

The roadmap for using ODA

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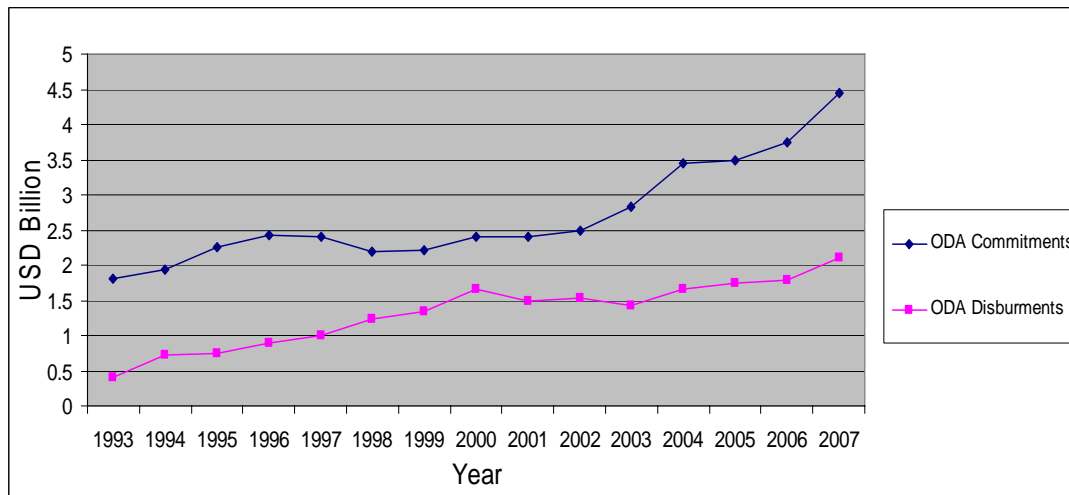
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ODA and its impacts

Vietnam has become an attractive destination for ODA on social and economic as well as political and strategic grounds since 1993. Figure 1 indicates that the flow of ODA is trending upward, but it is not always growing. The decline in commitments in 1997 and 1998 was a reflection of the Asian financial crisis. During 1993-2007, Vietnam achieved significant results in ODA mobilization and utilization. A total of 37 billion USD was pledged to Vietnam by international donors, accounting for around 2% of global ODA. Of these pledges, 22.6 billion USD was translated into formal agreements. On average, Vietnam has attracted 2.5 billion USD per year.

Figure 1: Commitments and Disbursements of ODA 1993-2007

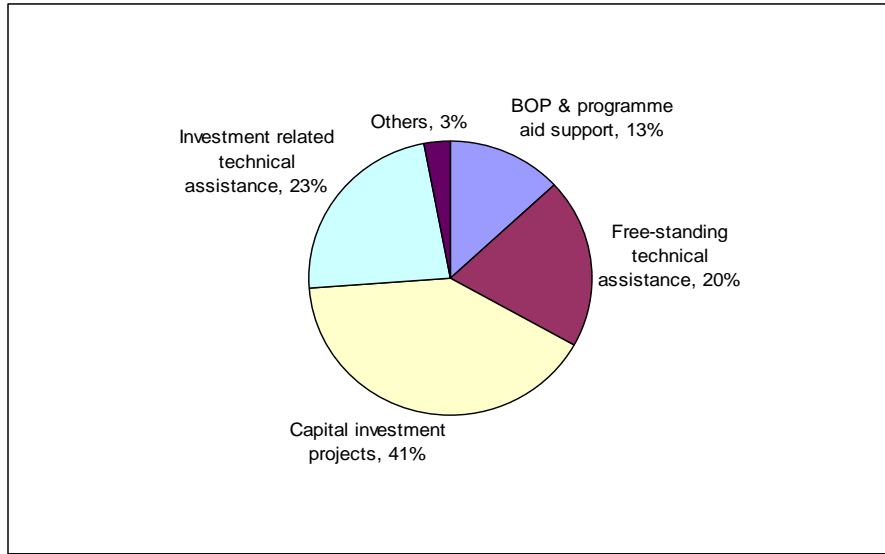


Source: MPI

As illustrated in Figure 1, ODA disbursements increased more than four times between 1993 and 2007. Most of the long-term increase in disbursements is accounted for by loans rather than grants. Almost half (49%) of the loans affected by international treaties have interest rates lower than 1% per annual and a maturity of at least 30 years, of which 10 years grace period. Another third of the loans are with the rate of interest between 1% and 2.5% per annual (MPI, 2007). Moreover, the large share of loans in ODA should be considered in the light of Vietnam's limited external indebtedness. The country's total convertible currency debt was 37% of GDP in 2007 (MPI, 2007), so it would appear that there is no imminent danger of debt crisis in Vietnam.

