Socialist Republic of Viet Nam

Data Collection Survey on Legal and Institutional Framework for Promotion of PPP Projects in the Socialist Republic of Vietnam Final Report

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Abbreviations

ADB	Asian Development Bank
ASA	authorized state agency
BLT	Build-lease-and-transfer
BOO	Build – Own – Operate
BOT	Build-Operate-Transfer
BT	Build-and-transfer
BTO	Build – Transfer – Operate
CAO	Contract-Add-and-Operate
DBCC	Development Budget Coordination Committee
DBFO	Design – Build – Finance – Operate
DOT	Develop-operate-and-transfer
EIRR	Economic Internal Rate of Return
FIRR	Financial Internal Rate of Return
FONADIN	National Infrastructure Fund of Mexico
GDP	Gross Domestic Product
GOCCs	government-owned and controlled corporation
HFIC	Ho Chi Minh City Financial Investment Company
IRR	Implementing Rules and Regulations
JICA	Japan International Cooperation Agency
JPY	Japanese Yen
LGU	Local Government Units
LM	Line Ministries
MOF	Ministry of Finance
MONRE	Ministry of Natural Resources and Environment
MOST	Ministry of Science and Technology
MPI	Ministry of Planning and Investment
MP3EI	Master Plan for the Acceleration and Expansion of Indonesia's Economic Development
NAFOSTED	National Foundation for Science and Technology Development
NEDA	National Economic and Development Authority (the Philippines)
ODA	Official Development Assistance
PC	People's Committee
PDF	project development facility
PFI	Private Finance Initiative
PPP	Public Private Partnership
ROO	Rehabilitate-own-and-operate
ROT	Rehabilitate-operate-and-transfer
RP	Indonesian Rupiah
USD	U.S Dollar
VEPF	Vietnam Environment Protection Fund
VFM	Value for Money
VGF	Viability Gap Funding
%	percent

1. Executive Summary

1.1 Introduction to Study

Vietnam lacks a functioning viability gap funding (VGF) management scheme. This lack of a VGF management scheme is proving a significant bottleneck in the development of public private partnerships (PPP) projects across both Central and Provincial Government.

Since early 2015, JICA has sought to provide leading technical assistance to the Ministry of Planning and Investment and Ministry of Finance of Vietnam to examine options for a VGF management system, which in turn would allow PPP projects to move through the pipeline. In addition to a need for VGF, the Government of Vietnam needs a system to manage government guarantees and account for contingent liabilities. To address these concerns, JICA offered a technical support package to MPI and MOF in the form of two studies:

(1) international best practices for the management of VGF and
(2) international best practices for the management of government guarantees.

Further, JICA offered assistance to MOF to draft a circular under Decree 15 (i.e. the PPP Decree). In Fall 2015, MPI and MOF agreed with JICA to a technical assistance package comprising this multi-variate Study which launched on 16 November 2015. This Study is made up of the following Chapters, where each can be viewed as a standalone study that are meant to be read together:

- Chapter 2. International VGF Study, which examines the core elements of VGF management systems with particular focus on India, Indonesia and Philippines;
- Chapter 3. VGF Fund Proposal for a VGF Management Scheme, in the form of the Proposed VGF Fund to promote the establishment of the VGF management scheme; and
- Chapter 4. Response to Government Feedback on the VGF Fund Proposal, a revised proposal for a VGF Management Scheme to take into account feedback from the Vietnamese Government in structuring a VGF management scheme.

The following sections will highlight the main findings of the Study.

1.2 Introduction to International VGF Study

Chapter 2 comprises the *International VGF Study* that was prepared for the benefit of the Government of Vietnam as it assesses its options for managing VGF for its nascent PPP program. The purpose of is the International VGF Study was to provide a ready reference for stakeholders in Vietnam's PPP program when considering their options for structuring a public finance management scheme when providing VGF for PPP projects The International VGF Study compares the VGF management schemes of India, Indonesia and Philippines and explains the key institutional and procedural elements of those management systems, focusing particularly on the following core components of those systems:

- *Legal framework*: describing the basis legal framework empowering the management of VGF in the country;
- *Institutional framework*: describing the institution used by the country to manage the VGF system;
- *Assessment procedures*: describing the key steps and actors involved with assessing the VGF needs of a project;
- *Approval procedures*: describing who approves the grant of VGF and when such approval is given;
- *Disbursement procedures*: describing how and when the VGF grant is paid to the project; and
- *Monitoring system*: describing how the country monitors its aggregated VGF usage.

