SUMMARY REPORT OF THE ASIA PACIFIC INFRASTRUCTURE PARTNERSHIP (APIP) DIALOGUE HELD WITH VIETNAM GOVERNMENT OFFICIALS AT THE MINISTRY OF FINANCE HANOI, VIETMAN 20TH JULY 2012.

Introduction:

A highly constructive dialogue involving senior Vietnamese officials from five departments of state responsible for PPPs and APIP panel members was convened at the Ministry of Finance, Vietnam. Mr Trung, Vice Minister of Finance opened the dialogue on behalf of the Vietnam government and Mr. Yoshihiro Watanabe led the APIP delegation in the absence of APIP Chairman, Mr. Mark Johnson. Participation lists of the Vietnamese officials and APIP panel members are attached together with the Dialogue Agenda.

The panel was advised of Vietnam's policy commitment to PPPs and the wide range of sectors identified as being important for PPP development, including roads, bridges, tunnels, railways, urban transport river ports, airports, fresh water supply systems, power, health care and the environment. Decree 71, issued in November 2010 provided for the adoption of pilot PPP projects, based on criteria, including large scale, urgency to support economic development, reasonable return on capital, use of technology and managerial and operational efficiency, the effective use of the financial capacity of the private sector and other criteria as determined by the Prime Minister.

The Decree provides for the State to finance projects up to a maximum of 30% of overall costs, although it will not take an equity interest, and the private sector would contribute 70%. In certain circumstances the Prime Minister could authorise higher State contributions. Ministries and equivalent bodies, the people's committee of a province or a city under central authority could enter into project contracts. The expectation is that the new PPP model would mobilise capital, although it was noted that the domestic financial market is not sufficiently developed, and various mechanisms need to be considered.

Recent major developments included the establishment of a PPP Task Force and a PPP Office under the Public Procurement Agency (established in March 2012), which will the focal point of PPP activities in the Ministry of Planning and Investment. A Steering Committee will be headed by the Deputy Prime Minister. Preliminary screening of more than 30 projects proposed by different authorities revealed a need for improved analytical capacities to demonstrate investment viability. Donor groups are expressing interest, including by the ADB, AfD (a French aid agency), USAID and DFIF of the UK; technical assistance is being provided and a loan approved to develop a Project Development Facilities (PDF Fund) to support project preparation, feasibility studies and the hiring of transaction advisors.

Differences were noted between Decree 108 relating to BTO and BOTs, and Decree 71 relating to Pilot PPPs. The former is regarded as the traditional process, while the latter provides for a more flexible approach to project development and financing. Consideration is being given to more closely align processes under Decree 71 with international practices. Greater cooperation between relevant departments, in particular MOF, MPI, the State Bank and line ministries in implementing PPPs will contribute to smoothing the implementation of Pilot projects.

Legal matters will come under scrutiny and this should raise the confidence of investors, and competencies in relevant agencies. Issues requiring clarification included policies in relation to foreign exchange, the measures necessary to establish Viability Gap Funding and cooperation by MOF with the financial markets to help make markets more responsive to long-term funding needs, and to build confidence in investment in infrastructure.

Various financing mechanisms and incentives are available to facilitate project finance, including tax incentives, government responsibility for land acquisition, loan guarantees, foreign currency purchasing rights, incorporated in earlier decrees relating to BT, BOT and BTO forms of procurement. The PPP decree provides for viability gap funding by the government, up to 30% of the value of a project. However, there is limited finance availability and the State budget is constrained.

Loans outstanding by the State commercial banks and joint stock banks represented nearly 100% of gdp but they are mostly short and medium term commercial loans. Institutions providing concessional credits and finance for infrastructure include development banks, Local Development Investment Funds with varying degrees of maturity and interest rates. Non-State sector institutions are reluctant to provide guarantees and the capitalisation of the capital market is relatively small, around 30% of gdp, liquidity is weak and corporate bonds outstanding are only around 2.5% of gdp. Private sector institutions are reluctant to provide guarantees.

Key issues considered in the dialogue:

- what financing measures will best ensure bankable projects

Specifically, the dialogue focused on:

- private investors' preferred form of State financial support to attract foreign investors
- preferred forms of Viability Gap Funding mechanisms eg. cash contributions by the State, revenue guarantees and/or repayments for services provided by the project organisers, and
- the maturity of Vietnam's financial markets in attracting foreign capital into PPP projects

Panel members drew on their various experiences both in Vietnam and in other economies. Based on the power sector in Vietnam and the involvement of the Japan Bank for International Cooperation (JBIC) in two projects, involving equity investment by Japanese entities, the lessons learned were,

- a PPP agreement needs to carry a guarantee by the government
- the government needs to provide assurance that foreign exchange will be available to cover the foreign exchange needs of investors and, as appropriate an assurance for the supply of coal (for coal fired power projects)
- Japanese trading houses will not participate in project development without the involvement of JBIC and the guarantees noted above.

- ***what other factors are relevant to financing PPPs?***

Foreign investors are now looking more seriously at investment opportunities in non-grade economies in Asian markets. Where manufacturing companies consider equity investments in foreign markets, and there is an opportunity to associate with physical infrastructure in say ports, rail and transport systems of relevance to products they might manufacture in and export from an emerging market, the prospect of monetising an investment in infrastructure may well be attractive.

