiple financial years when owed by borrowers which are facing payment difficulties but who have been assessed to be capable to repay principal and/or interest according to the restructured repayment term.

as revenue collection contracted by 7 percent in the first half of 2023 compared to a year ago due to the slowing economic activities. Meanwhile, total expenditure rose by 12.8 percent (y/y) in the first half of 2023, due to a 43 percent (y/y) increase in public investment disbursement related to implementation of the investment component (valued at 1.6 percent of GDP) of the 2022-2023 Socio-Economic Recovery Plan. However, the estimated cumulative disbursement of the public investment budget remained low at 30.5 percent of the annual budget at the end of June 2023.

Outlook, risks, and policy implications

Vietnam's economy is expected to grow by 4.7 percent in 2023, with a slow projected recovery to 5.5 percent in 2024 and to 6.0 percent in 2025. While softening, domestic demand is expected to be the main driver of growth in 2023. Private consumption will remain resilient, - growing 6.0 (y/y) percent, albeit slowing below its pre-pandemic growth of 7 percent (y/y) in 2019, and contributing 3.4 percentage points to GDP growth. Overall, investment will contribute 1.8 percentage points to growth. Private investment is expected to remain subdued, growing 4.3 percent (y/y) compared to 8.2 percent (y/y) in 2019 due to uncertainties in the external environment, contributing 1.2 percentage points to GDP growth. Public investment is expected to increase 9.5 percent (y/y) contributing 0.6 percentage points to GDP growth, but only partially compensating for the lower private investment. With the easing of liquidity conditions and SBV's renewed guidance on loan forbearance, the financing constraints in the real estate/construction sectors are expected to ease, supporting a moderate recovery of private investment from 2024 onward.

The CPI is expected to rise slightly from an average 3.1 percent in 2022 to an average 3.5 percent in 2023. The deflationary impact of slower growth and a VAT rate cut from 10 percent to 8 percent rolled out for the second half of 2023 is expected to be more than offset by a civil service salary increase of 20.8 percent. The CPI will moderate to 3.0 percent in 2024 and 2025 based on the expectation of stable commodity and energy prices in 2024.

The fiscal balance is expected to register a small deficit of 0.7 percent of GDP in 2023. Fiscal policy is expected to remain moderately supportive of the economy in 2023 given public investment implementation challenges. Starting in 2024, the government will gradually move back to consolidate its fiscal stance, in line with the Financial Strategy for 2021-2030. Public and Publicly Guaranteed debt (PPG) will remain sustainable, stabilizing at an estimated 36 percent of GDP in 2023 before falling to an estimated 34.4 percent in 2025. The current account is expected to gradually improve, thanks to a modest recovery of exports, continued recovery of international tourism, and resilient remittances.

Table 0.1. Selected Economic Indicators, Vietnam 2020-2025

Indicator	2020	2021	2022e	2023f	2024f	2025f
GDP growth (%)	2.9	2.6	8.0	4.7	5.5	6.0
Consumer Price Index (average, %)	3.2	1.8	3.1	3.5	3.0	3.0
Current account balance (% of GDP)	4.3	-2.1	-0.3	0.2	0.5	1.0
Fiscal balance (*) (% of GDP)	-2.9	-3.4	-0.3	-0.7	-0.3	-0.2
Public debt (% of GDP)	41.3	39.3	35.7	36.0	35.2	34.4

Source: GSO; MOF; SBV; IMF; and World Bank staff calculations.
Note: e = estimate; f = forecast, *: excluding unallocated expenditures and following GFS.

The outlook is subject to heightened domestic and external risks. Slower-than-expected growth in advanced economies and China could further dampen external demand for Vietnam's export sector, whose size is estimated at 50 percent of GDP. Continued uncertainties in the global financial market have the potential to rekindle stress in the global banking sector, intensify investor risk aversion, and discourage investment – including FDI to Vietnam. Additional monetary policy tightening in major advanced economies to combat persistent inflation could widen the interest rate gap between international and domestic markets. This could exert exchange rate pressures on the local currency. Moreover, an escalation of geopolitical tensions and climate-related disasters pose additional downside risks for the country, including through rising food and fuel prices. Domestically, the financial sector faces heightened vulnerabilities and risks that warrant close monitoring and reforms.

Since the economy is constrained by weak aggregate demand and growth has fallen significantly below potential active policy support is warranted:

Given ample fiscal space, fiscal policy should take the lead, ensuring a much better implementation of the investment budget for 2023. A full implementation of the planned investment budget would bring public investments to 7.1 percent of GDP in 2023, up from 5.5 percent planned in 2022, providing a fiscal impulse of 0.4 percent of GDP to support aggregate demand. The government has planned a 38 percent increase (y/y) in public investment for 2023 – equivalent to 1.6 percent of GDP (as part of 2022-2023 Socio-Economic Recovery Program). It is accelerating implementation with disbursement of the public investment budget jumping by 43.3 percent (y/y) during the first semester of 2023. However, historical public investment implementation rates have been low in the recent past, for example reaching only 67.3 percent in 2022.[9] Steps to accelerate and improve the efficiency of implementation would also help address emerging infrastructure constraints to growth, including critical investment needed in the electricity transmission network and in building resilience to climate change. These steps include setting investment targets and enforcing accountability at different intergovernmental levels for achieving them; focusing on key national investment programs such as national expressway, power transmission and national target programs; allowing flexibility in rules related to budget allocation for the projects identified as part of 2022-2023 Socio-Economic Recovery Program; and allowing some flexibility on certain advance procurement activities before budget allocation.

In addition to public investment, supporting workers and families affected by the slowdown through a more effective social protection system could also help support aggregate demand. To successfully do so, the authorities need to reform the targeting approaches and delivery mechanisms of the social protection system so it might serve as an agile tool to support the vulnerable during economic shocks.

Fiscal policy support should be accompanied by continued monetary policy accommodation but the space for additional loosening is constrained. As credit demand has remained persistently low despite interest rate cuts, further reducing interest rates may not have the desired effect of incentivizing credit growth. Also, further interest rate cuts would increase the interest rate differential with global markets, potentially putting pressure on the exchange rate.

Addressing heightened financial risks and financial sector vulnerabilities requires reforms to improve bank capital adequacy

[9] Of planned budget approved by the National Assembly, as of December 31, 2022.

ratios and strengthen institutional framework for prudential supervision, early intervention, bank resolution, and crisis management. These reforms are expected to help authorities effectively monitor and intervene in troubled financial institutions, preventing the escalation of crises and minimizing systemic risks. Additionally, a robust bank resolution framework is crucial to facilitate the orderly resolution of any failed banks, protecting depositors and preserving financial stability.

Launching a new round of structural reforms would help enhance the productivity and sustainability of economic growth, contributing to its ambitions to become a high-income country by 2045. Continued reforms to lighten the regulatory burden on businesses are necessary for productivity gains and increased competitiveness. More critically, relaunching the State-Owned Enterprises (SOEs) reform can act as a catalyst to attract private sector participation, improve productivity, and ultimately boost overall economic performance. Promoting an inclusive financial sector can empower individuals and businesses to participate fully in economic activities, in turn enhancing their contribution to sustainable growth. Furthermore, building medium-term resilience in exports is important to mitigate risks associated with external shocks. Diversifying the product base and export destinations helps reduce reliance on specific markets and products, making economies more resilient to global economic fluctuations. Additionally, fully utilizing existing Free Trade Agreements (FTAs) can unlock market opportunities, boost exports, and foster economic integration with partner countries.

In the medium term, fiscal policy can also help enhance the sustainability of Vietnam's economic growth. For instance, fiscal policy can help build resilience to climate change by incentivizing green production and consumption. Implementing carbon taxation and other fiscal instruments can incentivize industries to reduce their carbon footprint and adopt more sustainable practices. Simultaneously, providing time bound fiscal incentives for green consumption, such as tax breaks or subsidies for eco-friendly products, can encourage individuals to make environmentally conscious choices.

SPECIAL FOCUS: MAKING PUBLIC INVESTMENT WORK FOR GROWTH

Vietnam, in seeking to reach upper middle-income status by 2030 and high-income status by 2045, aspires to become a modern and industrialized nation with a higher quality of life for its citizens. To achieve this ambitious development goal, the Vietnamese Government estimates that it needs to invest an average of 7.3 percent of GDP annually into infrastructure during the 2021-2030 period.[10] Despite growing needs, Vietnam's public investments have been on a declining trend from 8 percent of GDP in 2011 to 6 percent in 2022. While every effort should be made to reverse this trend,[11] improving the efficiency of investment is also key, as it would have a major impact on aggregate productivity growth and GDP levels.

[10] Socio-Economic Development Strategy 2021-2030 and National Development Masterplan 2021-2030, vision 2050.

[11] The economy remains relatively capital scarce with a public capital stock per capita and per worker well below upper middle-income and high-income countries. Meanwhile, global experience suggests that capital accumulation as the most important driver for fast-growing countries when they were at Vietnam's level of development.

The investment budget decline is compounded by persistent allocative, technical, and operational inefficiencies. Between 2011 and 2019, it took more than six Vietnamese dongs in investment to generate one Vietnamese dong in additional output.[12] As a result, Vietnam achieves much less growth per dollar of investment than China, Malaysia, Republic of Korea, Singapore, and Thailand at comparable levels of per capita income and development. Vietnam's infrastructure quality ranked 77th out of 141 countries worldwide,[13] behind regional peers such as China, India, Indonesia, Malaysia, and Thailand—countries that Vietnam is competing with for FDI. Investment budgets suffered from chronic under-execution with only 77 percent of allocations spent between 2017 and 2022. The large differences between budgeted and actual spending (23 percent), and the consequential high capital expenditure carried over from one year to the next, are significantly larger than in many peer countries, and way beyond international good practices which suggest the variation levels to be below 5 percent.[14] Public investment management (PIM) inefficiency is also manifested in significant project completion delays and cost overruns. A recent World Bank review[15] of selected, large-scale transport projects found an average delay time of five years, and an average cost overrun double the original cost at the design and budget allocation stage.

In addition, public asset management remains inadequate. Post-construction infrastructure assets are not properly recorded nor managed after project completion, causing inadequate maintenance of public assets. Overall, it is estimated that the budget only financed 40 percent of minimum needs in road infrastructure maintenance.[16] There are no up-to-date and integrated asset registries that capture information—such as cost of investment, operation and maintenance, location, and price of asset over time-for all infrastructure at national and sub-national levels.

Since the 1990s, the Vietnamese Government has embarked on a policy of spending decentralization. The share of central government investment in total public investment declined from 40 percent in 2017 to 20 percent in 2022. This decentralization policy has channeled an average of 80 percent of public investment (2017-2022) through subnational governments (SNGs), more than double the averages in unitary countries (34.5 percent) and overall (39.5 percent). This devolution of spending decisions to provincial authorities has created many positive outcomes, particularly in service delivery. However, it has led to weak coordination across provinces and with central government and to proliferation of duplicate investments which are executed by both the central government and 63 provinces. There has been over-investment by provinces in low value, disjoint projects and stranded assets, with potential negative impact on the environment (such as low-occupancy industrial parks and provincial ports). Consequently, inefficiencies have arisen from allocative duplications, implementation challenges, negative externalities, and sub-optimal private sector mobilization and financing. Vietnam has pursued several approaches to regional investment coordination; however, none has produced the expected results due to legal constraints and the lack of effective financing arrangements.

Vietnam's public investments and assets are increasingly exposed to growing climate change related risks. These include physical threats related to extreme weather events and climate change, and transition risks as the country commits to net zero emissions by 2050. Vietnam's total incremental financing needs for the resilient and decarbonizing pathways could reach an estimated

[12] Incremental capital output ratio (ICOR) data from Vietnam General Statistics Office (GSO).
[13] World Economic Forum - The Global Competitiveness Index (2019).
[14] Public Expenditure and Financial Accountability (PEFA) Framework.
[15] Regional Investments in Vietnam: Challenges and Opportunities (World Bank Policy Note, 2023). In the same review, it is noted that time overrun tends to vary more widely between one to three years in the case of smaller projects.
[16] Vibrant Vietnam: Forging the Foundation of a High-Income Economy" (World Bank Report, 2019).

US$701 billion over 2022-2040, or approximately 6.8 percent of GDP per year.[17] Public investment—with its critical role as catalyst for private investment—would account for more than one-third of the financing needs, or about 2.4 percent of GDP. However, climate change adaptation is not fully accounted for in the overall fiscal strategy nor in prioritization of projects for budget funding in Vietnam. Subnational governments are least prepared as they lack policies and processes to assess and mitigate climate change's physical and transition risks on large investments and assets. The lack of information on the value of assets and their risk exposure increases the cost of their insurance. Transboundary development challenges are emerging more frequently with more severity and require coordinated actions across various levels of government.

Going forward, realizing the power of public investment in Vietnam will require sustaining its level, rationalizing its composition, and addressing the shortcomings in investment management and intergovernmental fiscal institutions—in ways that support Vietnam's move to a more resilient and greener model. More specifically, the government may consider the following measures in the short to medium-term.

To strengthen public investment management institutions, the government will need to improve the "quality-at-entry" of projects through providing more time and budget, and methodological guidelines to prepare project pre-feasibility studies. It will be important to regularly update unit costs and land prices close to market prices to ensure cost estimates are realistic. To enhance the impact of public investment on climate resilience, the government should also mandate climate change screening from the early stage of project preparation and evaluate adaptation measures in pre-feasibility studies and feasibility studies of projects with high risks. It is equally vital to accelerate project implementation. A practical action would be to separate land clearance and resettlement from the investment project particularly for large projects. Central ministries and provinces should develop a systemic digital mechanism to identify projects with a high risk of failure and streamline steps for project adjustment and/or termination. Also, the scope and depth of ex-post project assessments should be increased, at least for all large and medium projects. Public asset management also needs to be strengthened to maximize the impact of the project after completion. Foundational steps would include establishing a database of all infrastructure values, using technology applications and data analytics for budget allocation decisions for operations and maintenance (O&M) and new investments, and phasing in infrastructure asset accounting and reporting reforms.

To rationalize intergovernmental fiscal institutions, it is recommended that inter alia the government consider rebalancing the infrastructure investment budget from provincial level to central level. The budgets could be made more strategic and programmatic, instead of a list of fragmented individual projects, through improving budget classification structures and operationalizing more effectively the "public investment program" modality to facilitate policy orientation (including regional development, green transition, and climate resilience). In light of the upcoming revision of the State Budget Law, the fiscal decentralization framework should be modernized—including on SNG own-source revenue assignments, revenue sharing arrangements, equalization rules, and transfers mechanisms—to better balance the needs of central government and SNGs and incentivize green and climate actions across levels of government. Legal impediments to inter-linked public investment across levels of government should be unlocked. Last but not least, new co-financing mechanisms should be institutionalized based on a well-defined formula that integrate external and domestic financing considerations.

[17] Vietnam Country Climate Development Report (CCDR) (World Bank, 2022).

CHAPTER 1. ECONOMIC DEVELOPMENTS AND PROSPECTS

I. RECENT ECONOMIC DEVELOPMENTS

The global economy is facing strong headwinds

Global economic growth is expected to decelerate substantially from 3.1 percent in 2022 to 2.1 percent in 2023 (Figure 1.1). This slowdown is due to the continued tightening of monetary policy to control high inflation and weakening demand in most advanced economies.[18] Inflation is projected to decline gradually as demand weakens and commodity prices decrease but remain well above pre-pandemic levels. Global trade is expected to grow by only 1.7 percent in 2023 (2.6 percentage points lower than June 2022's forecast, Figure 1.2).