1.3 Lessons learned from International VGF Study

The International VGF Study concludes that when developing a VGF management scheme a government should consider the following six core elements:

1. Fund appropriation- creating a dedicated VGF management body with a clear funding commitment from the government. VGF should not be funded in an ad hoc manner. A strong government commitment to funding VGF in a consolidated manner is needed. This allows for a more streamlined and simplified VGF approval process, attracts attention and increases awareness, increases the number of infrastructure projects done as PPPs and enhances better policies and decision criteria.

2. Designated agency responsible for the assessment and approval of VGF. The assistance provided by the agency in charge of the subsidy program varies, depending on the specific institutional arrangement and the amount of experience with PPPs.[1] Those appraising VGF requests need the technical skillsets to independently assess project needs using clear criteria (below) without undue political influence.

3. Adopting clear, concrete project eligibility criteria. Clear eligibility criteria ensure that only well prepared, economically viable projects receive subsidies. They also increase the amount of private investment mobilized per dollar of subsidy by filtering out weaker projects in favor of more financial sustainable projects. On the other hand, where unclear eligibility criteria exist, projects can be pushed through based on political pressure, as such projects tend to be prioritized on a more *ad hoc* basis rather than the basis of objective criteria.

4. Setting a VGF cap or limit subsidization through competitive procurement. Setting the amount of VGF through competitive procurement minimizes the amount the government pays. Competitive pressure (when PPP contracts are openly and competitively tendered) drives private investors to request the minimum amount of subsidy to make a project financially viable. The extreme example of that is where bidders may offer negative VGF, meaning bidders offer a ‘premium’ to the government

[1] World Bank Institute, Best practices in public private partnership financing in Latin America, p 16-17.

if the discounted cash flow indicates that a project is independently financially viable without VGF. This creates an additional source of revenue and ensures the government maximizes value.

5. Disbursement of VGF funds. Using output- or performance-based milestones to trigger disbursement strengthens the incentives for the private proponent to meet its contractual obligations as well as ensure that projects are completed on time and the service standards defined in the PPP contract are met.[2]

6. Monitoring. A key benefit of a centrally managed VGF system is that it assists government to monitor the costs of VGF to the State. The optimal monitoring policy depends on the institutional arrangement in the particular country. There are usually three different approaches, each with different advantages and generally countries combine at least two approaches:

- lead private financial institution as the proxy monitor;
- staff of the subsidy fund or PPP unit assists or leads monitoring; and/or
- an independent agency monitors subsidies.[3]

1.4 Examination of Vietnamese Law Related to VGF

In parallel with the research for the International VGF Study, the study team examined Vietnamese law and practice related to state budget management, establishment of fund structures by Government, annual and medium term budget appropriations and ODA funding and on-lending, as well as other relevant laws. The underlying Vietnam legal study is reflected in the structuring of the VGF Fund Proposal set out in Chapter 3.

1.5 VGF Fund Proposal

Chapter 3 sets out the *VGF Fund Proposal*. After careful consideration of the best practices for VGF management schemes in the region and a review of Vietnamese public investment planning laws, PPP regulations and State budgeting laws and processes, the study team concluded that there is no sustainable alternative for operating a VGF management scheme in Vietnam without either (i) changing the Law on Public Investment and possibly the State Budget Law to accommodate a new appraisal and approval scheme for VGF or (ii) introducing a new financial institution empowered (by a Decision of the Prime Minister) to manage State capital. Both cases may require change in law and institutional structures. The key findings of the study team that have shaped the proposed VGF management scheme are:

The public investment plan and annual budget allocation systems does not match the PPP project cycle contemplated under Decree 15, leading to high risk of delay because of the mismatched timelines in how authorized state agencies (ASAs) plan their budget and how a project moves through the development cycle.

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[2] World Bank Institute, Best practices in public private partnership financing in Latin America, p 19.
[3] World Bank Institute, Best practices in public private partnership financing in Latin America, p 20.

