

A: Investment Concept Title: Australia – Vietnam Transport Development Partnership
Proposed investment start date and timeframe: March 2017 – June 2021
Proposed funding allocation __\$35m_____ Current program fund annual allocation_____\$58m_____
Risk and Value assessment result: ____Low____ Risk / ____Low____ Value
Consultation: MOT, TED and independent reference group
Proposed Design Pathway: DHOM Approval
Draft AidWorks Initiative number:

B: Problem/Issue definition and rationale for investment (Why)
<p>Improving transport infrastructure is a high priority for the Government of Vietnam. Importantly, it has been listed as one of three breakthrough areas in the Government's Socio- Economic Development Strategy required to meet the country's objective of becoming an industrialised country by 2020.</p> <p>Vietnam already has a positive history of using investment in transport infrastructure to drive economic growth and poverty reduction. Across the late 1990s and early 2000s Vietnam invested around 5 per cent of GDP in transport infrastructure and achieved impressive results in improving transport connectivity. However over the past five years, growth in infrastructure investment has slowed to only around 3 per cent of GDP¹. As a result, under developed transport infrastructure is becoming a significant constraint to economic growth and further poverty reduction in Vietnam. Perceptions of quality of road infrastructure in the World Economic Forum's competitiveness index show that Vietnam is perceived to have poorer quality roads than both Laos and Cambodia². While this is not an absolute measure of the quality of infrastructure, it highlights the extent to which Vietnam's transport infrastructure is not fit for purpose for the country's stage of development. Vietnam's infrastructure now needs to evolve in a direction that is better suited to a rapidly developing middle income country, for example by developing expressways to reduce traffic congestion on overburdened national highways and improving urban transport infrastructure to adapt to both rapid urban population growth and increasing car ownership. Poor infrastructure also adds to logistics costs and impacts on the competitiveness of Vietnam's private sector. Compared to some other lower middle income countries (notably Indonesia), Vietnam rates relatively well on this score. However it remains significantly below Thailand, China and Malaysia which it hopes to compete against in the global economy³.</p>

¹ Huynh, The Du, Key Transport Infrastructure Development, Saigon Times, 12/9/2015

² World Economic Forum, Global Competitiveness Report 2015-16

³ World Bank, Engaging the Private Sector in Transport and Logistics Policy Making – Options for Vietnam, 2015

The poor quality of Vietnam's transport infrastructure is also impacting on the government's efforts to reduce poverty, particularly in remote areas where many of the remaining extreme poor people live. In these areas, underinvestment in rural infrastructure is increasing road safety risks as connectivity to national highways relies on crossing numerous small bridges that are not receiving proper maintenance. Anecdotal evidence suggests that some provinces like Lao Cai have funding allocations equivalent to only approximately 10 per cent of their investment and operation and maintenance needs⁴. This also impacts particularly on women who represent a greater proportion of vulnerable road users and as users of the tertiary transport network⁵.

What is causing the infrastructure gap?

Vietnam's infrastructure gap is a result of a number of factors. Government revenues are unable to keep pace with both capital and recurrent spending requirements, and those funds that are available are in many cases being used inefficiently. In addition, institutional constraints are inhibiting other sources of finance, like private and ODA finance, from meeting the gap. These institutional constraints include underfunding for project preparation, risk aversion within the bureaucracy, an absence of rigorous project prioritisation processes and problems of coordination within and between different levels of government.

Risk aversion - A high aversion to risk across the bureaucracy is reducing efficiency, inhibiting innovation and leading to delays in project development. Complex processes and procedures are applied not only in approving new projects but also in applying the necessary variations to existing projects where circumstances change. This includes holding financial delegations at very high levels, such as the Prime Minister personally needing to sign off on all ODA projects valued at more US \$2m. Heavy penalties are imposed when deviating from these established procedures, even where an innovative approach can be shown to deliver better results. The rationale for applying these complex processes is that it limits opportunities for corruption from individual officials, but at the same time it reduces capacity for innovation and makes it difficult for MOT to incorporate international standards in project preparation, engineering approaches or contract management. For ODA projects, anecdotal evidence suggests that this is contributing to only approximately 60 per cent of ODA available to the sector in any given year being spent⁶. This is also holding back the implementation of international standard public-private partnerships as the government has not been able to put in place conditions that will give confidence to international investors particularly around appropriate risk sharing arrangements.