Figure 1.1. Global GDP growth
Percent (y/y)

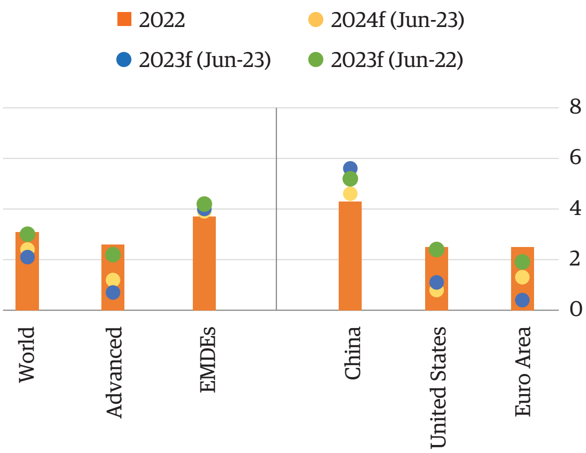
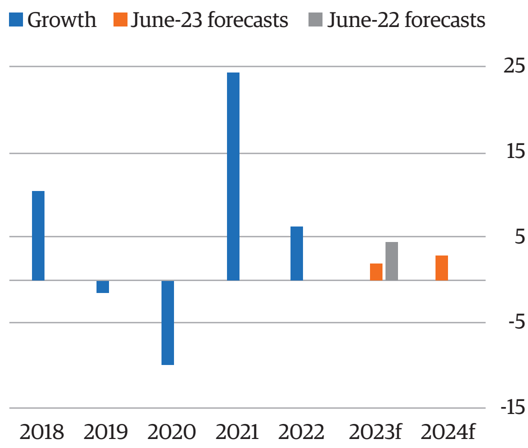


Figure 1.2. Global goods trade growth
Percent (y/y)



Source: Global Economic Prospects, June 2023, World Bank

Vietnam's economic growth decelerated sharply

After registering 8 percent real GDP growth in 2022, economic growth decelerated sharply in the first semester of 2023, reflecting a slump in external and weaker domestic demand. Vietnam's real GDP growth slowed to 3.7 percent (y/y) during the first semester of 2023,[19] well below growth posted during the same period in 2022 (6.4 percent, y/y) (Figure 1.3). The slowdown was led by a deterioration of external demand with exports contracting by 12 percent (y/y) in the first half of 2023, in turn weighing on the performance of the export sector, which is estimated to account for 50 percent of Vietnam's GDP directly and indirectly.[20] Simultaneously, domestic demand also moderated after the last's

[18] World Bank, Global Economic Prospects, June 2023.

[19] Real GDP grew by 3.3 percent (y/y) in Q1-2023, lower than other economies in East Asia except Thailand, but slightly improved to 4.1 percent (y/y) in Q2-2023.

[20] The size of export sector is measured by the domestic direct and indirect value-added from exports as a share of GDP. Source: Martins Guilhoto, J., C. Webb and N. Yamano (2022), "Guide to OECD TiVA Indicators, 2021 edition", OECD Science, Technology and Industry Working Papers, No. 2022/02, OECD Publishing, Paris, https://doi.org/10.1787/58aa22b1-en. The value 50 percent is for 2019.

year strong post-COVID rebound, due to fading base effects and weakening consumer confidence. Growth in final consumption expenditure slowed to 2.7 percent (y/y) in the first half of the year, compared with 6.1 percent (y/y) in the first semester of 2022. Despite resilient foreign direct investment (FDI) and a slight pick-up in public investment, total investment growth also declined, driven by weak growth in private domestic investment which slowed substantially to 2.4 percent (y/y) in the first semester of 2023 from 11.8 percent during the same period last year.

Figure 1.3. Real GDP growth by expenditure components
Percent (y/y, NSA)

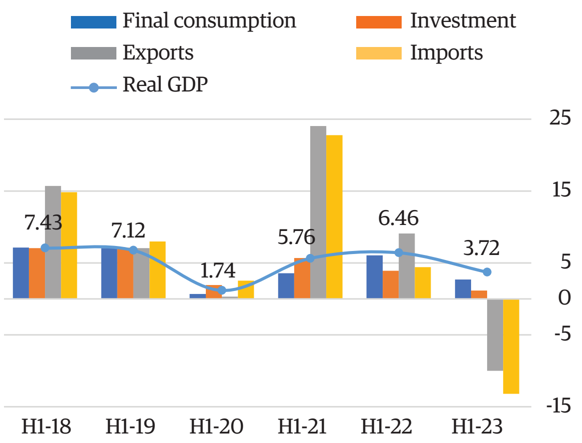
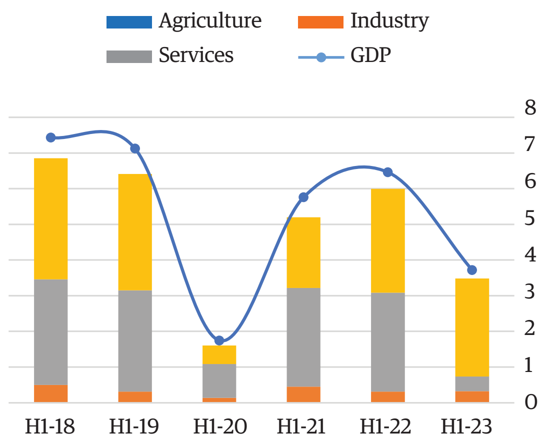


Figure 1.4. Contribution to GDP growth by sector
Percentage points (y/y, NSA)



Source: GSO and World Bank staff calculations

The slowdown on the demand side is mirrored on the production side of GDP. Reflecting the contraction in export demand, the contribution of the industrial sector to GDP growth fell to 0.4 percentage points during the first half of the year, compared with 2.8 percentage points during the same period last year. Meanwhile, services sector contributed 2.8 percentage points to overall GDP growth in the first half of the year, compared with 2.9 percentage points during the same period of 2022, as stronger performance in the hospitality sector driven by the recovery of domestic and foreign tourism offset normalizing retail and wholesale trade.[21] The contribution of the agricultural sector to GDP growth remained stable but low at 0.3 percentage points (Figure 1.4).

The slump in external demand and recurrent power outages dampened performance of Vietnam's export-oriented manufacturing sector. Tracking weakness in exports, industrial production contracted by 0.4 percent (y/y) in the first quarter of 2023 and subsequently expanded marginally by 2.5 percent (y/y) in quarter 2 (Figure 1.5).[22] Weaker external demand affected all key manufacturing exports in the first half of 2023, including garments and footwear (-6.8 percent, y/y), computers and other electronic products (-4.6 percent, y/y) and furniture (-7.7 percent, y/y).[23] In addition, frequent rolling power outages

[21] According to GSO, tourism and travel services grew by 65.9 percent y/y in the first half of 2023, while accommodation, food, and beverage services grew by 18.7 percent y/y in the same period. The number of foreign visitors increased from 0.6 M in H1-2022 to 5.6 million in H2-2023. The number of domestic visitors increased slightly from 60.8 million in H1-2022 to 64 million in H1-2023.

[22] Reflecting the contraction in industrial production, imports also contracted 17.9 percent y/y, in H1-2023

[23] Havers Analytics and World Bank staff calculations.

that affected northern Vietnam in May and June 2023 disrupted production and are estimated to have had a negative 0.3 percent impact on GDP (Box 1.1).

Figure 1.5. Industrial Production Index and Exports
Percent (y/y, NSA)

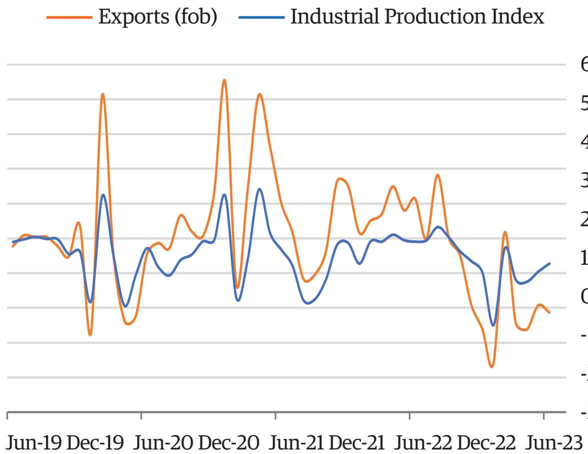
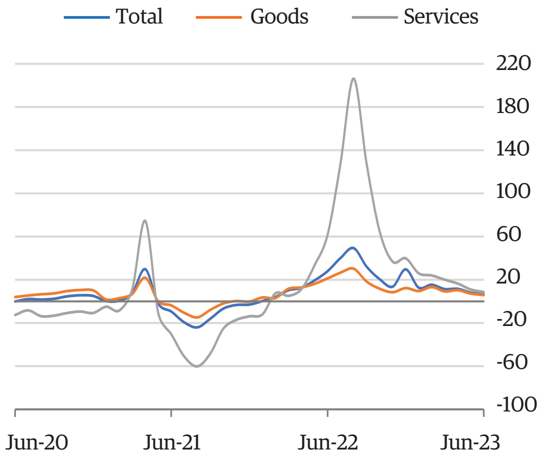


Figure 1.6. Retail sales by sector
Percent (y/y, NSA)



Source: GSO and World Bank staff calculations
Note: Industry includes construction

Meanwhile, private consumption also slowed due to fading base effects from last year's strong post-COVID rebound and weakness in consumer confidence. Growth of retail sales – a proxy for private consumption – slowed to 10.9 percent (y/y) in the first half of 2023 (compared with 12 percent (y/y) in the first half of 2022), with monthly retail sales growth showing a steady deceleration from 12.8 percent (y/y) in January to just 6.5 percent (y/y) in June (Figure 1.6).[24] This slowdown in private consumption is partly due to fading low-base effects but also reflects fragile consumer confidence and stagnating average incomes partly related to the effects of the external demand shock on the labor market. A June 2023 consumer survey found that 43 percent of respondents saw the economic situation as worse than a year ago compared to 27 percent in January 2023.[25] Data shows that average income stagnated at VND 6.3 million (real) in the first semester of 2023 after the steady improvement registered during 2022 (Figure 1.11).[26]

Total investment slowed substantially due to weaker private investment, which was only partially offset by a pickup in public investment. Growth in total investment slowed substantially to 4.7 percent (y/y) in the first semester of 2023, compared with 10.7 percent (y/y) in the same period of 2022, due to weaker private investment given slowing domestic and external demand (Figure 1.7). The contribution of private domestic investment to total investment eased to 1.4 percentage points in the first semester of 2023

[24] Sales of goods, which contributes about 70 percent to total retail sales, slowed from 9.7 percent y/y in January 2023 to 6 percent y/y in February, well below the pre-pandemic growth rates (11.9 percent y/y), due to knock-on effects of the external demand shock and loss in consumer confidence. The substantial slowdown in sales of services is largely due to the base effect (post-pandemic normalization in sales) in tourism and hospitality services (36 percent y/y in January to 6.5 percent y/y in June).

[25] Infocus, Consumer Survey June 2023.

[26] GSO data, World Bank staff calculations.

in contrast to 7 percent a year ago. The slowdown is related to the knock-on effect of slowing exports and expectations of continued unfavorable global economic developments, with private domestic firms cautious about making new investment (see below).[27] The contribution by FDI firms to total investment also fell (0.2 percentage point) in the first semester of 2023 compared to one year earlier (1.5 percentage point). On the other hand, public investment (financed by the state budget) jumped by 43.3 percent (y/y) in in the first semester of 2023 (Figure 1.25), contributing 3 percentage points to total investment. Its share of total investment inched up from 20.9 percent in 2022 to 22.1 percent in the first semester of 2023.

Box 1.1. Securing power supply for a high-income economy

The power sector has been an enabler of Vietnam's fast and inclusive economic development over the past three decades. By the end of 2021, 99.8 percent of the population had access to electricity. During the period 2000–23, the power sector was able to serve a parallel 10 percent annual electricity demand growth by installing a 16-fold larger generation capacity (5GW in 2000, 81GW in 2023). Transmission backbone lines also expanded almost four-fold over the same timeframe and overall, the sector has provided reliable electricity services for a growing population and economy.

However, during May and June 2023, northern Vietnam experienced recurrent power outages that affected households and enterprises on a large scale. In May 2023, a peak demand supply deficit of 5.4GW occurred.[28] The situation improved over June, and was resolved in July due to increased water availability. Power shortages during dry season already occurred in the summer of 2022 with an estimated peak demand supply deficit of 1.8GW.

The preliminary estimate of economic costs for the May-June power outages is about US$1.4 billion (or 0.3 percent of GDP).[29] In a small industry survey, businesses in the north reported losses of up to 10 percent of revenues.[30] Based on the estimated supply deficit through June, unserved energy will also result in lost revenues for Vietnam Electricity (EVN) of approximately US$75 million.[31]

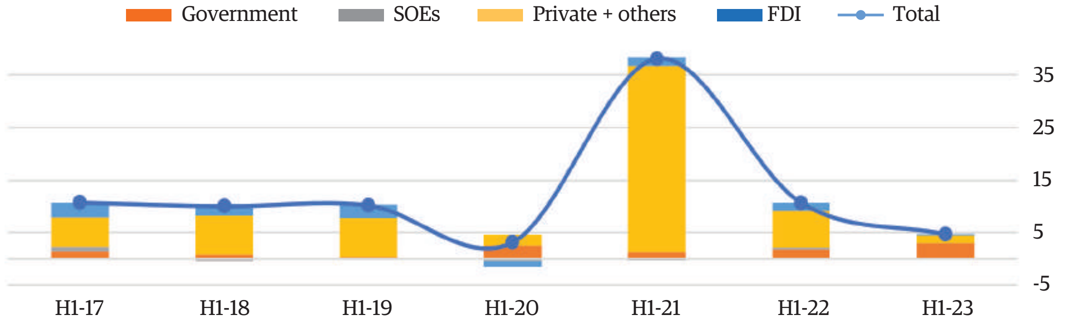
Supply imbalances are currently a northern issue, where demand has been growing at a higher rate (10 percent compared to 8.5 percent nationwide) and becoming more seasonal in May-July. This results from the combined effect of a supply reliance on hydro and coal-based generation[32] and delays in generation and transmission investments, the latter preventing access to large surplus capacity in the south (about 20GW).[33] The impacts of El Nino on water availability and electricity demand, and a greater reliance on hydropower due to increased fuel prices, highlighted regional vulnerabilities to climate change impacts (extreme temperatures and greater uncertainty in hydrological conditions) and commodity risks (global fuel price shocks).[34]

Prompt action is needed to mitigate future risks to energy security and economic losses. Demand side management interventions can be deployed immediately to tackle power shortages, for example load shifting of industrial loads. Critical short-term measures include: (i) avoiding any delays in the 2024 and 2025 schedules for power plant commercial operations, (ii) fast-tracking approval and implementation of transmission investments, and (iii) diversifying supply resources, from the composition of the energy mix by 2025 to increased reliance on regional imports. Energy efficiency measures can also have a relevant impact if compulsory targets and a monitoring system are immediately established as per the Law on Energy Efficiency and Conservation and through secondary regulatory instruments.

[27] S&P GLOBAL, Vietnam Manufacturing PMI, July 3, 2023. "Sustained drop in new orders amid demand weakness" https://www.pmi.spglobal.com/Public/Home/PressRelease/1abc42d09ef5440c81d425f21bd38393

[28] Based on reports by Electricity of Vietnam (EVN) and National Load Dispatch Center (NLDC).

Figure 1.7. Contribution of different components to growth of total nominal investment
Percentage points and percent (y/y, NSA)



Source: GSO and World Bank staff calculations

Businesses and the labor market were negatively affected.