See Section 3.3.1.2

The Law on Public Investment[4] and Decree 15 require the ASAs to prepare in advance the plan for the use of VGF needed for PPP projects within their medium-term (5 years) investment plan. The preparation of annual public investment plan and annual budget estimate must be based on the medium-term public investment plan of each ASA. Therefore, in order for a project to be allocated with annual State budget, it needs to be included in the medium-term public investment plan of the relevant ASA. That means the ASAs must prepare their public investment plans five years ahead. Meanwhile, under Decree 15, a project can only be included in the 5-year public investment plan after the project proposal is approved and the project is published. As a result, for a project which is developed and proposed during the five-year period and was not included in such five-year plan, the ASA may have to wait several years to include it in the next 5-year plan.

See Section 3.3.1.3

For these and other reasons set out in Section 3.3 of Chapter 3, the study team proposed that Vietnam establish a new financial institution under the Ministry of Finance to hold and disburse State capital as VGF for approved projects. This structure has been called the VGF Fund through the course of the Study, but it should be noted that the structure need not be a *fund* as commonly understood in Vietnam.

> The VGF Fund Proposal entails the creation of a hybrid VGF management vehicle (VGF Fund) financed by a combination of ODA and State capital seed funding coupled with annual budget allocations by ASAs (and/or the State budget).

1.6 Structure of VGF Fund

The study team proposed that the VGF Fund should be established as a State financial institution under the authority of MOF with a high degree of autonomy and a fully independent management team. Examples of similar funds already exist in Vietnam including:

- Vietnam Environment Protection Fund (VEPF) established by the Prime Minister under the form of a State financial institution under the Ministry of Natural Resource and Environment;
- National Foundation for Science and Technology Development established by the Government under the Ministry of Science and Technology; and
- Local Development Infrastructure Funds established by the People's Committee of some provinces.

[4] Law on Public Investment No. 49/2014/QH13 passed by the National Assembly on 18 June 2014 (Law on Public Investment).

1.7 Core functions of VGF Fund

As originally proposed the VGF Fund would conduct the following activities:

- It would aggregate and account for the use of ODA and State capital to provide VGF grant funding to selected PPP projects.
- It would conduct independent evaluation of the VGF needs of projects for which ASAs request VGF.
- It would apply consistent evaluation methodologies and criteria in evaluating the ASAs' requests for VGF.
- It would recommend to an executive committee (referred to as the "Approval Committee") for initial and final approval of the quantum, form, disbursement schedule and conditions for VGF grants using the funds under its management.
- It would disburse VGF grants in accordance with the approved disbursement plan for projects to receive VGF. The approved disbursement plan would be reflected in the PPP project contract between the ASA and the investor.
- It would provide annual accounting and medium to long term projections to Government of the aggregated ODA funding and State capital used for VGF support of PPPs and the projected impact on State debt management.
- It would consolidate project monitoring data and create a comprehensive database for Government of projects receiving VGF support.

Details of the proposed VGF Fund may be found in Chapter 3.

1.8 Response to Government Feedback on the VGF Fund Proposal

Chapter 4 examines the issues raised by the Government's VGF working group in response to the proposed VGF management scheme under this Study.

The VGF Fund Proposal was discussed over the course of three working meetings with a working group comprising members of the Ministry of Planning and Investment, Ministry of Finance and Office of Government. Although the terms of reference for this Study originally contemplated two workshops to engage stakeholders in a discussion on the proposed VGF management scheme, members of the working group preferred to hold smaller working sessions instead. The working sessions were held on 18 and 22 March 2016, during which the study team received the working group's feed.

The feedback received during those meetings can be found summarized in Table 4.4 of Chapter 4. In general, the working group's chief concerns include (i) the challenges of introducing a new extra-budgetary *fund* in the current political climate, (ii) that the proposed VGF Fund appears to duplicate the functionality of the PPP Office for appraising the VGF needs of a project and (iii) that the proposed VGF Fund would require changes in law (and cannot be simply plugged into the existing legal framework in Vietnam).

The study team met a third time with the working group and discussed and responded to the above concerns. The study team's response may be found in Table 4.4 of Chapter 4.

From these three meetings it may be concluded that:

- There is a legal inconsistency between (i) the functional needs and timing of a VGF system that would operate under Decree 15 and (ii) the timing of approvals and budgeting of VGF under the Law on Public Investment and State Budget Law. It does not appear that a long term sustainable VGF management scheme (that meets the functional needs identified in Chapter 2 and Chapter 3) can be readily implemented without legal reform.