ODA has been dominated by capital investment projects (41%), but with a substantial volume of technical assistance (23%) and free-standing assistance (20%). Only 13% of disbursements in 2005 were for programme aid and balance of payment support (see Figure 2).

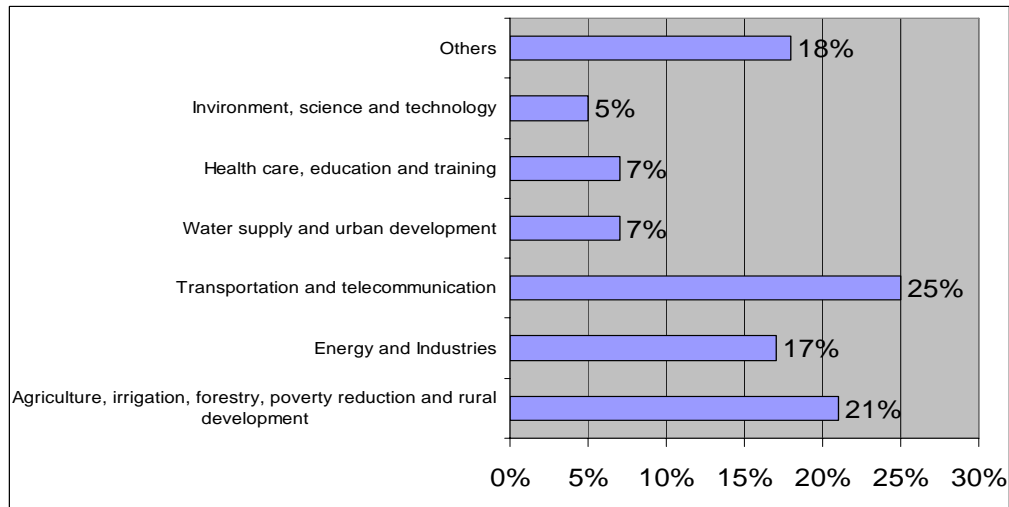
Figure 2: ODA Disbursement by Type – 2005



Source: MPI

ODA funds have mostly been allocated in accordance with the priority that the government places on economic sectors. The predominance of project ODA is commensurate with the sectoral focus shown in Figure 3. Transportation, telecommunication, energy and industries, with their scope for large infrastructure projects, are the largest sectors (42%), followed by agriculture, natural resources and rural development (21%), and with much less ODA allocated to education, training, health care, environment and technology (12%). All the other sectors received about 18% of disbursed ODA.

Figure 3: Sectoral Composition of ODA Disbursements, 2001-2005



Source: MPI

ODA has contributed a significant investment source to social-economic development. In the 2001-2005 period, ODA accounted for about 11% of total investments and 17% of total

government budgets. Thanks to ODA funds, development has been made in many aspects of the economy, including poverty reduction, human resources development, transfer of technical, managerial and institutional experiences, and institutional capacity.

One question needs to be answered is: why has Vietnam attracted ODA so much in recent years? There are some main reasons for this question. First, Vietnam has had stable political conditions and comprehensive social and economic reform which lead Vietnam to become one of the aid community's favorite countries. Second, Vietnam has benefited from its impressive track record of rapid growth and poverty reduction at a time when aid doctrines focus more explicitly on poverty reduction and there is more willingness to concentrate aid on those countries that seem to use it well. Third, the active integration into the global and regional economy, the dynamism of the economic and administrative reform process, and the Vietnamese government's willingness to engage with donors have reinforced donor enthusiasm.

From recipient perspectives, ODA is considered as a real resource if it is effectively combined with other domestic resources in order to achieve national targets in certain periods. From donor perspectives, ODA becomes a real aid if it is transferred to recipients to create directly or indirectly conditions for development. From both perspectives on ODA and its impacts, it can be stated that ODA in Vietnam has been a real aid in the renovation process. However, besides the success in ODA mobilization and utilization, there are still many issues that Vietnam has to solve in order to use this important resource more effectively in the future.