Data on enterprise openings and closures suggests declining private sector dynamism during the first half of 2023 as the economy cooled.[35] While the number of newly registered businesses still exceeded those closing by a factor of 1.5 during the first semester (compared to 1.8 during the same period of 2022), the pace of firm exits accelerated (11 and 18.3 percent y/y in quarters 1 and 2, respectively), while new entries remained anemic (-2 and 0.8 percent y/y in quarters 1 and 2, respectively) (Figure 1.8). The average size of new enterprises also declined. According to the GSO, on average, newly registered enterprises used less equity capital (-19.8 percent) and labor (-1 percent) in the first semester of 2023 than new market entrants in the first semester of 2022 (Figure 1.9).

Labor market conditions also weakened slightly during the first semester of 2023, mirroring the slowdown in economic activities. While unemployment and underemployment rates did not change during the first semester of 2023 compared to a year ago, employment growth dipped from 2.2 percent (y/y) in the first quarter of 2023 to 1.4 percent (y/y) in the second quarter (Figure 1.10), well below an average pre-pandemic level of about 4 percent, reflecting cooling economic activity. Following a gradual improvement in 2022, the labor force participation rate flattened at 68.9 percent during the first semester of 2023, still below the average level recorded for 2019 (71.1 percent). Lackluster labor market conditions were mirrored by flat average income in the first semester of 2023 (Figure 1.11).

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[29] Based on an estimated unserved demand of 36GWh in 2022 and about 900GWh estimated for May-June 2023 (NLDC operational reports and World Bank estimates).

[30] Anonymous surveys conducted by EuroCham among its members in June 2023.

[31] Applying the average sales price of 8.05 c/kWh to the 900GWh of estimated unserved energy for 2023.

[32] Hydro and coal-based generation respectively accounts for about 45 percent (13GW) and 50 percent (14GW) of the energy mix.

[33] NLDC reporting and World Bank estimates.

[34] About 20 percent of coal consumption in 2022 was from imports, indexed (together with gas and diesel) to international fuel oil prices.

[35] Data from the General Statistics Office (GSO).

Figure 1.8. Enterprise entries and exits
Percent (y/y, NSA)

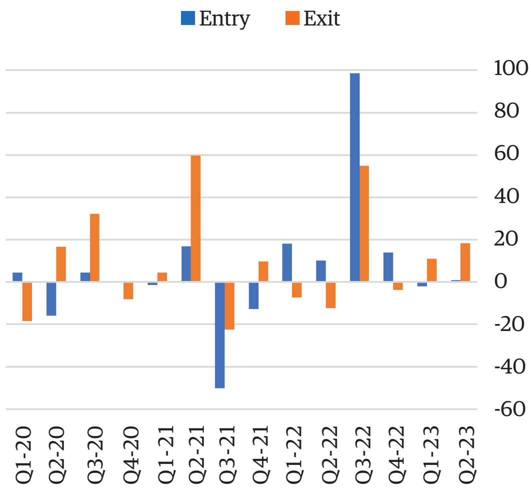
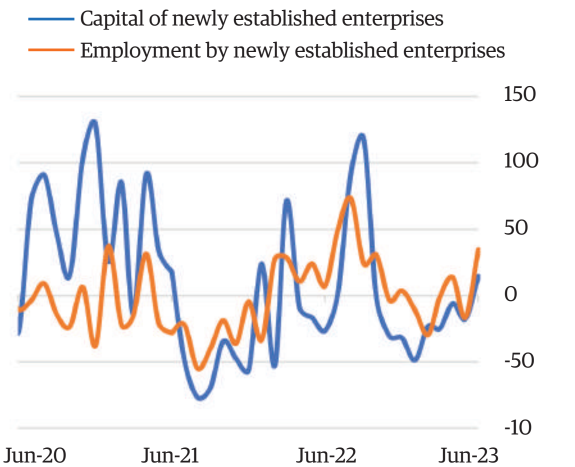


Figure 1.9. New enterprises: Use of capital and labor
Percent (y/y, NSA)



Source: GSO and World Bank staff calculations

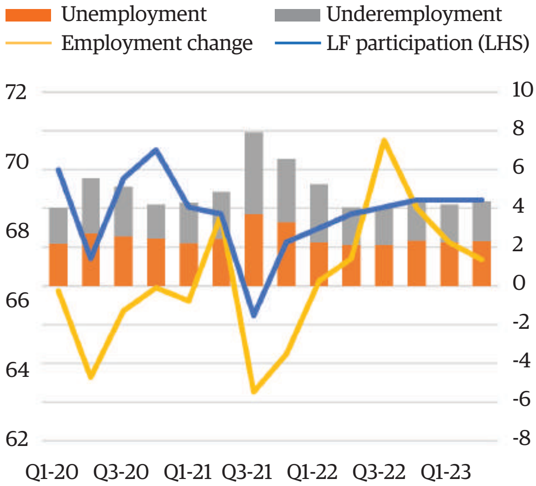
The slowdown in external demand especially affected manufacturing firms and workers in export hubs, such as those centered around Hanoi and Ho Chi Minh City. According to an April 2023 survey by the Private Sector Development Committee,[36] 71.2 percent of surveyed enterprises reported a cut of at least 5 percent in labor, while 60.1 percent revealed a reduction in revenue of at least 20 percent during the first four months of 2023. Of the enterprises surveyed, 59.2 percent reported reductions in orders. Looking ahead, more than 80 percent of enterprises anticipated worsening economic and business conditions during the remaining months of 2023. Mirroring the survey results, labor data from all 63 provinces published by the Ministry of Labor, Invalids and Social Affairs revealed an estimated 59 percent[37] increase in claims for unemployment benefits between the first and second quarters of 2023. The surge was uneven across regions, with the Southeast[38] experiencing a jump of more than 62 percent in the number people receiving unemployment benefits in the second quarter of 2023 compared to the previous quarter.

[36] The committee is under the Government Office. The survey was conducted during April 2023 with a sample size of close to 10,000 enterprises operating in major industrial production centers in or surrounding Hanoi, Ho Chi Minh City, Danang, Haiphong, Binh Duong, Dong Nai and Ba Ria-Vung Tau. About 90 percent of respondents are domestic private enterprises, and 7 percent from the FDI sector. More than 50 percent operate in services, 42 percent in industry and construction and 7 percent in agriculture. Full report available at: https://img.vietnamfinance.vn/upload/news/hoanghung_btv/2023/5/26/BC-KS-DN-thang-5.2023_final.pdf

[37] World Bank staff estimates from provincial labor data available at: https://dulieutonghop.molisa.gov.vn/so-lieu-tinh-tp-map/45 .

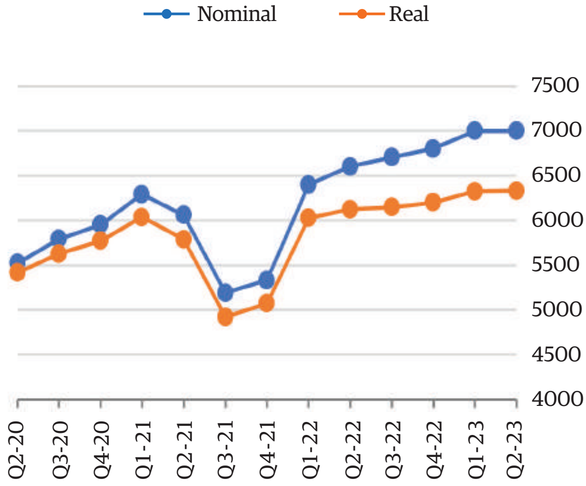
[38] The Southeast Region includes Ho Chi Minh City and Provinces of Dong Nai, Binh Duong, Ba Ria - Vung Tau, Binh Phuoc and Tay Ninh, contributing about 32 percent of GDP. The region is home to 18.7 million people or about 19 percent of Vietnam population.

Figure 1.10. Employment
Percent (y/y, NSA)



Source: GSO and World Bank staff calculations
Note: LHS = left-hand scale, LF = Labor force

Figure 1.11. Average income
Percent (y/y, NSA)



Source: GSO and World Bank staff calculations
Note: Real average income is measured at 2019 constant prices

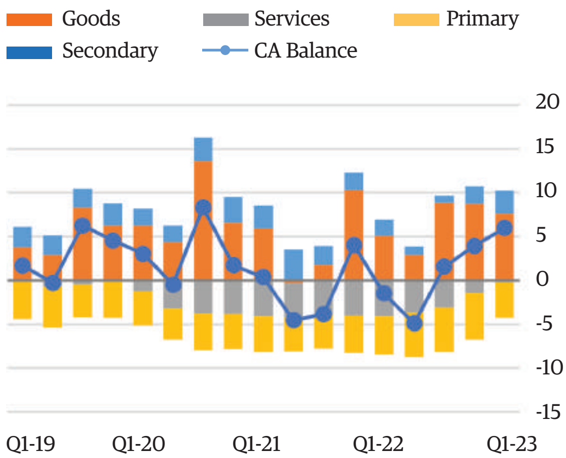
The current account surplus widened, despite a contraction in exports

Vietnam's external position improved in the first quarter of 2023, underpinned by a widening current account surplus. The current account registered an estimated surplus of 1.5 percent of 2022's GDP in the first quarter of 2023 (Figure 1.12), due to an improved merchandise trade balance (as the contraction in imports was larger than in exports), robust inflows of remittances (estimated at US$2.7 billion), and a narrowing deficit in the services trade account as inbound international arrivals continued to recover, with 5.6 million arrivals in the first semester of 2023 compared to 0.6 million arrivals in the first semester of 2022. The financial account remained in surplus as FDI disbursement and portfolio investment inflows remained steady (Figure 1.13). Vietnam recorded a significant net errors and omissions (US$7.5 billion in the first quarter of 2023),[39] likely reflecting continued unrecorded outflows due to persistent devaluation expectations and interest rate differentials. Despite this elevated net errors and omissions term, surpluses in both current and financial accounts helped boost the overall balance of payments surplus, allowing the State Bank of Vietnam (SBV) to build international reserves (US$87.1 billion at end the fourth quarter of 2022 to about US$88.7 billion by the end of the first quarter of 2023, equivalent to 3.3 months of imports.[40] Slowing imports and more flexible foreign exchange (FX) management introduced in 2022 by the SBV, which allowed a +5/-5 band around the central rate, contributed to a relatively stable FX market during the first semester of 2023 (Figure 1.14).

[39] The high net errors and omissions in Q1-2023 are like high values in Q2-Q4 2022 (-US$8.9 billion, -US$12.4 billion and -US$7.2 billion, respectively), suggesting continued informal capital outflows even before the SBV started reducing policy interest rates in mid-March 2023.

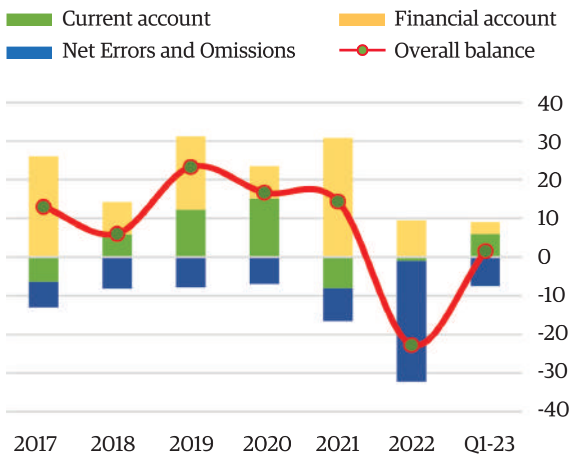
[40] In 2022, Vietnam's international reserves lost US$22.7 billion as the SBV intervened in the FX market to defend the value of the Vietnamese dong, decreasing from a peak of US$110 billion (Q4-2021) to just above US$87 billion (Q4-2022).

Figure 1.12. Current account balance
US$ billion (NSA)



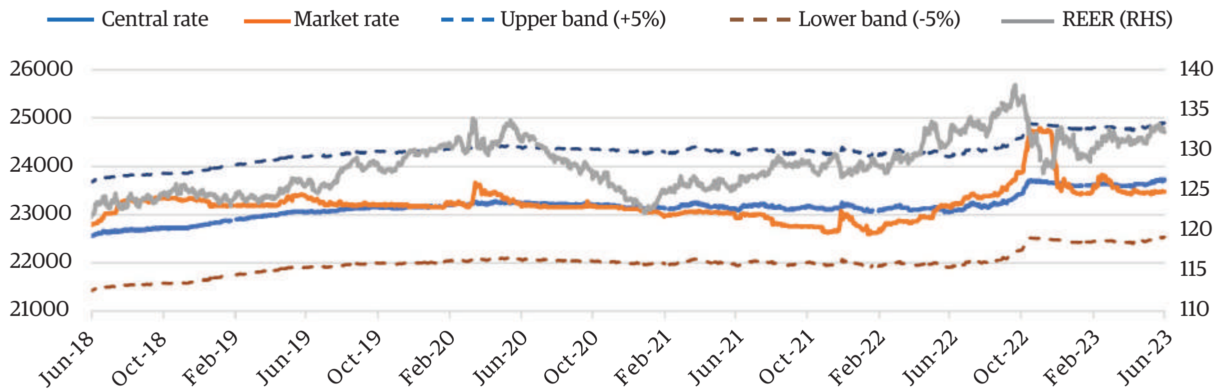
Source: SBV and World Bank staff calculations
Note: CA = current account

Figure 1.13. Balance of payments
US$ billion (NSA)



Source: SBV and World Bank staff calculations

Figure 1.14. Exchange rate
VND/US$



Source: SBV, Haver Analytics, Global Economic Monitor Database, and World Bank staff calculations
Note: A lower real effective exchange rate (REER) and a higher nominal exchange rate mean depreciation of the Vietnamese dong. RHS = right-hand scale

Weaker external demand weighed heavily on Vietnamese merchandise trade during the first semester of 2023. The contraction in exports (-12 percent y/y) in the first half of 2023 (Figure 1.15), was due to a broad-based decline in exports of key manufacturing products, including electronics (-13.9 percent), machinery (-8.6 percent), textiles (-15.8 percent) and footwear (-16.9 percent), to principal markets such as the United States (-21.3 percent y/y in the first five months) and European Union (-9.6 percent y/y in the first five months).[41] Total imports contracted more sharply than exports, falling by 17.9 percent (y/y) during the first half of 2023, with second quarter imports declining by 20.2 percent (y/y).

41 Vietnam Customs, Haver Analytics, and World Bank staff calculations

As imported inputs for production of exports account for 94 percent of total imports in Vietnam, the significant contraction in imports not only reflected the current slowdown in production for exports but can also be a leading indicator of further weakening of exports production in the coming months.

In contrast, trade in services continued to normalize to pre-pandemic levels, thanks to the recovery of international travel to Vietnam. Services trade balance improved substantially, registering a smaller deficit in the first semester of 2023 (-US$2.4 billion) compared to a year ago (-US$8.1 billion) (Figure 1.16). A strong recovery in international travel to Vietnam in the first semester drove this improvement (an increase of 5 million arrivals in the first semester of 2023 compared to the same period in 2022).