- The proposed VGF Fund need not be a *fund*, as such term is normally understood by the working group. Rather, the institutional structure of the VGF management scheme should be a vehicle having the ability to management State capital and disburse such capital without requiring a budget allocation to precede such disbursement. The study team proposed the vehicle be a financial institution established by the Ministry of Finance and supported through the technical appraisal of the Ministry of Planning and Investment. Therefore, some of the appraisal functions set out in Chapter 3 for the VGF Fund could be simply retained by the MPI, with the VGF Fund (vehicle) simply acting as the disbursement and accounting agent of the Government.

- While the proposed VGF management scheme is being further studied by Government, an interim solution needs to be developed by the MPI and MOF.

At the third working session, the working group appeared to settle on an interim action to propose to Office of Government the use of an ODA programmatic loan to support a pilot group of PPP projects. The working group expressed a plan to issue a circular on the usage of ODA for VGF for a program of pilot programs. JICA is asked to support this programmatic loan.

It should be noted, however, that establishing an ODA programmatic loan to support VGF will likely entail some of the same issues and barriers that have been raised in regards to the VGF Fund structure and that are known to cause difficulties for the Project Development Facility. For example, it is foreseeable that an account held by MPI for disbursal of ODA backed VGF to projects will give rise to the same problems that the current Project Development Facility account faces, namely an interpretation that such funding should be under the approved budget of the ASA rather than MPI. This issue will require additional legal analysis that is outside the scope of this Study to resolve, as it is caused by how Government is interpreting the Law on Public Investment against an existing loan treaty.

1.9 Conclusion

The Study catalyzed action and thought within the Government to pursue a tangible scheme to manage VGF. It has become clear during the course of the Study that VGF simply cannot be conveniently fit into existing State budget management schemes. A long term solution to managing VGF will require substantial legal and institutional changes. A short term fix may involve an ODA program loan to support VGF for pilot projects, but such approach will not achieve the key functionality of the VGF management scheme identified in this Study.

2. International VGF Study

This Chapter 2 of the Study comprises the *International VGF Study*, contemplated under task 6.3.1 of the TOR for the Study. This International VGF Study was presented to Government on 22 February 2016.

2.1 Introduction and study overview

This study is prepared for the benefit of the Government of Vietnam as it assesses its options for managing VGF for its nascent public private partnerships (PPP) program. The purpose of this document is to provide a ready reference for stakeholders in Vietnam's PPP program when considering their options for structuring a public finance management scheme when providing VGF for PPP projects. This study compares the VGF management schemes of India, Indonesia and the Philippines and explains the key institutional and procedural elements of those management systems, focusing particularly on the following core components of those systems:

- *Legal framework*: describing the basis legal framework empowering the management of VGF in the country;
- *Institutional framework*: describing the institution used by the country to manage the VGF system;
- *Assessment procedures*: describing the key steps and actors involved with assessing the VGF needs of a project;
- *Approval procedures*: describing who approves the grant of VGF and when such approval is given;
- *Disbursement procedures*: describing how and when the VGF grant is paid to the project; and
- *Monitoring system*: describing how the country monitors its aggregated VGF usage.

This remainder of this study is organized as follows:

- Chapter 2.2: introducing the core components (as mentioned above) for VGF management seen across a number of countries;
- Chapter 2.3: providing more specific examples of the application of the core components in each of India, Indonesia and the Philippines, as well as examples from other countries;
- Chapter 2.4: assessing examples of how VGF management systems may face hurdles or constraints; and
- Chapter 2.5: based on the above, extracting lessons that will be useful for Vietnam to consider as it shapes its own VGF management system.

This study has been supported by technical assistance from the Japan International Cooperation Agency (JICA). The views set forth herein are those of the authors and do not necessarily reflect the position of JICA or the Japanese Government in respect of the subject matter discussed below.

2.2 Core principles seen in the study countries

Different governments have adopted a number of different policy and institutional arrangements to provide VGF to infrastructure PPPs. This study brings out selected practices of the three study countries (India, Indonesia and the Philippines) to illustrate different approaches to provide VGF to PPP projects, which provide lessons to guide Vietnam when designing its own VGF management system and policies.