Investors usually determine a minimum size of around $100 mn. in allocating funds to an emerging market. Governments could consider pooling small projects into viable investment vehicles.

Project Development Funds have proved useful vehicles; in Florida for example, a PDF supports feasibility studies for a project.

Viability Gap Funding arrangements in India, Colombia and South Korea variously assist in meeting funding gaps through guarantees and through other forms. Mitigating default risk by a line of credit enables an asset which would otherwise cease to function, to continue in operation to the benefit of a government and private investors.

Long-term debt investors such as pension and insurance funds rarely take on project risks associated with PPPs, but some may invest in airport operations already in play because of the opportunity to enjoy early returns from an investment.

Even large projects may be impacted by changing economic circumstances and it is sometimes inevitable that governments may have to support a project and this may well be preferred to a project going bankrupt.

Funding social infrastructure is a critical matter confronting governments and may well involve the private sector in providing capacity building training programs for specialists, for example in health care. Revenue sharing arrangements may follow the provision of equipment by the private sector to a hospital.

Where a province of municipality in Vietnam may have difficulties in local currency financing the relevant authority could be encouraged to review its existing budgetary expenditure plans and consider a reallocation for a new PPP project. Consideration could also be given to generating revenue streams from non-core activities of a project and which might make a project bankable.

- ***what criteria do investors require in determining to invest in PPPs in Vietnam?***

Investors need to have confidence in the legal framework which should reflect the long-term nature of a PPP, and it is most desirable that government consult with investors. Responsibility for a feasibility study resides with the MPI and if the process does provide flexibility and a practical balance in risk sharing between government and business, the likelihood is that projects would be implemented smoothly.

Investors need to understand a project. Most investors in Vietnam understand the BOT framework as being appropriate for the energy sector where there is limited recourse financing. PPP projects may involve capital recovery over a 25 year period and while there is reference in MOF policies to a 12 year project cycle, it is important to reflect investor perspectives which require a stable cash flow over the actual life-cycle of a project.

- factors that will minimise project risk

It is important that the government issues input specifications so that the private sector can fully understand the needs and objectives of government in pursuing a PPP project. In this way, and through dialogue with the government, the private sector can get a real sense of life-cycle costs. The government should provide:

- sufficient information so that prospective investors are in a position to determine if their involvement is likely to be profitable

- open bidding processes (to ensure value for money) supported by mechanisms that allow for consultations with parties and taking into account in contracts that financial adjustments may be necessary over the life-cycle of a project.

- establish clear principles relating to the selection of key projects and involving a step-by-step approach and collaboration between the State and foreign investors.

It is sometimes inevitable that governments will have to support a project – even major projects where, at inception returns seemed to be high and certain. Governments and private sector financiers may have few options but to maintain an operating asset through difficult financial occurrences. Support may well be a necessary and a preferred alternative to a project going bankrupt.

- financing tools to support PPPs

Each economy is different and no one size approach fits all. It is important to pick from variants available in the market that are most likely to work best for a government. A critical question relates to tariff streams arising from a project yielding value in local currency terms. One way to deepen local currency markets is to promote Development Finance Institutions or an Infrastructure Finance Institution (IFI). Desirably, an IFI should have the following characteristics:

- distinct commercial objectives to lend for infrastructure
- initially, it is likely to require budget support
- a capital base against which to borrow funds
- functions which are clearly commercial with objectives clearly stated
- rigorous KPIs established to require and measure commercial performance
- authorised to borrow capital from the financial system – banks and the capital market, pension and insurance funds and ODA
- perform as a catalyst to draw in finance from various sources
- create a long-term debt financing pool
- authorised to make loans, facilitate syndicated services and it can take equity interests in infrastructure projects.
- issue infrastructure bonds
- tax advantages which can be available to potential investors

An Indian IFI had attracted private sector investors leading to a reduction in the State's capital holding from 70% to nearer 20%.

Conclusions:

The panel noted Vietnam's strong growth prospects and compared these prospects with those facing Japan five or six decades ago. Through the dialogue Vietnam had clearly outlined the issues faced by government as it implements the PPP pilot policy. Building the financial system required a long-term effort but it is essential in mobilising local finance for infrastructure development. Financing Japan's infrastructure over the last five or decades had been based on channelling domestic finance through postal and pension savings into the Government Fiscal Investment and Loan Program (FILP). This had led to a fusion of public/private partnerships. While the system changed in 2001 and finance for infrastructure is now based on funding through the market system, FILP had contributed to stable economic development.

It was noted that a report on the dialogue will be presented by ABAC to APEC Finance Ministers in Moscow in August. Among other things, the report should note the critical importance of PPPs in infrastructure to Vietnam's development and Vietnam welcomed more assistance from research undertaken by APIP. APEC ministers would be informed of the need for further dialogue with APIP and investors would be invited to support PPPs in Vietnam.

This report was prepared on behalf of the Asia Pacific Infrastructure Partnership by Ken Waller, and reflects the author's summary of presentations by and discussions among participants at the Dialogue.

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