Figure 1.15. Merchandise trade balance
Percent (y/y, NSA)

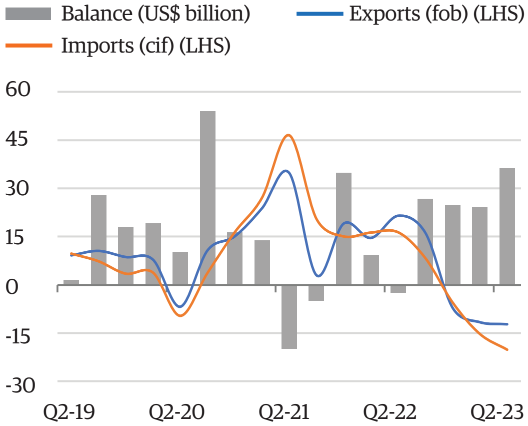
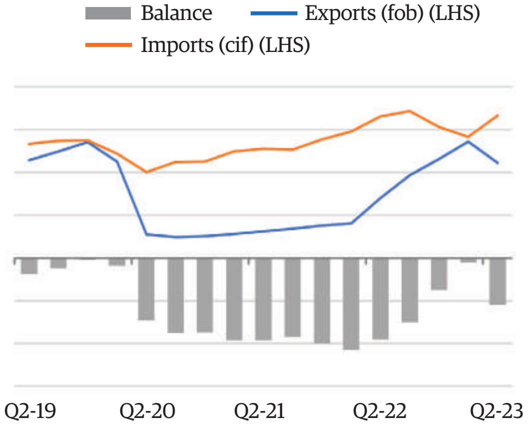


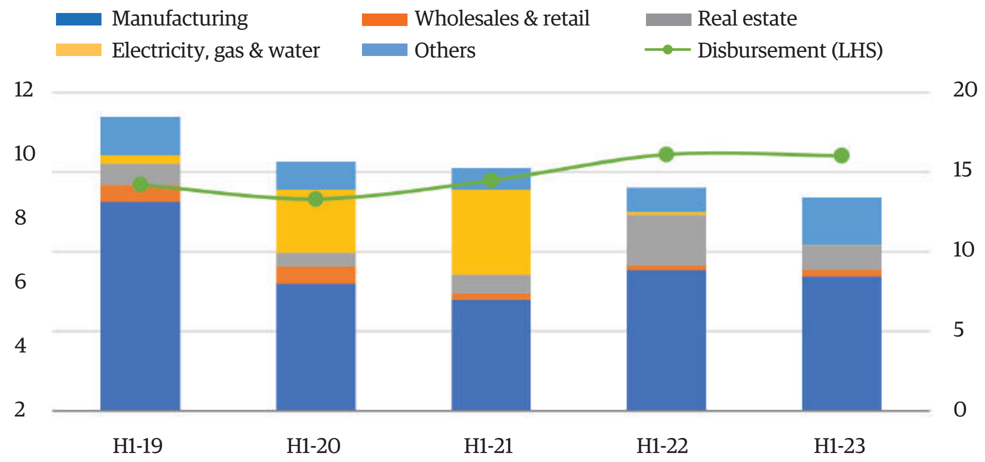
Figure 1.16. Services trade balance
US$ billion (NSA)



Source: Vietnam Customs, GSO, Haver Analytics and World Bank staff calculations
Note: fob = free on board; cif = cost, insurance, and freight; LHS = left-hand scale

Despite declining commitments, foreign direct investment (FDI) disbursement remained resilient during the first semester of 2023. As global uncertainties continued to weigh on investor confidence, FDI commitments for the first half of 2023 reached US$13.4 billion, 4.5 percent lower than the same period in 2022 and equivalent to 66 percent of pre-pandemic levels (H1-2019). In contrast, FDI disbursement reached US$10 billion for the first semester of 2023, similar to the same period in 2022 and comparable to pre-pandemic levels (Figure 1.17).

Figure 1.17. FDI commitment by sector
US$ billion (YTD)



Source: GSO, Haver Analytics and World Bank staff calculations

As inflation fell, SBV loosened monetary policy

After peaking in January 2023, headline inflation declined rapidly thanks to the slowdown in fuel prices in global and domestic markets and slower domestic consumption, while core inflation declined at a slower pace. The CPI declined from 4.9 percent (y/y) in January 2023 to 2 percent (y/y) in June 2023, well below the 4.5 percent target policy rate for the year (Figure 1.18). Transport services were the key driver of the declining CPI, with prices falling by 12 percent (y/y) in June 2023 thanks to cooling fuel prices in global and domestic markets (Figure 1.19). Core inflation (which excludes food, fuels, and government administered prices) declined to a lesser extent during the first half of 2023 but remains above pre-pandemic levels. This indicates that the pass-through effects of the 2022 fuel price hikes persist, including through higher costs of construction materials and subsequently housing.[42]

In the context of declining inflation and weaker growth, the State Bank of Vietnam (SBV) has loosened monetary policy since mid-March 2023. At the end of second quarter of 2023, SBV discount and refinancing rates were set at 3 and 4.5 percent, respectively, dropping by 150-200 basis points through a series of four policy rate cuts between March and June 2023 (Figure 1.20). Caps on interest rates for deposits with maturities less than six months and lending rates for priority sectors were also reduced by the same magnitude to encourage commercial banks to provide new, cheaper loans to enterprises and individual customers. Efforts were also made to accelerate implementation of the interest rate subsidy program as well as the introduction of social housing credit program to support the economy.[43]

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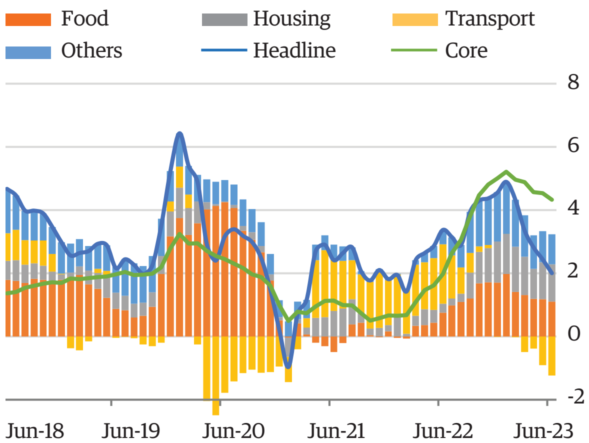
[42] Increases in housing costs have been persistent since September 2022, contributing from 20 to more than 50 percent to CPI inflation during the past 10 months.

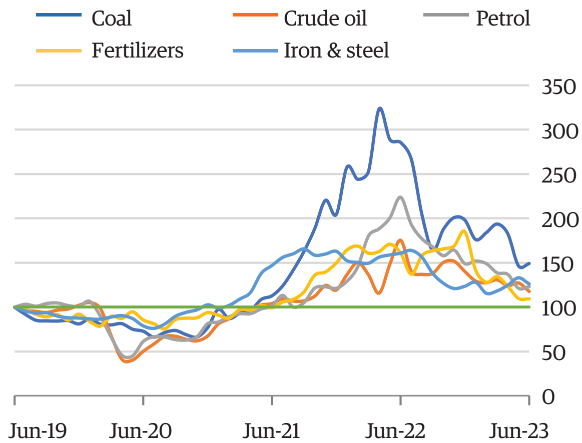
[43] The interest rate subsidy program is part of the Socio - Economic Recovery Package approved by the National Assembly in early 2022. The program, with an allocated budget of US$1.7 billion, provides an interest subsidy of 2 percent for targeted businesses to recover from the pandemic. In March 2023, the government approved a US$5.1 billion credit program to promote social housing developments in Vietnam. The credit will be provided by four state-owned commercial banks with preferential interest rates for developers and home buyers.

Figure 1.18. Contribution to CPI inflation
Percentage point (y/y, NSA)



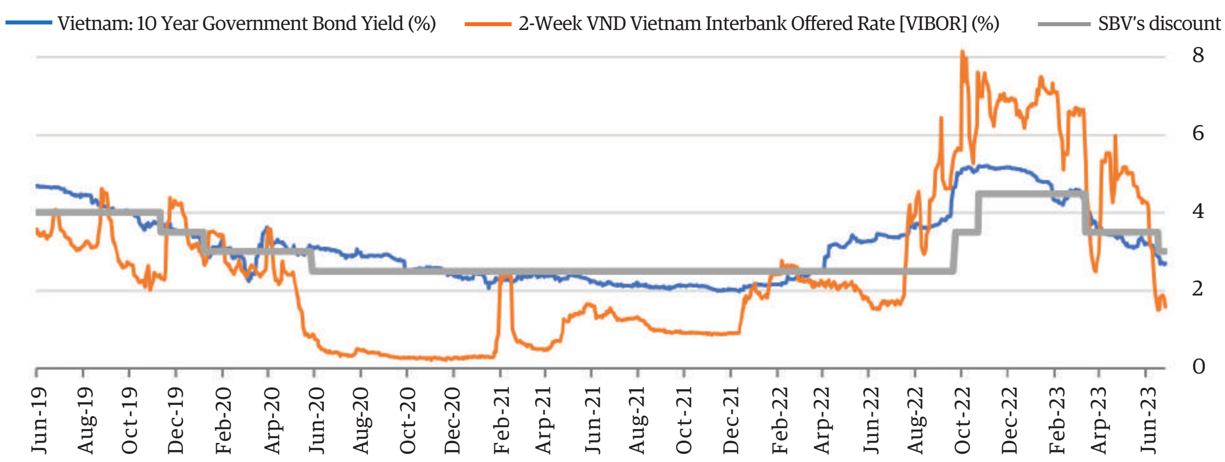
Source: GSO, Haver Analytics, and World Bank staff calculations
Note: Food includes grain, foodstuffs, and food consumption outside the home; housing includes rent, utilities (electricity, water, fuel), and construction materials

Figure 1.19. Price indexes of selected imports
Jun 2019 = 100 (NSA)



Source: GSO, Haver Analytics, and World Bank staff calculations

Figure 1.20. Interest rates
Percent



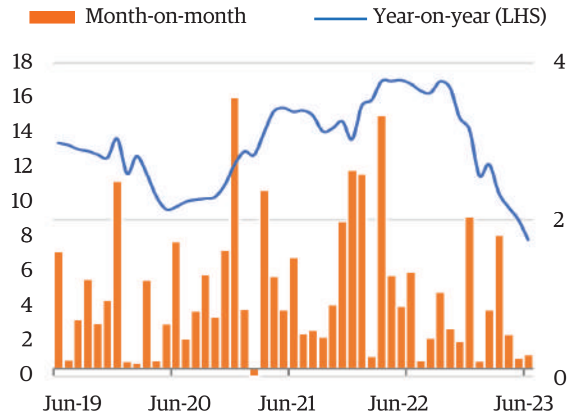
Source: Haver Analytics, State Bank of Vietnam

The banking sector continued to face challenges during the first half of 2023. Credit growth slowed to 7.8 percent (y/y) in June 2023 (Figure 1.21), well under the SBV's credit growth target of 14.0 percent for the year. This trend reflects weaker credit demand and investment activity amid cooling economic activity. Despite slower credit growth, the gross loan-to-deposit ratio remains above 100 percent[44] and maturity mismatches in bank balance sheets are of concern. While the average capital adequacy ratio

[44] Calculated by dividing total bank loans with customer deposits. This calculation is different from formal calculations of the loan-to-deposit ratio as per SBV regulations.

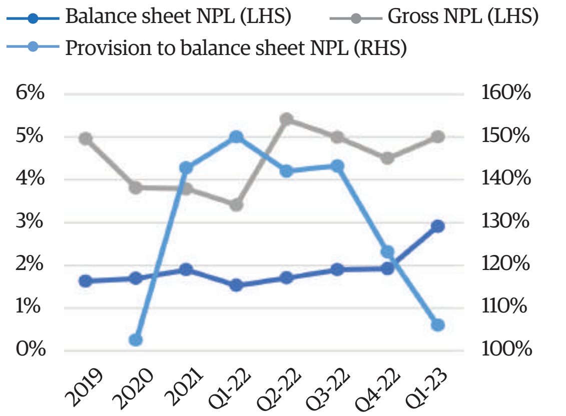
of the banking sector (11.4 percent in 2022)[45] remains above minimum prudential levels, capital buffers in some large state-owned commercial banks and smaller private banks are low, providing limited absorption capacity against shocks or rising non-performing loans (NPLs). Meanwhile, NPLs increased from 1.9 percent by December 2022 to 2.9 percent in by March 2023 (Figure 1.22).[46] The corporate bond market also remained sluggish with issuances at only about a quarter of the same period in 2022 and 98 companies defaulting on corporate bond payments totaling VND128.5 trillion (US$5.4 billion), approximately 11.1 percent of the total outstanding corporate bond market.

Figure 1.21. Credit growth
Percent (y/y, NSA)



Source: SBV, Haver Analytics, and World Bank staff calculations
Note: LHS = left-hand scale

Figure 1.22. NPL and provision of credit institutions
Percent



Source: FinnGroup, State Bank of Vietnam

In a bid to stimulate credit growth and address pressures on banking sector balance sheets, the authorities adopted supportive policies, including renewed regulatory forbearance. In March 2023, the government issued regulations allowing restructuring of corporate bonds and delaying additional rules for issuances as introduced in a previous regulation, providing short-term relief to borrowers and alleviating challenges in refinancing maturing bonds.[47] In April, the SBV re-introduced forbearance measures[48] first applied during the pandemic until June 2022. To further support social housing and industrial real estate development, SBV reduced capital charges on loan to these sectors.[49] The government also relaxed the rules pertaining to buy-backs of corporate bonds by credit institutions to ease a liquidity problem in the bond market.[50]

[45] Source: State Bank of Vietnam, FiinGroup, and World Bank staff calculation.

[46] Adjusted NPLs, which include loans held at Vietnam Asset Management company and restructured loans, stood at 5.0 percent in Q1-2023.

[47] Decree 08/2023/ND-CP amending and supplementing several provisions in Decree 65/2022/ND-CP.

[48] Circular 02/2023/TT-NHNN allows banks to restructure loans and stagger provisions over multiple financial years when owed by borrowers facing payment difficulties, but that have been assessed as capable of repaying the principal and/or interest according to the restructured repayment term.

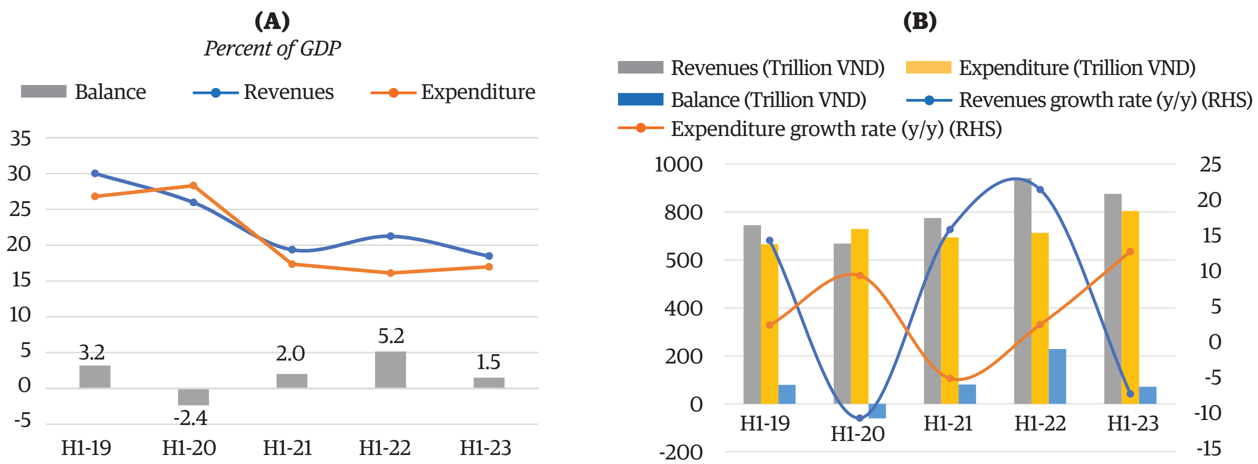
[49] Ibid 22.