2.2.1 Legal framework

Governments have different legal frameworks and policy arrangements in place to provide VGF to infrastructure PPPs with specific mechanisms including, among others, the following:

- definitions and objectives
- institutional structure
- eligibility criteria and
- how the amount of VGF is identified, appropriated, assessed, approved, disbursed and monitored.

Some VGF programs that have been analyzed in this study have faced significant implementation obstacles where their laws were not adequately supportive of PPPs or made implementation of VGF disbursals impossible.[5]

The following core elements are common to the study countries:

- a dedicated VGF management system (annual budget allocations or a capital fund) with a clear funding commitment from the government created by law;
- establishing the VGF cap or limit through competitive bidding against the VGF amount
- adopting clear eligibility criteria and
- having a responsible agency or entity for managing the VGF program (PPP Unit/Center).

The VGF limit or cap has two main benefits, namely:

- The most financially viable projects will be prioritized and developed first, which increases the amount of infrastructure that will be developed and the amount private finance that is mobilized.
- Financial viability is a proxy for economically viable projects. It prioritizes projects that will generate more economic and social benefits, because demand and the amount that users are willing to pay will increase project revenues and also reflect the benefits that users will gain from the infrastructure.[6]

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[5] See, e.g. Section 4.2 below on Mexico's Infrastructure Fund called "FONADIN".

[6] World Bank Institute, Best Practices in Public-Private Partnerships Financing in Latin America: the role of subsidy mechanisms, 2012 International Bank for Reconstruction and Development / International Development Association or The World Bank, p 97, available at: http://docplayer.net/11631989-Best-practices-in-public-private-partnerships-financing-in-latin-america-the-role-of-guarantees.html[hereinafter: World Bank Institute, Best practices in public private partnership financing in Latin America].

The VGF limit or the percentage of total project costs is maximum 40 percent (%) for both India and Indonesia and not exceeding 50% for the Philippines. All three countries have a specialized agency managing the VGF program, PPP Units in India and Indonesia and PPP Center in the Philippines.

> **Note concerning VGF budgeting and funding structure:** Government have various options on how they can structure their support. Those governments with efficient and flexible annual budget appropriation systems, can directly subsidize PPPs through annual budget appropriations. The budgets of the VGF of all three study countries (India, Indonesia and the Philippines) are funded through annual budget appropriations. A fund structure, whether controlled by a government agency or structured as a standalone body provides an alternative to annual budget appropriations, particularly where such appropriations cannot be made in a timely manner that matches the timing of the PPP project. For example, Mexico's National Infrastructure Fund of Mexico (FONADIN) has a structured VGF management fund with over USD3 Billion (JPY345 Billion)[7] of capitalization to provide subsidies and subsidized loans to qualifying PPPs. See Section 2.4.2 for more on FONADIN's fund structure.
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> **Note concerning India's Viability Gap Fund: I**ndia's VGF management scheme is often referred to as the Viability Gap Fund. It is one of a number of schemes the Government of India uses to support infrastructure projects. It is, however, based on annual budget allocations as noted above, rather than acting as a standalone fund. Notably, the approval process for VGF grants in India is relatively efficient and flexible (and has influenced the scheme the authors propose for Vietnam).

The snapshot of the legal framework, institutional set-up and basic funding commitment can be found in Table 2.2.1a below:

[7]**Note:** FX based on 2012 September average USD/JPY rate of 78.177 retrieved from: http://www.x-rates.com/average/?from=USD&to=JPY&amount=1&year=2012

Table 2.2.1a: Snapshot of the legal framework, institutional set-up and basic funding commitment in India, Indonesia and the Philippines.