Project preparation - A lack of financing for early stage project preparation is one of the critical issues holding back increased private and ODA investment. It is also negatively affecting the efficient use of Government's own funds. High quality early stage project preparation is critical to

⁴ Interviews with officials from Lao Cai Department of Transport

⁵ World Bank, Building Capacity to Make Transport Work for Women and Men in Vietnam, 2011

⁶ Adam Smith International, Assessment of the Effectiveness of Project Preparation Facilities in Asia – Report to the G20, 2014

provide confidence to enable investment decisions, however Vietnam consistently underinvests at these stages relative to international norms⁷. The availability of concessional loans from donors (World Bank, ADB, AIIB, JICA, KEXIM etc.) is increasing but without increasing funds for project preparation the overall effect is that these funds are chasing a smaller pool of well-prepared projects. It's unclear what is driving GoV's relative underinvestment in preparation, but it's possible that in a tight fiscal environment this is one area where the government can generate savings without direct impacts on hard infrastructure investments (despite there being substantial indirect impacts). This situation is leading to significant delays in project approval and construction as numerous revisions need to be negotiated to project preparation documents before they can meet the minimum quality requirements needs of the relevant project financier.

Prioritisation - Existing prioritisation processes mean that the highest priority projects are not necessarily the projects that receive funding. Prioritisation of infrastructure projects occurs through the aggregation of plans from the district level up to the central level but with limited cost benefit analysis to compare the relative value of individual projects.

Coordination - In Vietnam, no single Ministry is responsible for all aspects of project development and implementation. For example, while project implementation is led by various Sector Ministries, prioritisation, allocation and disbursement of funding are all controlled by central Ministries such as the State Bank of Vietnam, Ministry of Finance, and Ministry of Planning and Investment. Provincial Governments also have responsibility for any necessary land acquisition. These blurred lines between the role and responsibilities of individual Ministries and levels of Government is a significant contributor towards delays in project development and implementation. A further complicating factor is that Ministries operate under a large number of legislative instruments including legislation, decrees and implementing circulars which often contain contradictory clauses. Under the Central Mekong Delta Connectivity Project, Australia and ADB have established a multi-agency Project Coordination Committee to attempt to address this coordination problem. To date it has been very successful but has not yet been commonly applied in other infrastructure projects.

As a general rule, the constraints to the sector are not related to the capacity of Government officials but reflect a complex governance system. However, they continue to place a heavy cost on the efficient operation of the transport sector.

Recent government reforms

Despite these ongoing constraints, the Government of Vietnam has recently made some progress on reform to the transport sector. This includes the development of the PPP Decree which provides a clearer framework for the development of PPPs and defines an approach for public contributions to viability gap financing. However there still needs to be further work on the critical implementing guidelines by sector ministries which will outline how the decree will work in practice. Likewise MOT is looking at mainstreaming an approach to gender consultations in new ODA financed projects that will improve the effectiveness of these projects but has yet to look at adopting this practice in projects financed through its own budget. This is a consistent

⁷ Adam Smith International, Assessment of the Effectiveness of Project Preparation Facilities in Asia – Report to the G20, 2014

story across many reforms, where there has been positive legislative change but where this has not translated into change at the operational level, or where there have been positive changes at the project level but these have not been mainstreamed across all projects.

Other Donor Support

There is limited additional donor support available to address the critical institutional issues outlined above. Major donors to the sector, including JICA, ADB and the World Bank recognise these problems but their own activities are largely focused on project implementation with systems developed to bypass many of these institutional constraints. There is also less appetite from GoV in using loan funds for activities other than hard infrastructure investments.

Some donors (including ADB, World Bank and AFD) have attempted to establish project preparation facilities to address the issue of poor quality early stage project preparation. These have been based in the Ministry of Planning and Investment (MPI) with sector Ministries and Provinces then making bids for the use of these funds. However these facilities have generally not been successful in adding many new projects to the infrastructure pipeline. This is for three reasons: 1) reluctance to use MDB loan financing for project preparation rather than investments; 2) the complex approval project procedures acting as a disincentive for sector ministries and provinces to apply for funds; and 3) project preparation facilities have not focused on the pre-feasibility and feasibility stages which are the cause of many of the delays in project development.