Current issues of ODA

The efficiency of ODA use

Improving the efficiency of ODA use is one of the most important issues that Vietnam has to solve. One of the main reasons of the inefficiency of ODA is that awareness and understanding about the nature of ODA have not always been accurate and complete in the mobilization and utilization. Perceptions are made that ODA grant is free and the burden for repayment of ODA loans is with the government. This incorrect perception has led ineffectiveness in the implementation of ODA projects and programs. In fact, although most ODA is in the form of concessional foreign loans with low interest rates, long payment periods and grace periods, ODA is not free and therefore using ODA is a trade-off. If ODA is not used effectively, the burden for ODA repayment will be increased. On the other hand, the combination of ODA funds and other investments is still weak and therefore reducing the efficiency in using ODA.

Disbursement

The rate of ODA disbursement is still slow. From 1993 to 2006, ODA disbursement is 15.9 billions USD, accounting for only 42.9% of total ODA agreements (37 billion USD). As shown in Figure 1, on average ODA disbursement rate is about 50% in recent years. The average rate of ODA disbursement in Vietnam is also lower than the disbursement rate of ASEAN (see Table 1). ODA as a proportion of GDP in Vietnam is ranging from 3.5% to 4.5%, lower than some countries with the same economic development¹. Vietnam needs to exert more efforts to push up the disbursement because in comparison with the increasing

¹ See Vietnam Economic Times (2006)

total commitments each year, the result is far the expectation. As forecasted by some ADB experts, if Vietnam improved its ODA disbursement rate, the country's growth rate of GDP would be raised from the current 8-8.4% to close to 9% and the country might achieve middle-income status by 2009, earlier than its target of 2010.

Table 1: The rate of ODA disbursement in Vietnam and some ASEAN countries² 2001-2005

Donors	The average rate of ODA disbursement in some ASEAN countries	The average rate of ODA disbursement in Vietnam
WB	18 % per year	15 % per year
ADB	20 % per year	18 % per year
Japan (JBIC)	15 % per year	9.3 % per year

Source: MPI

There are several reasons to explain why ODA program and project implementation was delayed. First, very often it took a long time for ODA projects and programs to get off the ground. About 50% of ODA sources in Vietnam to infrastructure projects, which need more time to implement and even finish three or five years longer than projects in other sectors, also leads to the slow disbursement. Other developing countries, for example those in Africa, used only one-thirds of ODA for infrastructure projects and had higher disbursement rate. Second, the ability of Vietnamese personnel to manage ODA projects and programs, particularly when it came to local government involvement, was disappointing. Third, existing investment and construction, bidding, management and ODA utilization laws are inconsistent and are inconsistently interpreted. Furthermore, the difference in manner between Vietnamese personnel and international donor implementation of projects was oftentimes great and this hindered project implementation. At a recent Vietnam Donors' Consultative Group Meeting (2007), Vietnam's donors said that ODA disbursement would improve markedly if there was some harmony in the way the Vietnamese government and international donors choose to function.

Institutional arrangement and human capacity

Institutional arrangement and human capacity for the management and implementation of ODA are still weak and have not yet met the requirements for improved ODA effectiveness. The recent leakage and corruption in PMU 18 and in big projects of petrolimex are examples of the weak ODA management and monitoring. According to a survey by CIEM and JICA (2003), most participants in the ODA delivery process expressed the view that internal Vietnamese procedures for project appraisal and approval of new projects were complicated and generally not harmonized with donors' practices. A government decree aimed at redressing this problem was seen by many as having seen so far been insufficiently implemented. A remaining challenge is to ensure transparency and accountability of aid management on the Vietnamese side.

² ASEAN countries in this table include Thailand, Malaysia, Indonesia and Philippine.

Decentralization

Decentralized organizational structures for the management and utilization of ODA have been implemented and achieved significant improvements, such as the expansion of ODA beneficiaries or the respect of leadership and ownership of local governments. However, the decentralization of ODA has not met the requirements of the reform in public resources management. Decentralized policy in ODA management and utilization is not consistent between the central and local governments. Limited capacity of the local government staff in projects management and language skills is a factor hindering the ODA decentralization and the effectiveness of many ODA projects. Poor coordination between the central government and the local government, between the government and donors leads to delays in various steps of project design and implementation. This is the kind of situation that can easily lead to waste and inefficiencies. In order to improve ODA effectiveness, a greater investment in capacity building in local administration and management will be necessary.