Item	India	Indonesia	Philippines
Legal framework	Scheme for financial support to infrastructure projects that are to be undertaken through PPPs	Presidential Regulation 32/2011 regarding The Master Plan for the Acceleration and Expansion of Indonesia's Economic Development (MP3EI) 2011-2025 Presidential Decree 67/2005, amended by Presidential Decree 13/2010 Presidential Decree 56/2011	Revised Build-Operate-Transfer (BOT) Law (The Republic Act No. 7718) and its Implementing Rules and Regulations (IRR) Policy Brief Government Share of PPP Project Costs and Risk Republic Act No. 7160: The Local Government Code of the Philippines 1991
	The XII Five Year Plan (2012-2017) Annual Union Budget	Ministry of Finance Regulation No. 223/PMK. 011/2012 Ministry of Finance Regulation 143/PMK.011/2013 Minister of Finance Regulation 223/2013	General Appropriations Act National Expenditure Program 2015 Department of Budget and Management, National Budget Circular 538, March 22, 2012
VGF definition	a capital grant one-time or deferred with the objective of making a project commercially viable	government fiscal policy to support the infrastructure provision through the PPP scheme	grant, or the other value for the purpose of making the tariff affordable to users while improving the commercial attractiveness and sustainability of the project
Objective of VGF	to meet India's infrastructure needs, attract private sector expertise to mobilize additional finance, make PPP projects commercially viable, improve efficiencies, control timing and cost and develop projects through an 'inclusive' approach that does not neglect	to increase the financial viability of the project, increase certainty of infrastructure project provision in accordance to the designed quality and timing, enhance the public services provision through the infrastructure with affordable tariff	improve affordability, but in some cases also to accelerate the development of critical infrastructure

Item	India	Indonesia	Philippines
	geographically or economically disadvantaged regions		
Institutional set-up	PPP Unit under Ministry of Finance, Department of Economic Affairs Empowered Committee and Empowered Institution	PPP Unit in Ministry of Finance Risk Management Unit Indonesian Infrastructure Financing Facility and Sarana Multi Infrastruktur	PPP Center under Development Budget Coordination Committee (DBCC) of the National Economic and Development Authority (NEDA) Board
Type of contract	Proposals shall relate to a PPP project for delivering an infrastructure service on payment of user charges which is based on a contract or concession agreement between a Government or statutory entity from one side and a private sector company on the other side	VGF financed projects are Build-operate-transfer (BOT) and user-pays contracts	Revised BOT Law No. RA 7718 Sections 2(b)-(j) lists all contract types (e.g. BOT, BT, BOO, BLT, BTO, CAO, DOT, ROT, ROO)[8]
VGF appropriation	annual Government budget allocation; revolving fund of USD29.55[9] (JPY3.48 billion)provided by the Finance Ministry to the Empowered Institution	annual Government budget allocation	annual Government budget allocation

[8]According to the Revised BOT Law No. RA 7718 Sections 2(b)-(j), *BOT* stands for Build – operate - transfer; *BT* stands for Build-and-transfer; *BOO* stands for Build – own – and - operate, *BLT* stands for Build – lease – and - transfer; *BTO* stands for Build-transfer-and-operate; *CAO* stands for Contract – add –and - operate; *DOT* stands for Develop-operate-and-transfer; *ROT* stands for Rehabilitate-operate-and-transfer; and *ROO* stands for Rehabilitate-own-and-operate.
[9]**Note:** Revolving fund of Rs. 200 crore is provided by the Finance Ministry to the Empowered Institution which is equal to roughly USD29.55 million. Exchange rate is based on IND/USD 0.01475026 as of 22/01/2016, retrieved from: http://www.x-rates.com/average/?from=INR&to=USD&amount=1&year=2016.

Item	India	Indonesia	Philippines
	in cash at the stage of project construction	in cash for construction costs	in cash or contribution in kind VGF can take several forms (capital investment subsidies, operating subsidies, "hybrid" project arrangements[10] and any contribution of real property to a project over which usufruct rights to the proponent has been granted)
VGF calculation[11]	VGF limited to CAPEX, but can be up to 40% of total project cost.	VGF is limited to 40% of CAPEX.	VGF is limited to 50% of project cost.
VGF cap	determined through competitive bidding process- equivalent to the lowest bid for capital subsidy, but not exceeding 40% of the total project cost	maximum of 40% of the total project cost	maximum of 50% of the total project cost

[10]**Note:** "Hybrid" project arrangements are those where government of the Philippines makes assets available to a project under various legal structures (in lieu of other forms of subsidy) to the extent that they are concessionary.
[11]**Note:** The VGF calculations are based on assumptions and conclusions drawn from the material available to the study team.