[50] Decree 08/2023/ND-CP amending and supplementing several provisions in Decree 65/2022/ND-CP.

Accelerated public investment, but implementation challenges remain

The 2023 mid-year fiscal balance registered a smaller estimated surplus (1.5 percent of GDP) than a year ago (5.2 percent of GDP) (Figure 1.23A). The narrower budget surplus resulted from lower revenues and higher expenditures, providing a fiscal impulse equivalent to about 3.7 percent of GDP. Revenue collection fell by 7 percent (y/y) during the first semester of 2023, with falls in all major taxes, except corporate income tax[51] (Figure 1.24). By the end of June 2023, revenue collection reached 54 percent of the planned budget (or 18.5 percent of GDP), compared to 67 percent recorded for end-June 2022 (or 21.3 percent of GDP) (Figure 1.23A). On the other hand, total budget expenditure increased by 12.8 percent in the first semester of 2023 compared to a year ago (Figure 1.23B). Disbursement of the public investment budget jumped by 43.3 percent (y/y) during the first semester of 2023, providing some support to the economy (Figure 1.25). The surge in disbursement of the investment budget included the roll out the investment component of the 2022–23 Socio-Economic Recovery Program approved in early 2022 (1.8 percent of GDP).[52]

Figure 1.23. Budget execution



Source: MoF and World Bank staff calculations

Source: MoF and World Bank staff calculations
Note: RHS = right-hand scale

While overall budget expenditure increased in the first semester of 2023, implementation challenges associated with public investment remained. By the end of June, total expenditure lagged at 39 percent of the annual plan (or 17 percent of GDP), while disbursement of public investment reached only 30 percent of the annual planned budget. These low execution rates are comparable to 2022 and previous years, partly reflective of the traditionally slow start of investments in the first half of the year and partly related to chronic administrative and regulatory issues that hamper investment budget execution. In turn, this slow implementation of budget undermines the effectiveness of intended fiscal policies. Further discussion is provided in the second chapter of this report.

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51 The 16.9 percent (y/y) bump in corporate income tax in H1-2023 resulted from payments derived from 2022 tax deferrals which became due in Q1-2023.

52 The 2022-23 Socio-Economic Recovery Program includes a public investment component with a budget close to VND170 trillion (or 1.8 percent of GDP). As preparation of investment projects under this component took almost a year to complete, disbursement only commenced in early 2023.

Public and publicly guaranteed (PPG) debt remains sustainable highlighting ample fiscal space to use for counter-cyclical fiscal policy. PPG debt is estimated at 35.7 percent for 2022, continuing a decline from 2016 when PPG debt was 47.5 percent, and well below the mandated threshold of 60 percent set by the National Assembly. Vietnam's 2022 public debt is lower than its regional comparators – Indonesia (40.9 percent of GDP), the Philippines and Thailand (both 60.9 percent of GDP) and India (89.2 percent of GDP)[53] – suggesting that further countercyclical fiscal policy could be undertaken without compromising debt sustainability. This is reinforced by the authorities changing the tenure of public debt to domestic long maturities bonds in the first six months of 2023. Total bond issuances reached VND180 trillion (equivalent to 45 percent of the annual plan). About 95 percent of State Treasury bond issuances had long maturities (10-15 years).[54]

Figure 1.24. Government revenues

Percent (y/y, NSA)

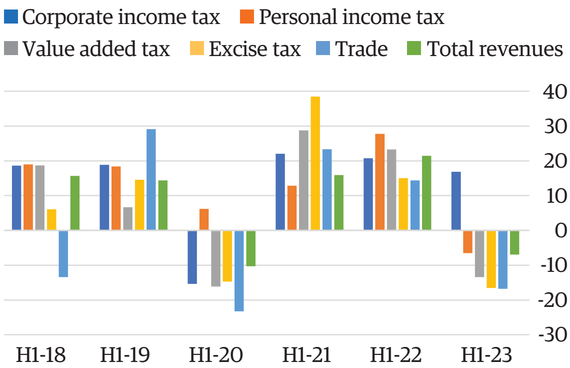
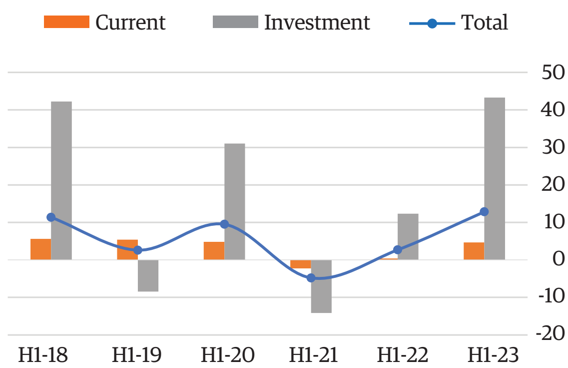


Figure 1.25. Government expenditure

Percent (y/y, NSA)



Source: GSO, Haver Analytics, and World Bank staff calculations

II. ECONOMIC OUTLOOK, RISKS, AND POLICY IMPLICATIONS

External headwinds expected to affect economic growth in the short term

Vietnam's economy is expected to grow by 4.7 percent in 2023, with a slow projected recovery to 5.5 percent in 2024 and to 6.0 percent in 2025. While softening, domestic demand is expected to be the main driver of growth in 2023. Private consumption will remain resilient, growing 6.0 (y/y) percent - below its pre-pandemic growth of 7 percent (y/y) in 2019 - and contributing 3.4 percentage point to GDP growth. Overall, investment will contribute 1.8 percentage point to growth. Private investment is forecast to remain subdued, growing 4.3 percent (y/y) compared to 8.2 percent (y/y) in 2019 due to uncertainties in the external environment, and contributing 1.2 percentage point

[53] Source: https://tradingeconomics.com

[54] Ministry of Finance, June 2023.

to GDP growth. Public investment is expected to increase 9.5 percent (y/y) contributing 0.6 percentage points to GDP growth, but only partially compensating for the lower private investment. With the easing of liquidity conditions and SBV's renewed guidance on loan forbearance, the financing constraints in the real estate/construction sectors are expected to ease, supporting a moderate recovery of private investment from 2024 onward. The growth projection assumes a moderate recovery in goods exports during the second half of 2023, especially the fourth quarter, based on a gradual recovery of demand from the European Union and United States.[55] Looking ahead to 2024, economic growth is projected to be driven by a moderate recovery in exports and imports, in line with the expected rebound in global growth, as well as improvements in private investment.

The CPI is expected to rise slightly from an average of 3.1 percent in 2022 to 3.5 percent in 2023. The deflationary impact of slower growth and a VAT rate cut rolled out for the second semester of 2023 are more than offset by the impact of a civil service salary increase (20.8 percent).[56] The 2 percent VAT tax break to support economic growth from July 2023 is expected to have a marginal and transitory impact on this year. Looking ahead, with projected declines in commodity prices in 2023 and broadly stable commodity and energy prices[57] in 2024, the CPI is expected to decline to 3.0 percent in 2024 and 2025, its pre-pandemic rate.

The fiscal balance is expected to register a small deficit of 0.7 percent of GDP in 2023. The wider fiscal balance is partly due to the slowdown in economic activity that affects revenue collection, with 2023 planned revenue collections by June 2023 some 7 percent lower than in June 2022[58]. Fiscal policy is expected to remain moderately supportive of the economy in 2023, with the government intent to increase investment expenditure, albeit with partial success given persistent implementation challenges. Looking ahead to 2024 and 2025, as the economy starts to recover, the authorities are expected to revert back to fiscal consolidation in line with the Government Financial Strategy for 2021-2030.[59] Public and publicly guaranteed debt will remain sustainable, stabilizing at an estimated 36 percent of GDP in 2023, before falling to a projected 34.4 percent in 2025.

The current account is expected to register a small surplus in 2023, thanks to a positive trade balance, continued international tourism and resilient remittances. The global demand is expected to gradually recover from the fourth quarter of 2023 and gain momentum into late 2024, leading to increased goods trade and contributing to an improved trade balance. In addition, international tourist arrivals are projected to continue growing. Remittances are expected to reach US$14 billion in 2023 and US$14.4 billion in 2024.[60]

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[55] IMF World Economic Outlook Update, July 2023.

[56] Vietnam currently has a payroll of approximately 3.5 million, including 2.5 million public service workers (including teachers, doctors, and nurses) and about one million military staff. Pensioners will also benefit from a 12.5 percent increase in their monthly pension.

[57] World Bank Global Economic Prospects, Commodity Market Outlook. April 2023. "Commodity prices are expected to fall by 21 percent this year and remain mostly stable in 2024. The expected decline in prices for 2023 represents the steepest decline since the pandemic. The decline in energy prices in the first quarter of 2023 is expected to fade and be followed by stable prices over the remainder of 2023 and a slight uptick in 2024. Energy price forecasts have been downgraded sharply. The energy price index is expected to fall by 26 percent in 2023 (much of that decline has already taken place) and remain broadly unchanged (up 0.1 percent) in 2024." (pg. 2).

[58] MoF June 2023 fiscal data, World Bank staff calculations.

[59] Prime Minister Decision No. 368/QD-TTg dated March 21, 2022, on Approval of Financial Strategy until 2030.

[60] World Bank/KNOMAD. 2023. "Remittances remain resilient but are slowing." Migration and Development Brief 38, World Bank, Washington, DC.

Table 1.1. Selected economic indicators, Vietnam 2020-2025

Indicator	2020	2021	2022e	2023f	2024f	2025f
GDP growth (%)	2.9	2.6	8.0	4.7	5.5	6.0
Growth of expenditure components						
Private consumption	6.0	6.0	6.5	6.0	6.0	6.5
Public consumption	4.8	4.8	4.4	4.8	4.8	4.4
Investment	5.3	5.9	6.7	5.3	5.9	6.7
Exports	2.1	3.1	4.1	2.1	3.1	4.1
Imports	3.0	3.5	4.5	3.0	3.5	4.5
Consumer Price Index (average, %)	3.2	1.8	3.1	3.5	3.0	3.0
Current account balance (% of GDP)	4.3	-2.1	-0.3	0.2	0.5	1.0
Fiscal balance (*) (% of GDP)	-2.9	-3.4	-0.3	-0.7	-0.3	-0.2
Public debt (% of GDP)	41.3	39.3	35.7	36.0	35.2	34.4

Source: GSO; MOF; SBV; IMF; and World Bank staff calculations.
Note: e = estimate; f = forecast, *: excluding unallocated expenditures and following Government Finance Statistics (GFS).

The risks to growth have materialized and the balance of risks to Vietnam's economic outlook remains tilted to the downside. Slower-than-expected growth in advanced economies could further dampen external demand for Vietnam's export sector, whose size is estimated at 50 percent of GDP.[61] In addition, given that China is Vietnam's largest trade partner,[62] continued weakness in China's post-pandemic recovery heightens risks for Vietnam's economic growth. Continued uncertainties in the global financial market have the potential to rekindle stress in the global banking sector, intensify investor risk aversion, and discourage FDI flows to Vietnam. Additional monetary policy tightening in major advanced economies to combat persistent inflation could widen the existing interest rate gap between international and domestic markets.[63] This could exert exchange rate pressures on the local currency. Moreover, an escalation of geopolitical tensions and climate-related disasters pose additional downside risks for the country, including through rising food and fuel prices.

As growth has slowed sharply, active fiscal policy support is warranted

Given ample fiscal space, fiscal policy should take the lead, ensuring a much better implementation of the investment budget for 2023. A full implementation of the planned investment budget would bring public investments to 7.1 percent of GDP in 2023, up from 5.5 percent planned in 2022, providing 0.4 percent of GDP in fiscal impulse to support aggregate demand.[64] The government has planned a 38 percent increase (y/y) in public investment for 2023 – equivalent to 1.6 percent of GDP. It is accelerating

[61] The size of the export sector is measured by the domestic value-added (direct and indirect) from exports as a share of GDP. Source: Martins Guilhoto, J., C. Webb and N. Yamano (2022), "Guide to OECD TiVA Indicators, 2021 edition", OECD Science, Technology and Industry Working Papers, No. 2022/02, OECD Publishing, Paris, https://doi.org/10.1787/58aa22b1-en. The value 50 percent is for 2019.

[62] On average, 16.3 percent of Vietnam's exports went to China during 2018-19, while 28.6 percent of its imports came from China during the same period.

[63] As of July 2023, the US Federal Reserve funds rate is 2.5 percentage points higher than SBV's re-discount rate.

[64] https://www.elibrary.imf.org/display/book/9781557751928/ch005.xml. Equation (3) is used to estimate the fiscal impulse: FI=(ΔG-nG-1) - [ΔT-(ΔY/Y-1) T-1].

implementation with disbursement of the public investment budget jumping by 43.3 percent (y/y) during the first semester of 2023. However, historical public investment implementation rates have been low in the recent past, for example reaching only 67.3 percent in 2022.[65] Steps to accelerate and improve the efficiency of implementation would also help address emerging infrastructure constraints to growth, including critical investment needed in the electricity transmission network and in building resilience to climate change. These steps include setting investment targets and enforcing accountability at different intergovernmental levels for achieving them; focusing on key national investment programs such as national expressway, power transmission and national target programs; allowing flexibility in rules related to budget allocation for the projects identified as part of 2022-2023 Socio - Economic Recovery Program (1.8 percent of GDP); and allowing some flexibility on certain advance procurement activities before budget allocation.

In addition to public investment, supporting workers and families affected by the slowdown through a more effective social protection system could also help support aggregate demand. To successfully do so, the authorities need to reform the targeting approaches and delivery mechanisms of the social protection system so it might serve as an agile tool to support the vulnerable during economic shocks.

Fiscal policy support should be accompanied by continued monetary policy accommodation but the space for additional loosening is constrained. As credit demand has remained persistently low, further reducing interest rates may not have the desired effect of incentivizing credit growth. Also, further interest rate cuts would increase the interest rate differential with global markets, potentially incentivizing capital outflows and putting pressure on the exchange rate. Attempts at directing credit to priority sectors, such as the recent initiatives to support social housing or industrial real estate, should be balanced against considerations of ensuring efficiency in the allocation of credit.

Financial sector fundamentals should be improved in several ways to strengthen the resilience of the banking system. While measures such as cutting interest rates, easing of liquidity constraints, forbearance and restructuring helped to address credit market difficulties in the short-run, they could also lead to a rise in NPLs and loan-to-deposit ratios, raising concern about maturity mismatches and banks' balance sheets. In the medium term, structural reforms are critical to address emerging financial risks and position the sector to facilitate sustainable growth. Strengthening bank capital adequacy ratios ensures sufficient capital to absorb potential losses and maintain stability in the face of economic shocks. Strengthening institutional frameworks for prudential supervision, early intervention, bank resolution and crisis management helps authorities effectively monitor and intervene in troubled financial institutions, preventing the escalation of crises and minimizing systemic risks (see Box 1.2). Additionally, a robust bank resolution framework is crucial to facilitate the orderly resolution of failed banks, protecting depositors and preserving financial stability.

Launching a new round of structural reforms would help enhance the productivity and sustainability of economic growth, contributing to its ambitions to become a high-income country by 2045. Continued reforms to lighten the regulatory burden on businesses are necessary for productivity gains and increased competitiveness. More critically, relaunching the State-Owned Enterprises (SOEs) reform can act as a catalyst to attract private sector participation, improve productivity, and ultimately boosting overall economic performance. Promoting an inclusive financial sector can empower individuals and businesses to participate fully in economic activities, in turn enhancing their contribution to sustainable

[65] Of planned budget approved by the National Assembly, as of December 31, 2022.

growth. Furthermore, building medium-term resilience in exports is important to mitigate risks associated with external shocks. Diversifying the product base and export destinations helps reduce reliance on specific markets and products, making economies more resilient to global economic fluctuations. Additionally, fully utilizing existing Free Trade Agreements (FTAs) can unlock market opportunities, boost exports, and foster economic integration with partner countries.