Australia's future support to the transport sector

The investment proposed in this concept note looks to address both the symptoms and the institutional causes which are leading to inefficient investment in the transport infrastructure in Vietnam.

We will provide additional support for project preparation to meet development partners' needs in the short term, particularly at the critical pre-feasibility and feasibility study stage. We will focus on providing support to prioritised ODA financed activities as this is the key area where there is a bottleneck between early stage project preparation (pre-feasibility and feasibility stage) and the stage where ODA donors are prepared to invest. In the short to medium term this bottleneck is likely to become even more of a problem as AIIB funds also begin seeking projects in which to invest. Our investment will help to provide a demonstration effect to GoV on the value of high quality project preparation by reducing the total time required to approve new activities but also increasing efficiency and reducing overall project costs. It may also help encourage other donors to provide financing earlier in the project cycle to further loosen this bottleneck. Over time, our support could be expanded to privately financed projects once GoV has put relevant enabling guidelines in place.

At the same time we will take an innovative approach to working with MOT to address the longer-term causal factors. This could include strengthening the evidence base on the benefits of reform, identifying champions who can help to promote reforms through GoV systems and strengthening incentives. Priority measures include demonstrating the benefits of value engineering, International Federation of Consulting Engineers (FIDIC) style contract management approaches and new technical engineering measures. There are also likely to be opportunities to enhance consideration of cross cutting issues like disability and gender, particularly in project preparation which will improve effectiveness. We have already provided support to MOT on mainstreaming gender across both project preparation and implementation and there is support

for these reforms at very senior levels in the Ministry. Overall, individual reform opportunities will become increasingly clear once the activity begins operations. Some reforms may also require corresponding hard infrastructure investments to provide a demonstration effect. However we will need to be selective and realistic about the reforms we target. For example, in the short term it is unlikely that we will be able to make major reforms to the government's complex project identification processes or to procurement where responsibility largely sits outside the responsibility of MOT.

This new Partnership represents a change in approach for our development assistance to transport infrastructure in Vietnam, particularly as we are moving away from the delivery of hard infrastructure. However this is closely aligned to Australia's new aid policy and our interest in developing economic partnerships in the region. We will seek to shift from direct financing of service delivery to a focus on addressing bottlenecks that can help to release other sources of finance. This will increase the overall impact of Australia's investments by crowding in additional finance and improving the effectiveness of GoV's own funds.

This is also a new type of assistance for any donor in the transport sector in Vietnam. PPTA facilities have been developed by the MDBs but these have not been linked to a broader policy reform agenda. Australia is well placed to provide this assistance as it has more flexibility to work in this space than other donors. We are able to provide grant financing for which there is a greater appetite from GOV to use for project preparation and on policy reform. At the implementation stage we are also able to operate more flexibly to address emerging priorities compared to MDBs who in general have more rigid project approval processes procurement policies. We have also established good relationships with other donors and already Australia is a donor of choice for some project preparation activities. These strong relationships will be critical in facilitating coordination with downstream investments. Through our support to MOT we will also look to take advantage of Australia's reputation as a leading provider of engineering services and an expert on issues such as road safety and PPPs by engaging with Australian institutions and with Australian business.

Australia has a long history of engagement in the transport sector in Vietnam dating back to the development of the My Thuan bridge in 1995. This has helped us to develop good relationships with both MOT at a central level and with implementing PMUs. We have also developed a good understanding of issues related to transport infrastructure development through our engagement in the Cao Lanh bridge.

C: Proposed outcomes and investment options (What)

Goal and Outcomes

The overall goal of the project is to add to Vietnam's transport project pipeline, leverage increased financial allocations and increase efficiency of spending in the transport sector. This will in turn help to promote economic growth and reduce poverty.

