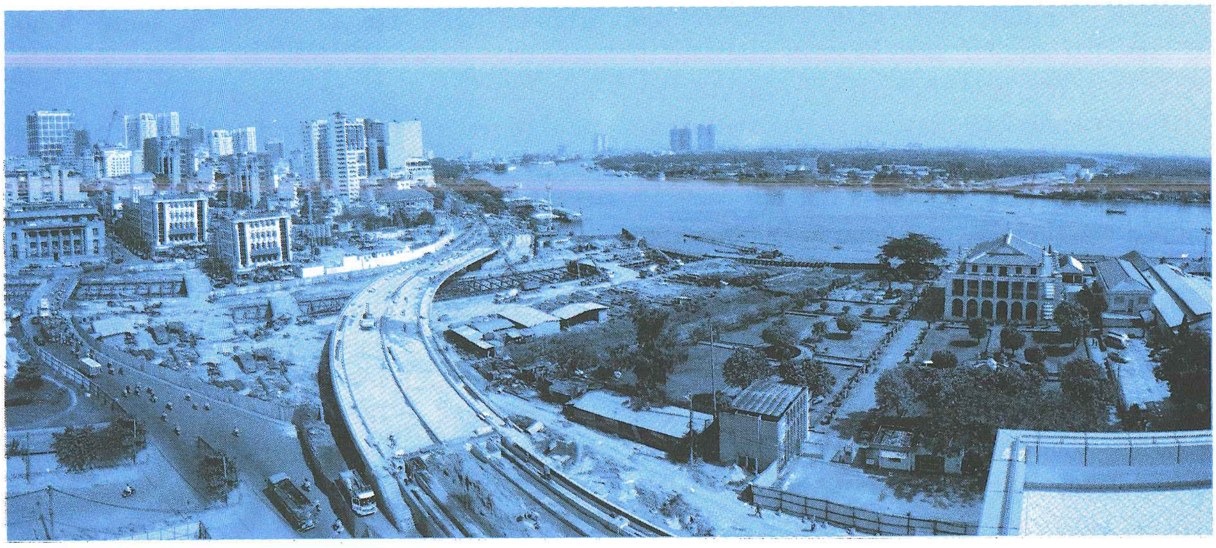

An infrastructure building work in HCMC. Photo: Hòa Tấn

On Possible Improvements in Public Investment

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Introduction

Investment is the only measure to promote socioeconomic growth and development because it creates future added value. In Vietnam today where the private sector is still small and scattered[1],and its resources are not big enough to make substantial investment in key industries, such as infrastructure, power, telecommunications, petrochemical and biotechnology, etc. the public investment become the dynamic of the economy. Badly- oriented and managed public investment supported by the government's stimulus[2], however, may increase the money supply without correspondent increases in the supply of goods and services, which can lead to high inflation and deep recession, and damage to the environment and social life.

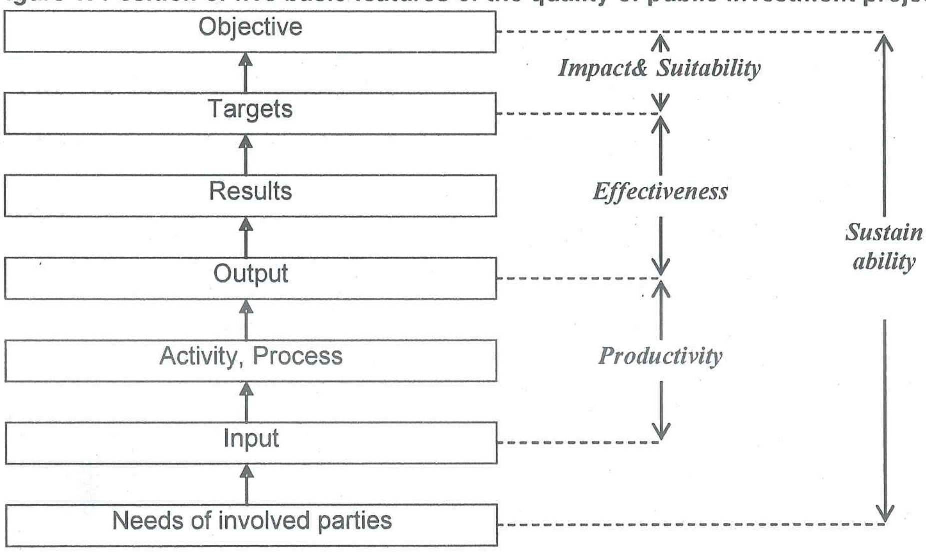
This paper discusses the policy on public investment from the following aspects: defining the concept of quality of public investment; of the making and evaluation of the public investment projects; and establishing the PPP[3]. This paper is limited to investment projects by the central and local governments only and doesn't mention the ones financed by foreign governments or run by foreign parties. In addition, the paper also discusses measures to beef up state-owned companies and use of capital in the public sector[4].