Fiscal policy can also help enhance the sustainability of Vietnam's economic growth. For instance, investing in human capital and skills can help improve productivity and drive economic growth. Also, fiscal policy can help build resilience to climate change through prioritizing greening production and consumption. Implementing carbon taxation and other fiscal instruments can incentivize industries to reduce their carbon footprint and adopt more sustainable practices. Simultaneously, providing time-bound fiscal incentives for green consumption, such as tax breaks or subsidies for eco-friendly products, can encourage individuals to make environmentally conscious choices.

Box 1.2. Reforms of Vietnam's banking laws

An opportunity to further strengthen the foundations for financial stability in Vietnam

A modern financial system that aligns with international standards and good international practice is a precondition for Vietnam to achieve its aspiration to become a high-income country by 2045. Vietnam is currently reviewing the Law on Credit Institutions (LCI). The existing LCI has significant gaps that impede the SBV's ability to adequately supervise banks and financial groups, maintain financial stability and protect depositors. Since the last limited revision of the LCI in 2017, Vietnamese banks and financial groups have become larger, more sophisticated, and complex. International standard setters and Southeast Asian peers have revised their legal frameworks to incorporate lessons from the Global Financial Crisis.

The review of this law presents an opportunity to strengthen the legal powers of the State Bank of Vietnam (SBV) as the regulator and supervisor of banks, to enhance its operational independence, to improve banking supervision powers and functions, and to provide a legal framework for enabling non-viable banks to be resolved in ways that maintain financial stability and minimize public financing costs.

Key considerations for fundamental changes to the current LCI include:

- Aligning the law to international standards and good international practice such as the *Core Principles for Effective Banking Supervision,* issued by the Basel Committee on Banking Supervision and the *Key Attributes of Effective Resolution Regimes for Financial Institutions,* issued by the Financial Stability Board.
- Enabling risk-based, consolidated, and financial group supervision to promote effective forward-looking supervision of financial institutions as well as financial groups.
- Strengthening macroprudential policy, including powers, transparency, and accountability of the SBV, for formulating and implementing macroprudential policies and supervision.
- Facilitating banks' recovery planning by empowering the SBV to require credit institutions to prepare, maintain and regularly test recovery plans to enable them to respond proactively to emerging stress.
- Dealing with failing banks through robust laws, policies and procedures for banks' recovery and resolution, and associated financial safety nets (including deposit insurance and emergency liquidity assistance). Financial

institution failures should be managed in ways that maintain the continuity of systemically important financial systems and preserve financial stability, while also ensuring that shareholders and large creditors bear their fair share of losses. Reforms would include designating the SBV as resolution authority, specifying a clear set of triggers for entry into resolution, equipping the SBV with powers to implement a range of resolution options, and establishing a robust framework for the funding of resolutions.

- Replacing special loans to financial institutions with a mechanism that empowers the SBV to extend liquidity support to a financial institution under strict soundness preconditions and does not require other credit institutions to lend to a financial institution in stress.
- Promoting operational independence for the SBV, with corresponding enhanced transparency and accountability, so that regulation and supervision of financial institutions are made impartially and in a neutral manner, without undue interference.
- Strengthening legal protection for SBV, its officers, staff, and agents to ensure it can meet its responsibilities in good faith and the proper performance of duties without fear of legal actions being taken against it or its officers, staff, and agents.

CHAPTER 2. MAKING PUBLIC INVESTMENT WORK FOR GROWTH

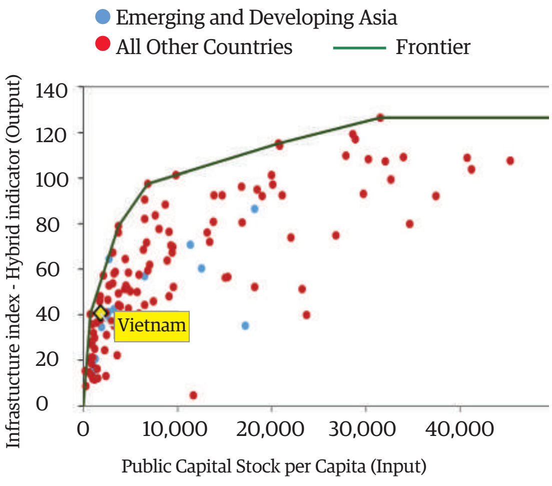
I. INTRODUCTION

Public investment level low compared to growing needs

Vietnam, in seeking to reach upper middle-income status by 2030 and high-income status by 2045,[67] aspires to become a modern and industrialized nation with a higher quality of life for its citizens. To achieve these ambitious development goals, the government estimates that annual gross domestic product (GDP) growth must be maintained at 7 percent during 2021-2030 and 6.5 to 7.5 percent through 2031-2050.[68] The country also needs to ensure that gross capital investments from all sectors account for 32 to 35 percent of GDP on average from 2021 until 2030, including government investment at an average of 7.3 percent of GDP annually to support infrastructure development during this period.[69] This is in line with global experience that fast-growing countries are characterized by high public investment, defined as 7 percent of GDP or more.[70]

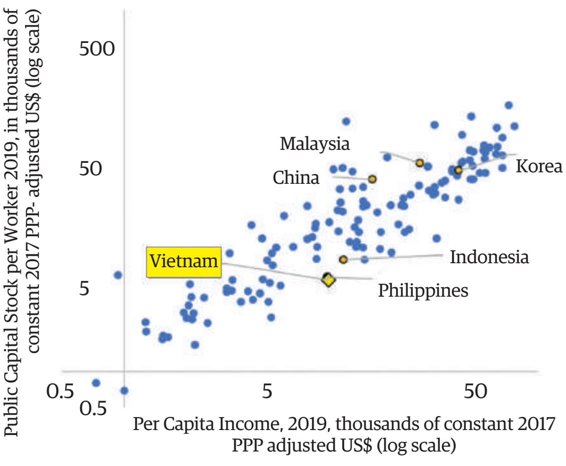
Despite critical growing needs, Vietnam's public investment level has declined in the past decade. From 2011 to 2022, the share of public investment in total government expenditures and GDP fell from 27 to 20 percent, and 8 to 6 percent, respectively.[71] Yet the economy remains relatively capital scarce with a public capital stock per capita and per worker well below upper middle-income countries (UMICs) and high-income countries (HICs) (Figures 2.1 and 2.2). Meanwhile, global experience suggests

Figure 2.1. Public capital stock per capita and Infrastructure index



Source: IMF (2021)

Figure 2.2. Public capital stock per worker at different income level



Source: IMF (2021), World Bank WDIs

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[67] Socio-Economic Development Strategy 2021-2030 (approved by Central Party Committee in 2021) and National Spatial Development Masterplan 2021-2030, vision 2050 (approved by the National Assembly in January 2023).

[68] National Spatial Development Masterplan 2021-2030, vision 2050.

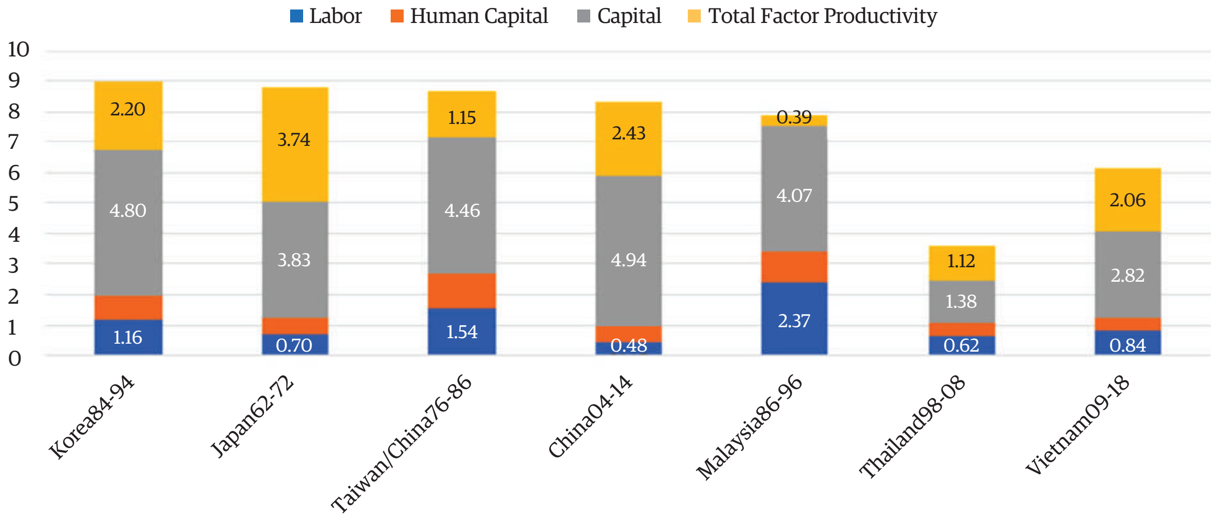
[69] Socio-Economic Development Strategy (SEDS) 2021-2030.

[70] The Growth Report: Strategies for Sustained Growth and Inclusive Development (Commission on Growth and Development, 2008). The report reviewed 3 economies that have grown at an average rate of 7 percent a year or more for 25 years or longer since 1950; and at that pace of expansion, they almost doubled in size every decade.

[71] Ministry of Finance and General Statistical Office. Excludes investment by state-owned enterprises.

that capital accumulation was the most important driver for fast-growing countries when they were at Vietnam's level of development (Figure 2.3).

Figure 2.3. Capital stock accumulation as a major driver for fast-growing economies



Source: Bank staff calculations based on Total Economy Database (https://www.conference-board.org/data/economydatabase/total-economy-database-productivity).

Sustaining the levels of public investment will be critical to secure productive and social infrastructure as public goods which will facilitate greater private sector investment. Vietnam has ample fiscal space—with Public and Publicly Guaranteed Debt (PPG) at 35.7 percent of GDP in 2022[72] compared to the 60 percent debt threshold set out by the National Assembly—and can spend more on public investment to boost sustainable growth (see Box 2.1 for illustrative example on transport infrastructure needs).

Box 2.1. Transport infrastructure constraints

In the past 20 years, transport spending—roughly 23 percent of general government capital spending and 3.5 percent of GDP—has focused more on rural transport infrastructure (75 percent), which is managed by provinces. Given budget constraints, this focus came at the expense of implementing nationally strategic investments. As a result, the expressway density in Vietnam is among the lowest in the East Asia and Pacific (EAP) region, and the road transport costs are highest when compared to others in the region. Many segments along the North-South expressway axis have not been constructed. Railway infrastructure has also been neglected. Multimodal connectivity is limited, particularly between roadways, seaways, in-land waterways, and railways, while connection between railways and seaports is almost non-existent. Transport connections at the gateways of major cities, as well as to economic zones, industrial parks, seaports, and border gates remains limited.

[72] Ministry of Finance.

Substantive scope to increase public investment efficiency

While higher investment is necessary, Vietnam also needs better investments and there is scope to increase the efficiency of public investment. Between 2011 and 2019, it took more than six VND in investment to generate one VND in output.[73] As a result, Vietnam achieved much less growth per dollar of investment than China, Malaysia, Republic of Korea, Singapore, and Thailand[74] when they were at comparable levels of per capita income and development. The IMF (2018) estimated that the output efficiency of public investment for Vietnam could be 23 percent higher if the efficiency of public investment management reached the global frontier.[75] Increased public spending efficiency could have a major impact on aggregate productivity growth and GDP levels. Policy research suggests that a one percentage point rise in public investment through efficiency improvements lifts growth rates by 0.1-0.2 percentage points over the next few years.[76]

Efficient public investment in Vietnam is however hampered by weaknesses in both public investment management (PIM) and intergovernmental fiscal (IGF) institutions. To explore Vietnam's potential for gains in public investment efficiency,[77] this chapter reviews the overall performance and key challenges to date and provides recommendations on adjustments to the current frameworks—including legal, institutional, incentive, and enforcement arrangements.

II. PUBLIC INVESTMENT PERFORMANCE AND CHALLENGES

Persistent implementation inefficiencies

While there have been notable efforts by the government to improve PIM in the last decade, public investment continues to suffer from persistent allocative and operational inefficiencies. Steps to boost PIM have included hardening budget constraints to eliminate expenditure arrears, introduction of independent appraisals and a centralized monitoring scheme. Despite these efforts, inefficiencies remain within the PIM cycle. Both central and provincial governments are unable to disburse their appropriated capital budgets. Between 2017 and 2022, investment budgets suffered from chronic under-execution with

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73 Incremental capital output ratio (ICOR) data from Vietnam General Statistics Office (GSO): The 2011-2015 ICOR was 6.25, 2016-2019 ICOR was 6.13 and 2016-2020 ICOR was 7.04 as 2020 was an exceptional year due to the COVID-19 pandemic.

74 Various sources including World Development Indicators (2022); "Sector Assessment (Summary): Industry and Trade." (Asian Development Bank (ADB, 2016); and "China's Productivity Slowdown and Future Growth Potential." (World Bank Policy Research Working Paper 9298, 2020).

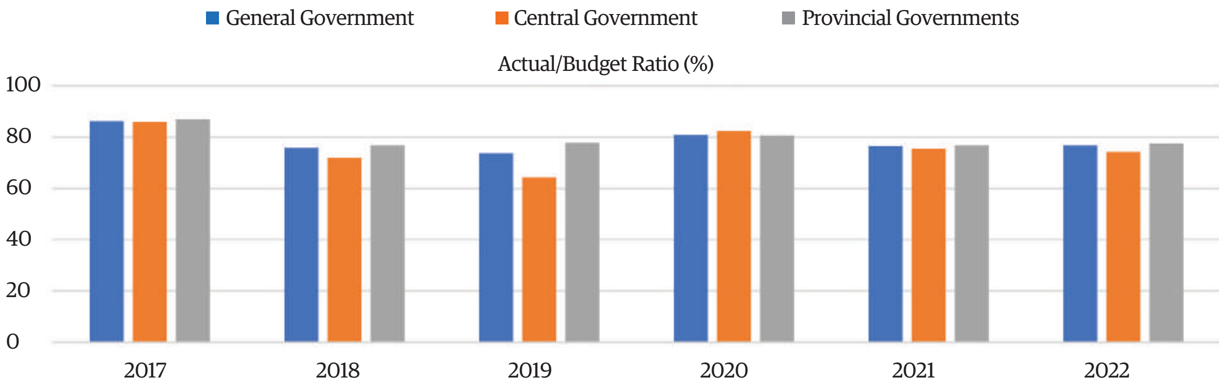
75 Vietnam: Public Investment Management Assessment (PIMA) (IMF, November 2018).

76 Assessing the Effect of Public Capital on Growth (World Bank Policy Research Working Paper 8604/2018).

77 The Power of Public Investment: Transforming Resources into Assets for Growth (World Bank, 2014). Inefficiencies in PIM exist at three levels: (i) allocative efficiency—meaning channeling of resources towards programs/projects with higher social rates of return and in line with government priorities, (ii) productive/technical efficiency—meaning efficient conversion of capital spending into infrastructure, optimizing the use of resources for investment once allocated, mitigating cost overruns, delays and sub-optimal diversion from specification at design and incompleteness and (iii) operational efficiency—including using assets, new and existing, more efficiently and addressing the under-provision of complementary resources required to achieve service delivery targets for the assets created.

only 77 percent of allocations spent (Figure 2.4). The differences between budgeted and actual spending (23 percent) and the resulting capital expenditure carried over from one year to the next (18 to 31 percent of total capital expenditures) are significantly larger than in many peer countries, and way above international good practices which suggest budget deviations to remain below 5 percent.[78] PIM inefficiency is also manifested in significant project completion delays and cost overruns. A recent World Bank review[79] of selected large-scale transport projects found an average delay of five years, and an average cost overrun of double the original cost at the design and budget allocation stage.