Our assistance to the transport sector will need to be flexible to meet joint Government of Vietnam and Australian priorities and so final outcomes of the project will be best defined through the design phase and through the development of prioritised annual plans. However, examples of outcomes to be achieved through this investment include:

- Improved quality of project preparation contributing to increased annual donor

- expenditure and reduced lead times between project identification and construction
- Revised policies adopted that will strengthen safeguard management and better integrate and monitor the impact of gender and disability considerations in transport projects.
- Revised policies and procedures in asset management and contract management that will increase transparency, reduce costs and improve efficiency in transport projects
- Demonstration and uptake of innovative technical approaches and value engineering that will reduce costs, improve safety and reduce construction periods for infrastructure.
- Strengthened implementing guidelines for PPP development to facilitate international private sector engagement in the sector.

Proposed Activities

We will focus on three types of assistance: 1) early stage project preparation; 2) policy reform; and 3) demonstration investments.

Project Preparation - Initially the investment will focus on early stage project preparation for ODA financed projects that will help to unlock the pipeline for transport infrastructure projects. This will likely focus heavily on the pre-feasibility and feasibility study stages, which are currently being prepared by local consultants with limited involvement from donors. These stages in particular are underfinanced by GOV and Vietnamese consultants are often unfamiliar with donor expectations. From our experience with previous projects we know these issues well and how to address them. A well timed investment in early stage project preparation can have large impacts, for example improving the quality of a feasibility study can help to accelerate implementation, reduce costs and improve the quality of an infrastructure project valued at hundreds of millions of dollars. We will also consider providing support for project preparation for public-private partnerships but progress on financing for these is likely to be dependent on Vietnam first providing a clearer investment framework.

Policy reform - Achieving success in reform on policy issues will require a more detailed understanding of the operations of MOT including identifications of champions who can help navigate proposed reforms through appropriate channels. Therefore a focus on reforms to policies and capacity building are likely to be a smaller focus of activities in the initial stages but this will grow as Australia (and the project) gains credibility and trust within the Ministry. However we have already begun work in some of these areas (e.g. supporting women's leadership in MOT and gender mainstreaming in project development) which we can build on early in the life of the investment. Successful reforms in this area will have impacts across the entire sector.

Demonstration Investments - We will also consider providing targeted support for hard infrastructure and innovative technical approaches where this can be shown to have a demonstration effect that can be carried through into other projects. This is an approach that Australia has employed already by increasing our investment in the Southern Coastal Corridor Project to demonstrate the sustainability and road safety improvements from investments in soft soil treatments. These hard infrastructure interventions are likely to be relatively small and will be targeted to where there is interest from MOT or Provincial Departments of Transport in testing the viability of approaches but where it may be difficult to gain approvals to use their own funds.

Delivery Options

There are two options available for us to deliver this investment: i) provide assistance through MDBs to targeted project preparation and policy reform activities; ii) provide assistance directly to MOT with additional technical support from Australia

Option 1 – support to MDBs) – Under this option, Australia will finance individual MDB proposals through a competitive process that are consistent with the principles of Australia’s proposed support to the transport sector. The benefits of this option are that by providing assistance directly to MDBs we will have close links to future major infrastructure projects, gain access to the Banks’ expertise and continue to work through familiar systems. However MDB procurement and project approval systems are relatively inflexible and so will reduce the capacity of the program to respond to emerging priorities at short notice. Through this approach we are also less likely to develop a clear understanding of the operations of MOT as we will be further removed from activity implementation. This will also be difficult to manage as this approach will likely require us to oversee a large number of separate agreements.

Option 2- direct support to GOV) – Under this option Australia will work directly with MOT under an innovative approach on jointly agreed project preparation and reform activities. Working directly with MOT will require the Australian Embassy in Vietnam to engage additional technical expertise in the investment and will require a concerted effort to ensure coordination with future project pipelines of other donors. However this approach will allow greater responsiveness as DFAT systems can be more flexible at the implementation stage than other donors. By working directly with MOT we will also have greater visibility and influence in engaging with MOT directly in policy dialogue. This approach will also allow us to work more flexibly in engaging Australian expertise and institutions.

Option 2 is our preferred approach. Overall there will inevitably be a higher management burden for Embassy staff to manage this activity compared to Option 1, however the benefits in visibility and flexibility from this approach should outweigh this cost. This approach is also consistent with the shift towards developing economic partnerships that will make more effective use of Australian expertise and leverage a range of sources of finance for Vietnam’s economic development.