The paper comprises three sections. The first one tries to clarify the concept of quality of investment by concretizing the quality of investment with characteristics approved by many economists. The second one discusses the quality of project evaluation with a view to explaining why projects of poor quality are still carried out and what damage they cause for the environment and socioeconomic life. Finally, the third section offers measures to beef up the quality of investment project – one of the most basic ways to promote the sustainable development and control the inflation effectively.

1. Quality of public investment

Investment project is a combination of suggestion about organized activities that take place during a period with a defined budget in order to achieve selected purposes. The quality of public investment is a concept comprising the five following features in an investment project

Figure 1: Position of five basic features of the quality of public investment project



financed by the public fund: productivity, effectiveness, impact, suitability and sustainability, Position of each feature in the project is shown in the following figure.

- Productivity reflects performance of the project. It measures the rate in which units of inputs are turned into a unit of output. A project reaches its highest productivity when it uses resources at the possibly lowest cost to produce an expected volume of output. The clearest sign of this feature is the present net value that is as much positive as possible. To achieve this aim, there must be many processes that produce the same output and the one with the lowest cost or highest present net financial value will be selected.

- Effectiveness: is the measure for results and objectives from output of the project.

- Impact: Impact means positive or negative, direct or indirect, accidental or intentional, changes caused by implementation of the project. This concept is related to influences and effects of activities and based on indicators of socioeconomic, environmental and development aspects.

- Suitability: This feature is related to appropriateness of the project to strategic priorities of the country.

- Sustainability: This shows itself in the duration of benefits brought about by the project. Positive effects of the project on the economy can't last long if the project is short-lived. Under current conditions, the sustainability of the project is found in its eco-friendliness and financial efficiency. Considering the sustainability of the project aims at estimating benefits that can last over time after completion of the project. Both private and public investment projects in Vietnam today usually pay no attention to this feature with the result that their "on paper" benefits couldn't last long.

Thus, the concept of the effective investment project only reflects costs and direct benefits of the project, that is, it does not reflects in an overall and reasonable manner expectations of the society as required by the concept of the high-quality investment project. In short, relations between high-quality investment and effective investment is shown in the following formula:

Investment of high quality	=	Effective investment	+	Impact and suitability	+	Sustainability

In Vietnam today, the concept of effective investment is widely used and the effectiveness comprises financial and economic efficiency. To include the sustainability, impact and suitability to economic development strategy of the country, however, the concept of quality of investment is more appropriate.

2. Evaluation of quality of public investment in Vietnam in the past few years

To supervise and evaluate investment in Vietnam, especially projects of public investment and projects financed by the national budget; state capital for development, credits guaranteed by the state and state capital in companies, the MPI issued Circular 03/2003/TT-BKH on May 19, 2003 providing guidelines on this task. According to this Circular, the evaluation of investment comprises: evaluating management of investment; evaluating realization of objectives (evaluation of observance of plans and socioeconomic development objectives), evaluation of completion, and evaluation of efficiency of investment.