Figure 2.4. Persistent execution gaps (2017-2022)



Source: MPI (mpi.gov.vn) and MoF (mof.gov.vn) websites and World Bank staff estimates.

Increasing capital spending decentralization

Public investment efficiency is also affected by Vietnam's fragmented intergovernmental system and increasingly decentralized capital spending. Since the early 1990s, the Vietnamese Government has embarked on a policy of rapid spending decentralization. Within the unitary set of rules and norms applied across the country, the share of subnational governments' (SNGs) in total government expenditures increased from 26 percent in 1992 to almost 60 percent in 2022.[80] This spending is significantly higher than the international average (21.5 percent) and the lower middle-income economies' average (18.8 percent) and Asia Pacific region (33.7 percent). As for capital expenditure, Vietnam's central government accounted for a mere 20 percent of total government investment in 2022, compared to 40 percent seven years ago. This decentralization policy has channeled on average 80 percent (2017-2022) of public investment through SNGs (Figure 2.5), more than double the averages in unitary countries (34.5 percent) and overall (39.5 percent) (Figure 2.6).

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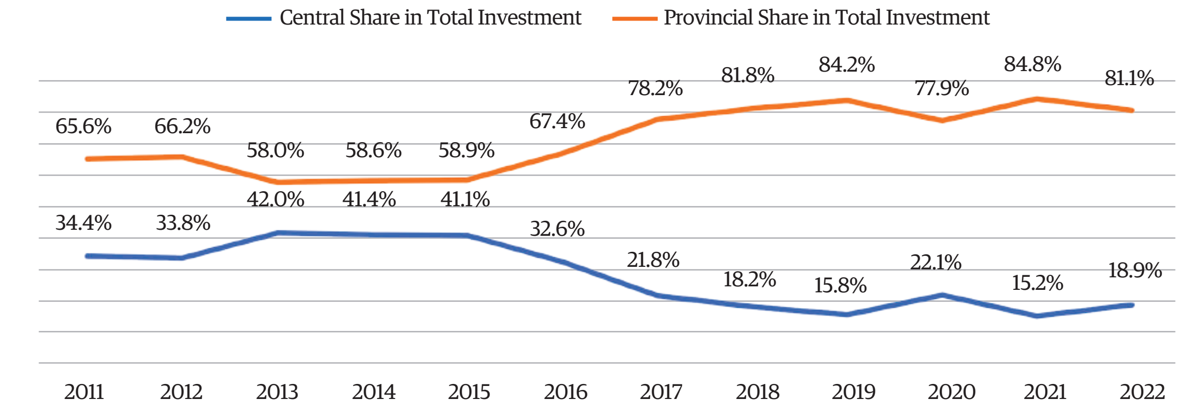
78 Public Expenditure and Financial Accountability (PEFA) Framework, Performance Indicator 1.

79 Regional Investments in Vietnam: Challenges and Opportunities (WB Policy Note, 2023). Review sample included 14 transport projects which accounts for 13 percent of transport investment budget during 2011-20 (sourced from MOT). In the same review, it is worth noting that time overrun tends to vary more widely between one to three years in the case of smaller projects (those in group B or C).

80 Source: MoF data and staff calculations.

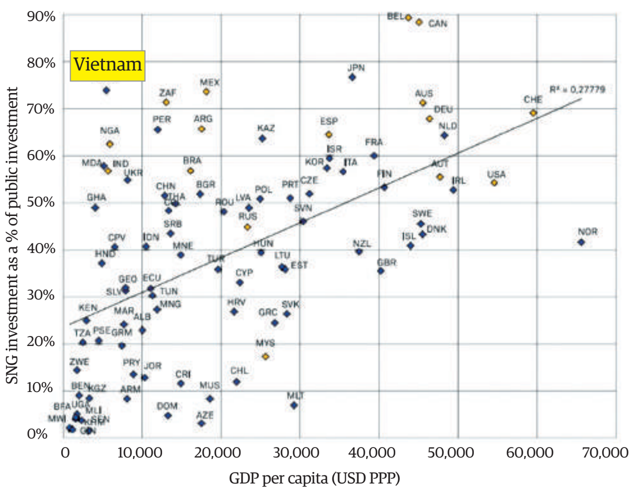
Figure 2.5. Increasing level of provincial spending in total public investments



Source: MoF (mof.gov.vn) and World Bank staff estimates

Figure 2.6. Vietnam high level of decentralization compared to development peers

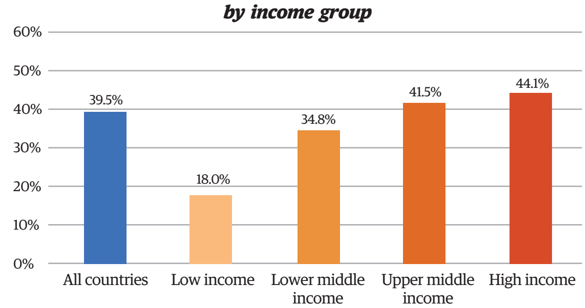
SNG investment as a share of public investment and GDP per capita



Share of SNG expenditure / investment in countries

SNG expenditure / investment	All countries	Unitary countries	Federal countries
SNG expenditure / % of GDP	8.3% (122 countries)	6.6%	16.0%
SNG expenditure / % of total public expenditure	21.5% (122 countries)	17.1%	41.9%
SNG investment / % of total public investment	39.5% (93 countries)	34.5%	59.0%

SNG investment as a share of public investment by income group



Source: Subnational Governments around the World: Structure and Finance (OECD/UCLG, 2019) and World Observatory on Subnational Government Finance and Investment (OECD/UCLG, 2022 Synthesis Report).

Consequently, inefficiencies have arisen from allocative duplications, implementation challenges, negative externalities, and sub-optimal private sector mobilization and financing. This devolution of spending decisions to provincial authorities has also led to weak coordination across regions and with central government as well as a proliferation of duplicate investments-executed by both the central government and 63 provinces (some of which are very small in size).[81] For example, ineffective coordination between SNGs and national governments is also evidenced by duplicate investments in

[81] OECD, Multi-dimensional Review of Vietnam (2019): The average size of provinces in Vietnam is relatively small compared to those in other countries. There are on average 1.5 million inhabitants for each province and 8,500 inhabitants per municipality. These ratios are much smaller than the OECD average (three million inhabitants per region and 37,800 inhabitants per municipality) and in other more populous countries, such as China and India, but also Malaysia and Mexico.

seaports, airports, and hydro-power generation. Vietnam has 47 seaports of all sizes across provinces, but 95 percent of cargo goes through three ports invested and operated by the Ministry of Transport.[82] While there are 22 airports nationwide, only eight are considered international and the remainder can only accept smaller, narrow body aircrafts.[83] Most airports are loss-making and unable to even cover operations and maintenance (O&M) costs. In just three Central Highlands provinces (Dak Nong, Gia Lai and Kon Tum), 256 small and medium-scale hydropower plants were approved and are being operated without fully consulting the affected stakeholders.

In addition, public asset management (PAM) remains inadequate. Post-construction infrastructure assets are not properly recorded nor managed after project completion at national or sub-national levels, leading to inadequate maintenance of public assets. Overall, it is estimated that the budget only financed about 40 percent of minimum needs in road infrastructure maintenance, although some partial progress has been made in certain sectors, such as national roads and clean water and irrigation infrastructure assets.[84]

Infrastructure quality lags that of regional peers

As a result of these challenges, Vietnam's infrastructure quality lags that of many Asian countries and could impact its attractiveness as an FDI destination and potential growth in the long term. According to the World Economic Forum Survey, perceived infrastructure quality had improved in line with increasing capital stock, but Vietnam still trailed emerging and developing Asian countries in 2019. It ranked Vietnam 77th out of 141 countries worldwide, behind regional peers such as China, India, Indonesia, Malaysia, and Thailand—countries that Vietnam is competing with for FDI (Table 2.1). The Global Quality Infrastructure Index 2021 ranked Vietnam 51st out of 184 economies, below Indonesia (28th), Malaysia (29th), and Thailand (33rd). One example of infrastructure quality is the expressway density, which is one of the lowest in the region, while road transport costs are the highest regionally.[85] The infrastructure investment gap will constrain Vietnam's ability to attract and retain FDI, including those looking to relocate from China.

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[82] Haiphong city in the north and Ho Chi Minh City and Ba Ria-Vung Tau province in the south. The remaining 44 ports account for only 5 percent of cargo volume, reflecting uneconomic investments by provinces. Despite the gamut of seaports nationwide – including two special, 12 Grade I and 20 Grade II seaports – there is a dearth of modern facilities to receive ships of high dead weight tonnage.

[83] According to International Civil Aviation Organization classification. There is a concentration of airports in the central coastal region, home to 14 provinces, with an average distance of around 100km between nine of the 22 airports. Only six airports have experienced passenger growth, while the remainder have hit just 40 percent of projected volumes.

[84] Vibrant Vietnam: Forging the Foundation of a High-Income Economy" (WB Report, 2019).

[85] In Vietnam, road transport represented about 79 percent of overall transport budget with the highest budget-to-volume ratio. Road transport remains the most important mode in terms of volumes, accounting for more than 90 percent of passengers and 70 percent of freight volumes during 2010-2020, also the costliest form of domestic freight transport.

Table 2.1. Quality of infrastructure

	Overall infrastructure		Roads		Railroads		Seaports		Air transport		Utility infrastructure	
	Score	Rank	Score	Rank	Score	Rank	Score	Rank	Score	Rank	Score	Rank
Vietnam	65.9	77	3.4	103	3.6	54	3.8	83	4.0	103	79.6	87
China	77.9	36	4.6	45	4.5	24	4.5	52	4.6	66	86.9	65
India	68.1	70	4.5	48	4.4	30	4.5	49	4.9	59	69.8	103
Indonesia	67.7	72	4.2	60	4.7	19	4.3	61	4.9	56	79.4	89
Malaysia	78.0	35	5.3	19	5.1	13	5.2	19	5.5	25	89.7	51
Thailand	67.8	71	4.4	55	2.8	75	4.1	73	5.0	48	78.9	90

Source: World Economic Forum - The Global Competitiveness Index (2019 report)
Note: Overall infrastructure and Utility infrastructure Scores 1-100 Best; Sub-sector Transport infrastructure Scores 1-7 Best;
Rank: out of 141 countries

Challenges are further compounded by climate change

Vietnam is among the 10 countries most affected by climate change and natural disasters globally.[86] Each year, an average of US$852 million worth of economic activity and 316,000 jobs are at risk from riverine and coastal flooding in the agriculture, aquaculture, tourism, and industry sectors. This is particularly acute for many of the growth engines of the country and respective regions—like Ho Chi Minh City, Da Nang, and Can Tho cities—which are on the frontline of climate-related and extreme weather events. For instance, the World Bank estimates that Da Nang city would incur around VND900 billion—about 4.5 percent of its annual spending and 0.8 percent of GRDP—in asset loss annually due to extreme weather events during 2021-2030. Compounding the threats of sea level rises are risks due to salination, land subsidence, and erosion in populous regions of the country such as the Mekong Delta with more than 17 million citizens.[87]

Vietnam's public investments and assets are increasingly exposed to growing climate risks and physical threats related to extreme weather events. In 2022, the cost of direct damage to energy and transport infrastructure from typhoons and floods was estimated at US$475 million. Firms had estimated expenses of US$280 million due to a lack of reliable and resilient infrastructure. Despite such risks, the average investment in disaster protection infrastructure is only an estimated 0.05 percent of GDP. The forecasted cost to improve coastal resilience will climb to US$4 billion by 2035, of which US$2 billion alone will cover the cost of constructing and heightening sea dikes.[88]

Vietnam's total incremental financing needs to address the green transition and climate change-related challenges could reach an estimated US$701 billion over 2022-2040, or approximately 6.8 percent of GDP per year.[89] Public investment—with its critical roles as the trailblazer and the

[86] Various sources: including climateknowlegeportal.worldbank.org; climatelinks.org; and climaterisk.undp.org.
[87] Vietnam Country Climate Development Report (CCDR) (World Bank, 2022).
[88] Resilient Shores: Vietnam's Coastal Development between Opportunity and Disaster Risk (World Bank, 2020).
[89] Vietnam Country Climate Development Report (CCDR) (World Bank, 2022).

catalyst for private investment—would account for more than one-third of the financing needs, or about 2.4 percent of GDP. The pathway to improve climate resilience alone would account for about two-thirds of this amount as substantial financing will be required to protect the country's assets and infrastructure as well as vulnerable people. However, climate change adaptation is not fully accounted for in the overall fiscal strategy nor in prioritization of projects for budget funding in Vietnam.[90]

III. WEAKNESSES IN THE INSTITUTIONAL FRAMEWORK

Interconnected issues across the entire PIM cycle

The inefficiencies highlighted above are rooted in weaknesses in the public investment management system. Challenges persist across the entire PIM life cycle: project preparation, implementation, monitoring and evaluation, and post-construction asset management. These issues are inherently interconnected. Weaknesses during planning and appraisal—leading to low 'quality-at-entry'—feed through to implementation and adjustment where they become apparent in cost overruns and delays. Similarly, difficulties in downstream implementation of projects amplify problems at planning and appraisal. More specially:

Project preparation/selection stage: A key impediment is the absence of unified methodological guidelines to support evidence-informed decision-making.[91] Pre-feasibility studies (PFSs) are not prepared for Group B[92] projects (which can be considered large for most provinces)[93] and not made public, except for official development assistance (ODA) projects. The lack of rigorous project costing—due to low technical cost norms, often underestimated land acquisition and resettlement cost/timeline—leads to subsequent adjustments and delays when inaccuracies are exposed. These chronic problems come from the lack of dedicated budget and time to prepare meaningful PFSs with credible cost estimates, since this concept proposal stage runs on a five-yearly cycle, linked to the preparation of Medium-Term Investment Plans (MTIPs). However, there is generally reluctance to revise the total investment cost at the feasibility study (FS) stage because if any change is needed, the project has to be returned to the PFS stage. In addition, life-cycle project costs, including capital and operating costs, are not estimated at the PFS stage.[94] This results in the underfunding of O&M for most public investment projects.

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[90] This report also acknowledges the importance of greening public investment but does not discuss related issues in detail. The issues include among other things: the lack of effective green taxonomy (to scale up sustainable investment and apply eligibility criteria for green bonds/credits), green public procurement being in its infancy (as existing legal framework needs to be operationalized and aligned better with international good practices), and green financing (particularly green bonds) not being implemented despite the availability of initial legal enablers.

[91] While a feasibility study including examination of economic efficiency is required for large projects—Group A projects and nationally important projects—there are no common methodological guidelines, including for social cost benefit analysis (SCBA), to support decision-making. As in many other countries, social and political factors weigh heavily on investment decisions, with less focus placed on evidence of public value and sustainability.

[92] The Public Investment Law groups projects (A, B, C) based on sectors and total investment cost.