Repayment

Repayment prospect of ODA is an issue that Vietnam needs to be concerned from now on. In Vietnam, the focus of ODA mobilization has been mainly on attracting as much as ODA with easy conditions, but the aspect of repayment resources and capacity has not been paid much attention. According to data from MPI, the total debt of Vietnam is currently around 22 billions USD and accounts for 37% of GDP. With the safe level of 40% of GDP advised by IMF, the loan capacity of Vietnam is not much. Therefore, Vietnam needs to consider the source of repayment, and the effective use of ODA becomes more important for ODA repayment.

Table 2: Total convertible debt of Vietnam

	2000	2001	2002	2003	2004	2005	2006
Total debt (billion USD)	11.8	11.9	11.8	13.3	16.7	18.9	22.2
As % GDP	39	37.4	34	34	36.8	35.8	36.6

Source: MPI

The use of ODA with regional development approach

The use of ODA is still not fully consistent with regional development approach with large infrastructure as core. Since infrastructure development was one of the top priorities in the Vietnamese development plan, the largest amount of ODA has been allocated in this area. However, many of the approved ODA are behind the schedule and have not been completed yet due to various causes. Given the fact that domestic private participation in infrastructure has been negligible, ODA should not only focus more extensively on infrastructure, but should also be based on long term economic strategy.

The roadmap for future use

In the 2008-2010 period, the direction for ODA is to continue utilizing funds with attention made to ODA effectiveness and payment capacity. The focus of this period is to accelerate the disbursement of signed ODA projects and programs in order to put their outputs into operation and enhance ODA effectiveness. In order to ensure aid effectiveness, ODA projects

and programs should be utilized based on the national, local and sector socio-development plans. Beneficiaries should also mainstream ODA projects and programs in their socio-economic plans. The following priorities in ODA utilization should be given for ODA projects and programs in this period: Agriculture and rural development; economic infrastructure development toward standardized and modern approach; social infrastructure development; environment and natural resources protection; institutional capacity and human resources development; and technology transfer, research and development capacity building. In addition, Vietnam will need to prepare effective and high quality projects that continue after 2010.

In the coming years, the demand for infrastructure development is still large to support the continuous increase in expected industry production. In addition, the internal rates of return from road, bridge and power generating projects have been so high that further allocation of funds into this area is justified. The Vietnamese government has the objective of having the industry sector absorb a larger portion of the labour force and of decreasing the ratio of population in the agricultural sector significantly. According to this economic structural change, ODA strategic approach is necessary. On the one hand, the infrastructure development, especially transportation, telecommunication and electric power sectors, is assigned one of the top priorities. Therefore, Vietnam should continue to use and attract ODA to these sectors. On the other hand, ODA should be allocated to prioritized areas, especially poor and difficult areas. The priority use of ODA in infrastructure and prioritized areas is necessary to maintain sustainable economic growth and to reduce poverty.

Vietnam is moving to commercial loans after 2010. According to international practices, a developing country classified as having middle-income status (GDP per capita of over 1,000 USD) receives less preferential ODA funding sources. By 2010, GDP per capita of Vietnam is planned to reach 1,050 USD. When that time arrives, donors will likely wish to raise the ODA amount they would wish to loan to Vietnam. In the meantime, Vietnam needs to make better use of the ODA loan capital it is now receiving. On the other hand, Vietnam becomes one in which more people are living with medium level incomes, new problems arise. In fact, in some countries such as the Philippines or Sri Lanka no improvements were seen after medium income levels were attained. Therefore, Vietnam should not follow in their footsteps. Instead, Vietnam needs to follow through with its own strategic framework, particularly regarding mobilization and utilization reforms. Capacity building for future needs is also of paramount importance, particularly institutional and human capacity.

When Vietnam becomes a middle-income economy, the proportion of concessional ODA will be reduced, and ODA with conditions closer to commercial loans will become more common. Therefore, it is necessary to built active plan for reducing ODA loans after 2010. In addition, the experience of using commercial loans needs to be examined in order to prepare for effective mobilization and utilization of these sources of funds after 2010. To utilize those sources of funds, the appropriate direction for using ODA is necessary. In particular, while ODA loans with concessional conditions should primarily be used for construction of national socio-economic infrastructure, ODA loans with less favorable conditions should be utilized for sectors and areas with high financial returns and sustainable debt capacity.