Realities show that the evaluation process contains some basic shortcomings:

a. Ways of calculating cash inflows and outflows for evaluation of efficiency are monotonous and unrealistic, which reflects itself in the following facts:

- Not reflecting changes in prices of inputs and outputs.
- Not quantifying latency in implementation of projects and losses caused by this latency. These losses include bank interest and price support from the state. According to the MPI, there were 552 projects that prolonged over four years (Group B) or five years (Group C) in 2008. In the MPI plan to allocate capital for development in 2009, "the public fund is only used for projects in transition, and works that require more investment because of increased prices of inputs."
- Not anticipating impacts of market prices on the cash flow.

b. Lack of a long-range vision of the project from construction to operation and settlement: In basic construction field, many works are damaged and wear down quickly. This fact means that the work was built badly and there was no long-term vision and no reserves for maintenance.

c. Failure to estimate exactly socioeconomic and environmental effects of the project: The following effects are usually not estimated fully: volume of smoke and gases emitted, water and soil pollution, traffic congestion in big cities, inflation rate, per capita plant cover, gender equality, and gap between rich and poor.

d. Discount rate in public investment projects has no theoretical and practical grounds, that is, it is determined carelessly. When using such a rate to work out the NPV, the result, even if it is positive, never reflects exactly the social opportunity cost.

e. The planning task is poorly done at both national and local levels[5] because most plans lack firm arguments, and analyses and predictions of macroeconomic changes in medium and long terms (from 10 to 20 years). This lack makes poor project making and evaluation inevitable.

f. There is almost no assessment after completion of the project. Post-project assessment means considering long-term effects of the project on the socioeconomic life compared with before-the- project period with a view to drawing lessons needed for similar projects in future.

g. There is no army of experts in evaluation of public investment projects. In provincial people's councils and committees, there is no civil servant trained in project evaluation to give advices to authorities.

3. Suggestions

Up to 2010, the total public investment reaches VND1,572.1 trillion equaling the 2008 GDP and 82% of the gross investment in the years from 1995 to 2005 ; and of this sum, the investment from the national budget accounts for the biggest share : 33.43%

Table 1: Structure of public investment in 2006 – 2010 (VND1,000 billion)

Source	Sum	Share (%)
National budget	525.6	33.43
State credit	203.9	12.97
State-owned companies	416.6	26.50
Government bonds in domestic market	220.0	13.99
Others*	206.0	13.10
Total	**1,572.1**	**100.00**

* Others = Foreign capital (including the ODA) + Government bonds issued in foreign markets + Loans by state-owned companies.

Source: (1) Public investment program up to 2010 by the MPI; and (2) GSO.

I suggest here three groups of suggestions for effective use of this capital.

a. On the policy on public investment:

- Up to 2020, top priority must be given to infrastructure projects, especially in the following fields:

+ Communications: The communication system forms the backbone of the economy and its must be upgraded and developed in the two economic centers – HCMC and Hà Nội – and then in others, such as Cần Thơ, Đà Nẵng and Hải Phòng. We have seen bottle necks at local level, and if the system in big cities is not improved soon, we may suffer a bottle neck of national level.

+ Ports: It isn't wise to build too many ports when we need big scale ones evenly distributed along the coastline.

+ Electricity: The power is as important as the communications and Vietnam has suffered shortage of electricity for years. We need a breakthrough in this industry.

- Need for reports on project evaluation: The evaluation requires expertise, a long-term vision and honesty of the evaluator. But above all, there must be clear regulations on the evaluation. In my opinion, all projects of the Group B (as classified by Decree 16/2005/NĐ-CP dated Feb. 7, 2005) must include a logical framework, or Project Design Matrix, that is as follows:

Table 2: Logical framework for a project

	Narrative	Objectively Verifiable Indicators	Means of Verification	Assumptions
Activities (inputs)				
Output (results)				
Purpose				
Goal				
				Preconditions

- Reaching an agreement about definitions of terms relating to investment, and standardizing officials specializing to making and evaluating the projects.

- Rejecting firmly all projects and works inappropriate to the master plan on socioeconomic development, or market trends.

b. On state-owned companies:

Up till now, there are still many difficulties and conflicts in dealing with state-owned companies. They are not only purely economic entities but also «important instruments for the state to direct and regulate the economy and society» and therefore, «the evaluation of performance of state-owned companies must be based on an overall view on economic, political and social aspects.» It's difficult to build, and there is no example of, a set of standards used for evaluating the business performance that comprises all economic, political and social aspects. This means that the government keeps protecting and financing the state-owned companies in years to come.