Project implementation stage: Overly complex processes impede implementation and disbursement of projects and approvals of adjustments. Despite budget appropriation at the beginning of the year, most projects take approximately three to five months to complete the detailed activity and procurement plans before implementation. The time and costs for land clearance and resettlement processes affect the roll out and implementation processes. The value-for-money advantages of open, competitive procurement – even though it is the default method as per the Public Procurement Law – are being dissipated due to frequent use of direct procurement.[95] Organizational arrangements for monitoring implementation are diffuse and monitoring tends to be passive and does not lead to a fundamental review and adjustment of struggling projects. There is no systemic mechanism for central ministries and provinces to identify projects at high risk of delivery failure and take adequate remedy actions in a timely manner. The information systems on outstanding and multi-year financial commitments, essential to ensure financing of on-going projects, are poorly developed.

Project monitoring and ex-post evaluation stage: There is notable room for improvement of the project database, a critical element of a well-functioning M&E system. A State Budget Investment Management Information System (SBIMIS) developed by the MPI in 2017 now captures investment allocation and execution information of more than 41,000 projects nationwide (at national and partially at subnational levels). However, there are significant data gaps, limited compliance of investment owners on updating data, and limited data sharing across government agencies. The shares of projects monitored, inspected, and evaluated through SBIMIS in 2022 were only 47.3, 25.6 and 39.2 percent, respectively.[96] The SBIMIS is not interoperable with the Treasury and Budget Management Information System (TABMIS) on necessary information—such as commitments, disbursements, and implementation progress—to inform corrective actions as needed. Some provinces invest in their own systems to monitor projects, leading to fragmented databases. Investment data is commonly not disclosed hindering M&E of public projects. While the legal basis for ex-post evaluations was established, evaluation of project completion is rarely performed, except for ODA projects, and reflecting on lessons is not a strong feature of completion reports.

Public asset management: The lack of a comprehensive legal framework for asset accounting and reporting and up-to-date and integrated asset registries has hindered effective decision-making on new infrastructure investment, O&M, and revenue policy for all infrastructure (at national and sub-national levels). While there is a clear definition of infrastructure assets in the Public Asset Management Law, there is currently only management and accounting guidance for roads and water/irrigation infrastructure assets, but even this is not consistently applied, which impedes accuracy of asset value reporting. The dual budgeting system, with the MoF overseeing the recurrent budget and MPI managing the capital budget, also accounts for the underfunding of O&M.

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93 For many Groups B and C projects, to be included in the MTIPs, project owners only propose the names of projects without proper justification of their linkages to the development strategy or cost benefit analysis.

94 This is partly due to the dual budgeting system in Vietnam, where the project owner is allocated capital budget only, while O&M costs are allocated to another agency as part of the recurrent budget.

95 See Vibrant Vietnam, pp. 66-68, World Bank (2021). Also, there is historical evidence of some projects completed below cost thanks to competitive bidding, as indicated by a JICA construction assessment of about 100km of National Highway No.10 from Haiphong to Ninh Binh together with 40km of bypass roads and several bridges, with the actual project cost only 76 percent of the estimate.

96 Public investment monitoring report (MPI, 2022).

Misaligned spatial planning and budgeting

In the context of high levels of decentralization, the planning and budgeting systems face challenges in coordinating top-down strategic prioritization with bottom-up project identification by 63 provinces. The Spatial Planning Law (2019) aims to achieve a paradigm shift in the master planning approach towards integrated spatial development at national and regional levels. The National Spatial Development Master Plan (NSDP) to 2030, vision 2050 places an emphasis on supporting four dynamic zones and three economic corridors, with linkages within and across zones and six socio-economic regions. More recent efforts towards integrated spatial development support a coherent regional investment approach, but face implementation challenges. The plethora of planning tools—including national, regional, sectoral, and provincial 10-year masterplans—are tenuously linked to their respective five-year Medium-Term Investment Plans. Investments that span multiple provinces are critical to enhancing inter-provincial connectivity, addressing the adverse impacts of environmental pollution and climate change, and achieving synergies between public and private investments. However, there are several impediments to linkage investment, both vertically and horizontally across levels of government, including:

Legal constraints to linkage investment: The State Budget Law (SBL, 2015) does not include institutional mechanisms for vertical and horizontal coordination. On vertical coordination, the laws generally assign projects of national or inter-provincial scope to ministries. However, the nature of interprovincial investments and respective responsibilities are not clearly defined. The State Budget Law also provides a general description of responsibilities in infrastructure services without adequate consideration of resources and incentive mechanisms to ensure these services are provided. The result is underinvestment in infrastructure networks, particularly those with interprovincial characteristics. On horizontal coordination, the State Budget Law is not conducive to coordinating across spatial or sectoral jurisdictions. For example, the State Budget Law (Article 9) explicitly bans the transfer of investment funds from one province to another, even in cases where the benefits of cross-provincial projects are evident. Although the intention of the legal framework is to maintain fiscal discipline, such a strict rule creates a financing gap for regional projects.

Institutional challenges in coordination: Vietnam has pursued several approaches to regional investment coordination since the early 2000s, however, none has produced the expected results. From 2002 to 2020, several efforts were made to establish steering committees for selected regions, such as in the southwest (2002), Central Highlands (2002), northwest (2004) and most recently, the Regional Coordination Council for the Mekong Delta region (2020). However, these experiences suggest that the challenges cannot be addressed exclusively by coordination councils without addressing the real legal and financial constraints and disincentives to realize regional investment needs (see Box 2.2).

Lack of effective linkage investment and financing mechanisms: The modality of "public investment program" is included in the Public Investment Law (PIL, 2019),[97] but not elaborated nor utilized effectively in practice. This modality could connect the players vertically and horizontally. For domestic resources, the only mechanism for such vertical linkages is through National Targeted Programs (NTPs). From 2011 to 2021, the government has reduced the size of targeted (or conditional)

[97] Article 4, item 8: "Public investment program refers to a combination of goals, duties and solutions designed to carry out socio-economic development objectives."

transfer schemes in terms of expenditure (from 9.1 to 2.8 percent of total expenditure) and in terms of their number (from 16 NTPs and 45 smaller targeted programs to three NTPs and several on-granting schemes).[98] There is ongoing debate on the adequacy of size and institutional structure for NTPs to better link resourcing to targeted results. For external financing, governed by the Public Debt Management Law (PDML, 2017), the co-financing arrangement was introduced in 2017.[99] Provinces have been categorized into five groups, depending on their fiscal capacity measured by the level of dependency on central budget transfers, with respective co-financing ratios. However, the programmatic mechanism that connects the central budget and multiple provincial budgets (the so-called "umbrella projects") was removed in recent years due to concerns over its complexity.[100]

Box 2.2. Coordination and investment challenges in the Mekong Delta region

Even in regions, such as the Mekong Delta, championed by the government and development partners, progress in promoting horizontal and vertical coordination has been slow and piecemeal. In the Mekong Delta, after significant efforts to strengthen regional coordination institutions, initial results were achieved with the establishment of the Regional Coordination Council (RCC) in 2020, a regional data center in 2022 and the Integrated Regional Master Plan in 2022.

As per Prime Minister's Decision 825 (2020), the focus of the Mekong Delta RCC, with representation from all regional provinces and key sectors, is to support development and implementation of inter-provincial investments that promote climate smart and sustainable economic transformation of the region. After two years in operation, the council has yet to receive sufficient authority and resources to intervene in planning processes. Similarly, engagement in implementation processes is dependent on the executive authority of the government, both local and central.

In 2019, the Prime Minister issued Directive 23 with the promise to provide additional targeted transfers of US$2 billion to the region on top of balancing transfers for 2021-2025. As a result of ambiguity in relevant laws, it took almost another four years for the government and concerning provinces to discuss and agree in principle on priority investment projects for the package and respective expenditure assignments between central and provincial budgets. Finally, a co-financing ratio of 90:10 between central and provincial responsibilities was decided on an ad-hoc basis, different from the applicable on-lending ratio of external financing. It will expectedly take more time for the investment decisions to realize.

With provincial governments holding the lion's share of public investment resources, the central government leverages co-financing from richer provinces to undertake infrastructure projects that are regional.[101] The recent approval by the National Assembly of Ring Roads No.3 and 4 demonstrates the importance of such vertical coordination—albeit still on an ad-hoc basis—for nationally

[98] Source: World Bank staff calculations based on MoF and MPI websites.

[99] Through Decree 52 (2017), which was subsequently replaced by Decree 97 (2019) and supplemented by Decree 79 (2021) on ODA and concessional lending.

[100] This mechanism was stipulated in Decree 38 (2013) then removed in Decree 56 (2020) and Decree 114 (2021) on the management and utilization of ODA and concessional financing.

[101] Within this context, when regional projects need to be financed and undertaken by provinces, the case is to be made to the National Assembly, which in turn needs to issue a resolution to make a special case to adjust MTIPs.

important projects.[102] However, such ad-hoc decision making process raises concerns over the potential inconsistency related to co-financing ratios between central and local governments. Additionally, other inter-governmental PIM mechanisms—such as revenue mobilization, on-lending of domestic financial resources from central government to SNGs, joint procurement/contract management, and O&M responsibilities—are unclear.

Climate change largely absent in fiscal and investment decision

Climate change adaptation is not fully accounted for in the overall fiscal strategy nor in prioritization of projects for budget funding. The high-level policy commitment by the Prime Minister at COP26 (net zero by 2050) and the Green Growth Strategy until 2030, vision 2050 (approved by the Prime Minister in 2021) and action plans are yet to be associated with credible estimates by either the MoF or MPI of their fiscal implications. Thus, there are insufficient numbers of green and disaster/climate-resilient infrastructure investments. On the other hand, most budget allocations include funding for complementary measures to make projects more sustainable and resilient, and a contingency for unforeseen circumstances, including climate-related events.[103] Additionally, SNGs are least prepared to assess and mitigate physical and transition risks of climate change on investments and assets as they lack policies and processes. The lack of information on the value of assets and their risk exposure increases the cost of SNG's insurance. To ease some of these challenges it would help to digitize these core public finance and asset management functions and engage in more proactive risk management.

Transboundary development challenges are emerging more frequently, and with more severity, and require coordinated actions across different levels of government. These include issues such as climate change mitigation and adaptation, ground water overexploitation, surface and groundwater pollution, waste and air pollution, aging water supply infrastructure, emerging water-sharing conflicts, and increasing drought and flood events. In many cases, industrial plants, plastic waste, submersion of dredging materials in upstream provinces pollute waterways creating serious negative externalities for downstream provinces, but efforts have failed to deal with the polluters.[104] For instance, in the central coast region, Danang city has sent multiple complaints to Quang Nam province and to the Prime Minister regarding problems created by changes in water flows, which exacerbate floods during heavy rains upstream and cause drought in downstream areas in dry season.[105] While the estimated cost of addressing this issue in Quang Nam (upstream) is US$50 million, downstream in Danang the estimated cost of the flood risk management has ballooned to more than US$350 million.[106] However, as

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[102] Ring Road No.3 (76km) connects four SNGs (Ho Chi Minh City and Dong Nai, Binh Duong and Long An provinces in the Southeast region) and Ring Road No.4 (113km) connects three SNGs (Hanoi city, Hung Yen and Bac Ninh provinces in the Red River Delta region).

[103] While the Ministry of Natural Resources and Environment updated the national climate change and sea level risk scenarios in 2021—which alerted even more threats to low land and coastal areas—it together with sectoral ministries have not issued any guidelines for applying the scenarios in sectoral strategies and investment design for projects. Given the increasing uncertainties, a different approach—that is flexible and adaptive—is required for risk management in spatial planning, and design and management of investment projects. However, this is currently being confused with the ministry's role in reviewing project environmental impact assessments. Therefore, an adaptation framework is not applied in practice.

[104] For example, in 2017-2020, the northern provinces revealed 45 businesses as the highest polluters and requested their closure or employment of more advanced technology. However, 10 years after the establishment of the Basin Protection Committee, only 64 percent of the polluters had adopted pollution mitigation measures.

[105] Small and medium scale hydropower plant development master planning in the central region (Tuoi Tre News, 2019).

[106] Resilient Shores: Vietnam's Coastal Development between Opportunity and Disaster Risk (World Bank, 2020)

discussed above, the current PIM and IGF systems are unable to prioritize and implement these kinds of transboundary resolutions and investments.

General weaknesses in appraisal methods mean limited attention is paid to the specifics of climate change risk and adaptation. These shortcomings in the appraisal process, particularly the absence of systematic methodologies like social cost-benefit analysis, have already been identified earlier in the section discussing the PIM challenges. This weakness means there is no formal methodological basis for evaluating climate change impacts of projects and respective mitigation efforts or evaluating alternative adaptation options in response to identified climate change risks. Project appraisals for large projects require environmental impact assessments. Notionally, in relation to climate change and responses, this should consider both the impacts of and on the project. While procedures for construction projects in the Construction Law and supporting regulations recognize the need to consider climate change risks and adaptation, there is no regulatory requirement to examine climate change risks early in project preparation, such as during preparation of the feasibility study and appraisal, when it is more efficient to develop, analyze, and integrate adaptive responses.

IV. RECOMMENDATIONS

Going forward, Vietnam will need to sustain its level of public investment, rationalize its composition, and enhance the efficiency and effectiveness of PIM and IGF institutions. To achieve these goals, the government may consider the following:

First, it will be critical to improve project planning and appraisal, as the low 'quality-at-entry' has fed through to implementation and adjustment where they become apparent in cost overruns and delays. Recommended reform actions include providing more time and budget to prepare project Pre-FSs and updating Medium-Term Investment Plans on a rolling basis. Unit costs and land prices should be regularly updated closer to market prices to ensure cost estimates are realistic. In addition, providing methodological guidelines to prepare project Pre-FSs, both generic and sectoral, should be elaborated for the application of social cost benefit analyses and other complementary or supplementary tools and for the total costs for the entire project lifecycle to be estimated in project proposals. In order to enhance climate resilience of the country, climate change screening should be mandated from the early stage of investment policy and associated adaptation measures should be evaluated in both the Pre-FSs and feasibility studies of projects with high risks.

Second, it will be equally important to enhance project implementation and M&E for efficient conversion of capital spending into infrastructure once the resources are allocated. Separating land clearance and resettlement from the investment project could help accelerate implementation particularly for large projects. Effective project adjustment and termination measures should be informed by a systemic mechanism for central ministries and provinces to identify projects with a high risk of delivery failure and through streamlining steps. The use of satellite and GPS data should be explored further to analyze and make decisions. And the scope and depth of ex-post assessments of projects should be increased, at least for all large and medium projects.

Third, public asset management should be strengthened for more effective spending and revenue measures. A foundational step would be to establish a database of all infrastructure assets with their values and employ technology applications and data analytics for budget allocation decisions for O&M and new investments. Reforms on infrastructure asset accounting and reporting should be phased in methods for more accurate asset valuation and presentation of amortization and depreciation expenses.

Fourth, the budgets should be made more strategic and programmatic. This includes improving budget classification and presentation structures, and operationalizing "public investment program" modality as stipulated in the PIL more efficiently to facilitate policy orientation (including regional development, green transition, and climate resilience).

Finally, intergovernmental fiscal and investment institutions should be modernized. SNG own-source revenue assignments, revenue sharing arrangements, and equalization rules should be rationalized to better balance the needs of central government and SNGs. The SNGs include the dynamic provinces that act as growth engines and the poorer provinces. Unlock legal impediments in the State Budget Law to inter-linked public investment across levels of government will help enhance investment synergies. Mandates of Regional Coordination Councils should be extended to setting investment priorities in line with regional masterplans. New co-financing mechanisms should be institutionalized based on a well-defined formula that integrate external and domestic financing considerations into a holistic framework. Finally, fiscal mechanisms and incentives should be provided to enable green and climate actions across levels of government, such as ecological fiscal transfers and payments for ecological services.

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