2.2.2 Assessment for VGF

It is recommended that a specific agency/ies or government approved bodies shall be responsible for identification, preparation and procurement of projects. Rather than focus on which agency or entity reviews requests for VGF, it is important to make sure staff managing subsidies are involved in the PPP project structuring process to ensure an optimal balance of private sector financing and State subsidization. The feasibility study phase of a PPP project is typically where the optimal project structure and VGF needs are determined.

Governments need to analyze, clearly state and define priority sectors that are eligible for VGF as the private sector might be able to deliver better results for the long term delivery of efficient services.[12] Clear eligibility criteria applied to a rigorous feasibility study process ensures that only well prepared, economically viable projects receive subsidies and it also increases the amount of private investment mobilized per dollar of subsidy. Other conditions may apply, such as requiring competitive pressure, adherence to a clear approval process and application of a VGF cap.

[12] Ministry of Planning and Investment/Ministry of Finance, Government of Viet Nam, TA-8313 REG: Developing PPP Government Support and Risk Management Systems, Final Report, 21 January 2015, p 20.

Table 2.2.2a: Snapshot of eligibility criteria for in India, Indonesia and the Philippines.

India	Indonesia	Philippines
1. Eligible sectors		
roads and bridges, railways, seaports, airports, inland waterways, power, urban transport, water supply, sewerage, solid waste management and other physical infrastructure in urban areas, infrastructure projects in Special Economic Zones and international convention centers and other tourism infrastructure projects.	transport infrastructure (railroad, ports/harbors, airports, roads, etc.), irrigation equipment, waterworks facilities, communication facilities, electric power infrastructure (power generators, distribution equipment, etc.), oil and gas related facilities, and other equipment related to these fields.	roadways and railroad, ports/harbors, airports, electric power infrastructure, communications, IT, irrigation, water infrastructure, education, land reclamation, real estate development for industry/tourism, government buildings, warehouses, meat processing plants, fishing ports, and environmental and waste treatment facilities.
2. Eligibility criteria		
There are criteria to be met to receive funding: 1) proposals shall relate to a PPP project for delivering an infrastructure service on payment of user charges which is based on a contract or concession agreement between a Government or statutory entity from one side and a private sector company on the other side. 2) the project shall provide a service against user charge or payment of a pre-determined tariff. 3) VGF applies only if the contract/concession is awarded in favor of a private sector company in which minimum of 51% of the subscribed and paid up equity is owned and controlled by a private entity.	There are criteria to be met to receive funding: 1) economically viable but not financially feasible project 2) VGF financed projects are BOT and user-pay principle contracts 3) minimum investment of approximately USD10 million, equivalent to 100 billion Indonesian Rupiah (RP) or 33 billion JPY 4) the cooperation agreement should set up the asset transfer and/or asset management scheme from the investors to Government Contracting Agency at the end of concession period	There are criteria to be met to receive funding: 1) projects based on a concession agreement, with pre-determined tariff and actual grant identified on the results of bidding; among other variables, bidders will request the level of VGF they think they need to achieve the project's commercial objectives; 2) company selected via competitive bidding 3) company in which the private sector ownership exceeds 51%. 4) Economic Internal Rate of Return (EIRR)above 15%

India	Indonesia	Philippines
4) a private sector company shall be eligible for VGF only if it is selected on the basis of open competitive bidding and takes up the responsibility of financing, construction, maintenance and operation of the project during the concession period.[13] 5) government/statutory entity shall certify the following: - the tariff/user charge cannot be increased for elimination or reduction of the viability gap of the PPP - the project term cannot be increased to reduce the viability gap and - the capital costs are reasonable and based on the standards and specifications normally applicable to such projects and the capital costs cannot be further restricted for reducing the viability gap.	5) private capital selected following open and competitive bidding process following PPP regulations where VGF amount is the only financial bidding parameter and 6) feasibility study should show the optimal risk allocation between investors and Government Contracting Agency and that the project is economically viable and becomes financially feasible with VGF support.	Furthermore, VGF grants will cover construction costs only excluding interest costs; 5) VGF projects must be publicly solicited; *unsolicited proposals are not eligible for VG*F; 6) purpose of the grant is to improve affordability, however in some cases to accelerate the development of critical infrastructure. Hybrid projects may be exceptions. 7) subsidy should be drawn during construction period only and shall not exceed 50% of project costs; ROWA is currently included for the purpose of establishing limits, but may be excluded over the longer term.