Need for state-owned companies and groups can be affirmed but the government had better stop providing them with more capital, cut the number of state-owned companies to the bone (the present number of over 1,700 state-owned companies[6] is still too big), and beef up financial control over state-owned groups because their debts are very big while their business performance doesn't match the volume of capital and resource they hold.

c. Others:

- Supporting development of NGOs by placing orders from the government for counterarguments from the public : Counterarguments from NGOs can make public investment projects in particular and public expenditures in general more transparent and realistic.

- Identifying exactly the role of the public sector: Whatever policy on the public investment the government adopts, it's very difficult to control the quality of public investment and sources of inflation if a new concept of the role of the public sector isn't accepted. The role as a dynamic of the public sector can't be denied in emerging economies where the private sector is small and lacks an appropriate business strategy. But it will be wrong to think that the government and public sector can do successfully everything because the government never has enough financial sources, human resource and time to complete everything effectively. Before intervening in a project or a public expenditure program, the government has better answer the following questions:

+ Is it possible to leave this project to the private sector?

+ What are reasons for the government to intervene in this field?

+ How is the effectiveness measured, on paper or in reality?

+ How is economic opportunity cost of the public investment calculated and employed? (Supply of public fund to state-owned groups without taking its opportunity cost or with careless consideration can make the public fund produce effects different from social expectations.)

+ Will this practice produce free riders and inequalities in the public- private relations ?

- Encouraging the private sector to develop:

+ The government had better distribute evenly business opportunities among companies of all sectors instead of saving them for the public one only.

+ The government should attract investors, especially foreign ones with financial strength and business experience by adopting reasonable policies on land rental, taxes, low-interest credit, and support to land clearance, etc.

+ Private investors can be oriented towards major infrastructure projects as subcontractors or suppliers of necessary materials.

4. Conclusions

Poorly managed public investment and indefinite concept of state-owned companies[7] is the main cause of ineffective macroeconomic management that leads to inflation and/or recession.

According to the report by sponsorrs to Consultative Group Meeting for Vietnam in Hà Nội in December 2004, Vietnam has realized rather well the investment but its quality was still low. Regarding the volume of gross investment (ratio of investment to the GDP), Vietnam ranked third among 23 surveyed countries. Regarding the investment quality (shown in the ICOR), Vietnam ranked 43rd[8]. In addition, mechanism for identifying and evaluating public investment projects is poor and weak with a pressure from the target of economic growth, which easily leads to approval of poor-quality public investment projects and programs. This chain of actions produces a dangerous circle that erodes the national financial stability.

It's about time the central and local governments paid more attention to the investment quality instead of its volume to ensure a sustainable development and a healthy public finance ■

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Notes

(1) If a company with a work force of 300 laborers or smaller and a capital of VND10 billion or smaller is considered as small or medium, 96.81% of non-public companies are of this group, while 86% of them have a capital of under VND5 billion (Investigation of companies in 2006 by the GSO).

(2) In 2009, the central government offered a stimulus of VND17,000 billion to investment to cover part of interest rate on loans used for businesses secured by companies of all sectors.

(3) Puplic-Private Partnership.

(4) Circular 03/2003/TT-BKH by the MPI dated May 19, 2003 provides guidelines on supervision and evaluation of investment.

(5) The planning mentioned here implies the master plan on socioeconomic development, the development plan for each industry, the plan on land use, the plan to develop the infrastructure, and the plan to develop investment.

(6) Report and answers by PM Nguyễn Tấn Dũng No. 177/BC-CP dated Nov. 13, 2008 to the session 4 of the NA of 12th term.

(7) State-owned companies are not only purely economic entities but also important instruments for the state to direct and regulate the economy and society (Resolution of the third conference of the VCP Central Executive Committee of the 9th term).

(8) Management and governance, Vietnam Development Report 2005, report by sponsors to Consultative Group Meeting for Vietnam in Hà Nội in December 2004, p. 58.