D: Implementation/delivery approach (How and with whom?)

We intend to provide up to \$35 million over five years for this investment. We will provide relatively small contributions in years one and two (\$0.5m and \$3.5m respectively) which will increase to approximately \$10m per annum across years 3, 4 and 5.

The design team will explore a range of innovative approaches to determine how Australia can best provide a combination of incentives and direct technical support for reform. A principle for the design will be for the activity and its personnel to effectively be able to understand the institutional barriers for reform, provide appropriate incentives for MOT and maintain an acceptable level of risk for DFAT.

Options for support including establishing a project management unit (PMU) in MOT to assist in the prioritisation of activities, assist in preparing proposals for the facility, provide quality assurance to funded activities, provide secretariat support to the steering committee and provide financial management support. Alternatively Australia could directly engage a contractor to these provide services to MOT. This would incur lower financial and technical risk as these risks would be managed by the contractor but may limit the influence of the facility in progressing difficult policy reforms.

The investment will include a joint oversight mechanism, such as a steering committee, including both representatives from MOT and Australia, which could also include representation from MDBs to enhance coordination with downstream activities.

We expect that the majority of funding will be directed towards assistance for project preparation in the first two years but support for policy reform and financing demonstration of hard infrastructure investments will increase in years 3- 5.

The Embassy currently has 2.5 FTE staff overseeing the current infrastructure program. This includes 0.5 of a First Secretary, and 2 Senior Program Managers (Infrastructure and Social Development/Environment). The Embassy also currently engages a part-time external infrastructure adviser, particularly to provide assistance on the Cao Lanh bridge. This level of resourcing would need to continue, including engaging external technical expertise to assist senior management in its role on the steering committee.

E: Risk assessment approach (What might go wrong?)

There are a number of risks relevant to this project including:

- Allocations are not sufficient to achieve impact compared to the scale of challenges in the sector
- Proposed activities are not subject to adequate prioritisation processes
- Project preparation is not closely linked to subsequent investments
- Activities become fragmented and are not targeted to overall strategic priorities
- Policy reform is not realised
- Funds directed through GOV systems are subject to fraud or corruption
- Delays in activity approvals will limit effectiveness

These risks will be considered in the design process. It will be important that the design focus on the scope of activities that can be supported through the facility and that appropriate governance arrangements allow for effective prioritisation.

There will be opportunities to mitigate risks across the sector by strengthening broader GOV policies under the investment. These include strengthening social and environmental safeguards, fraud management and integrating gender equality measures in project development.

Through our support for project preparation, we will also help to identify likely social and environmental risks that can be addressed at the detailed design phase.

F: Proposed design and quality assurance process (What are the next steps?)

Following approval of this concept note, we will submit the concept through MOT for GoV approval. In parallel, we will begin the internal DFAT design process for this investment.

Already there are three key pieces of analysis that have been prepared by Australia and the World Bank that will help to inform the design of this investment:

1. A study on key constraints for project preparation in Vietnam, in particular current financing or capacity gaps
2. An analysis of institutional constraints in the transport sector in Vietnam
3. An analysis of gender impacts within the transport sector and recommendations on how to integrate gender considerations in the project cycle

The design will need to undertake two additional pieces of analysis – a political economy analysis to complement the already completed institutional analysis and a fiduciary risk assessment if the proposed design will use Partner Government financial management systems.

We intend to engage a team of four people: a Design and M&E Specialist; an Infrastructure Specialist; a Governance Specialist; and a Gender Specialist to prepare the design of the

investment. The team would be supported by DFAT's Senior Infrastructure Manager and Senior Safeguards Manager. We envisage that design will take approximately two months to complete and include a two-week in country design mission. A reference group will provide support to the design and will be engaged at critical points in the process (including providing feedback on the work plan and on the draft design). This reference group will include an Infrastructure Specialist, a Gender Specialist, a Disability Specialist, a representative of the Vietnamese Private Sector, an MDB representative as well as other representatives from within DFAT who have an interest in the design of this activity including Southeast Asia Regional Division, Trade and Economic Division, Development Policy Division and Contracting and Aid Management Division.