As the structure of ODA will be changed and ODA can be delivered through a variety of modalities, the use of a particular modality should be based on the specific requirements of the development challenge to ensure aid effectiveness. Moreover, Vietnam will need to promote the application of new aid modalities such as approach based on program, sector and

budget support. These new modalities will strengthen government ownership, reduce transaction costs, enhance harmonization between government and donors, and accelerate disbursement of ODA projects.

Policy measures

The rationale for a continuation of ODA to Vietnam remains strong. In order to use this important resource more effectively in the future, Vietnam should implement the following policy measures.

First, *enhance the awareness and understanding on the nature of ODA*. ODA should be considered as a catalyst, rather than substitute for domestic resources for development at all levels of beneficiary. It is also important to improve ownership in the mobilization and utilization of ODA to serve social-economic development of the nation, sectors and localities and to encourage effective use of ODA.

Second, *use ODA selectively*. It is important that ODA is used selectively in an appropriate combination with other investment resources. In fact, the major policy debates are no longer on whether or not to allow ODA, but how maximize the benefits of ODA for the country. Therefore, the quality of ODA mobilization is more important than the quantity of ODA. This means that using ODA needs to take into consideration socio-economic factors and carefully assess benefits from transfer of capital resources, knowledge, technology, management skills and international experiences.

Third, *speed up ODA disbursement*. The demand to increase the speed of ODA implementation is responsibility of both the Vietnamese government and donor community. From the Vietnamese side, the government should simplify ODA rules and procedures. From the donor side, harmonization and simplification of aid procedures with the Vietnamese government are also needed to ensure effective implementation progress. As said by WB country director Ajay Chhibber at the Vietnam Consultative Group Meeting (2007) “It is also common for the donor community to look at Vietnamese system and not always insist on using their own system for project implementation”.

Fourth, *maximize the effectiveness and widespread impacts of ODA*. The mobilization and utilization of ODA must be based on benefit-cost analysis of projects and programs to ensure that these projects and programs have high effectiveness and maximum widespread impacts which contribute to economic development. It is important that ODA should not be spread too thinly, resulting in an unsustainable foreign debt burden for the country. The effectiveness of ODA must be put in relation with economic growth and sustainable development. Moreover, national, sector and regional social-economic development strategies and master plans must be taken into account in order to enhance the effectiveness of ODA.

Fifth, *extend the beneficiaries of ODA to private sectors for projects and programs that serve public interests*. The broad participation of beneficiaries is an important way to ensure that the right interventions are selected, that ODA funds are used in an accountable, transparent and effective manner, and that the waste, leakages and corruption are prevented.

Sixth, *build an appropriate plan for ODA decentralization*. The decentralization in ODA management and utilization is an inevitable and common trend in the world and in Vietnam

as well. The point is that Vietnam should consider which the level of ODA decentralization is suitable and which ODA project is decentralized. From this perspective, experiences of ODA decentralization, which has been carried out, need to be examined. A criteria system for ODA decentralization which includes the duration and costs of projects, the capacity of ODA management and the effectiveness of projects, also needs to be developed.

Seventh, *strengthen the monitoring and management of ODA*. This includes: (i) ensuring the consistency, clarity, simplicity and transparency of the legal system on ODA management and utilization, (ii) reinforcing the government's anti-corruption efforts, (iii) accelerating administrative reforms and the effectiveness of state administration, (iv) enhancing professional training and retraining for project management officers, (v) improving financial policies for ODA which include implementing foreign debt management strategy and ensuring clear and transparent tax policies for ODA projects and programs; (vi) strengthening the management of ODA according to the Law on state budgets.

Eighth, *build plans to reduce ODA loans with short payment period and strict conditions*. Experiences from some Asian countries such as ASEAN and China show that the quantity of ODA mobilization depends on the degree of economic development in certain period. ODA is likely to decrease in ASEAN in both quantity and in per capita. Vietnam should begin to study plans and strategy to reduce gradually ODA, especially ODA with conditions, with attracting other foreign investments such as FDI. In doing so, Vietnam not only maintains an increase in total investments, but also improves the efficiency of all types of investments, including ODA.

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