[13] Rule 3.1 of the Scheme. Government of India, Ministry of Finance, Department of Economic Affairs, PPP Cell, Scheme and Guidelines for Financial Support to Public Private Partnerships in Infrastructure, 2008, p 1.

2.2.3 Approval of VGF

The VGF approval process and authority varies between the study countries.

Table 2.2.3a: Snapshot of the approval of VGF in India, Indonesia and the Philippines.

India	Indonesia	Philippines
Two-tier approval process: 1. In principle approval 2. Final approval, depending on the project cost either by Empowered Institution (up to Rs.100 crore)[14] or Empowered Committee (up to Rs.200 crore) or requiring the approval of Finance Minister (proposal exceeding Rs.200 crore)	Three-tier approval process: 1. 'Principle' approval 2. Approval of VGF amount via VGF Commission by Finance Minister 3. Final approval by Finance Minister	Four-tier approval process: 1. VGF budget 2. Submit proposal to DBCC 3. Additional surveys for DBCC-approved projects 4. PPP center approves VGF

2.2.4 Disbursement

The government needs to mitigate the risk of private sector performance through the adequate timing of VGF disbursement and the requirement for performance bonds. Using output-based or performance-based milestones to trigger disbursement strengthens the incentives for the private proponent to meet its contractual obligations and ensures that projects are completed on time and the service standards defined in the PPP contract are met.[15]

[14]**Note**: Rs. 100 crore is equal to roughly USD14.75 million. Rs. 200 crore is equal to roughly USD29.5 million.
[15] World Bank Institute, Best practices in public private partnership financing in Latin America, p 19.

Table 2.2.4a: Snapshot of the VGF disbursement in India, Indonesia and the Philippines.

India	Indonesia	Philippines
Cash contribution to cover part of upfront capital costs. (In some cases the subsidies are paid later) Disbursed only after 100% equity is paid, in proportion to the balance debt disbursal by the Lead Financial Institution during the construction period Payments beyond construction period are not precluded	One-off cash injection to support construction costs No disbursement records exist	Cash contribution for capital costs or operating subsidies or hybrid arrangements No disbursement records exist

2.2.5 Monitoring and accounting for state budget

The use of VGF must be monitored to ensure that government can account for the costs to it of PPP project. The method of monitoring VGF usage varies amongst countries including:

- lead private financial institution as the proxy monitor (as in India) and/or
- staff of the subsidy fund or PPP unit assists or leads monitoring (as in India and Indonesia).

Table 2.2.5a: Snapshot of the monitoring of VGF in India, Indonesia and the Philippines.

India	Indonesia	Philippines
Lead Financial Institution monitors the VGF disbursement and achievement of milestones for debt/VGF disbursements are and sends quarterly reports to the Empowered Institution. Under the PPP contract, the contract manager or the implementing agency also monitors performance	PPP Unit monitors contract implementation for VGF	Department of Finance, PPP Center

2.2.6 Institutional structuring options

After reviewing a number of countries' institutional structures (in addition to the study countries) in regards of VGF, the study team has come to a number of general conclusions in regards of institutional structuring options and what general structure that is required to provide VGF.

- Firstly, there is a need for a VGF or PPP unit/body. This unit will usually be established under the Ministry of Finance (or equivalent) with the aim to support implementing agencies in the preparation or VGF proposals, review and circulate the proposals, and confirm projects comply with policy.

- The implementing agency is generally any government body such as local governments, state governments, or Ministry of Transportation (or equivalent) in need of VGF funding to make a PPP project financially viable. The implementing agency takes the lead to develop the project and first assess the VGF needs of the project. With assistance of the VGF unit, they will submit a proposal to a sanctioning authority.

- The sanctioning (approving) authority may be the unit within the Ministry of Finance (or equivalent) tasked with reviewing, providing comments, and approving the VGF proposals. The sanctioning authority could be structured as a smaller council or unit, with time limits imposed on them to review, provide comments, and approve/reject proposals. Once a project has received an initial approval, or in-principal approval, the implementing agency will put the project up for bidding with the VGF amount being the major and deciding factor. Once a private partner for the PPP has been decided on, the project goes back to the sanctioning authority for final approval. The typical structure can be seen below in Table 2.2.6a:

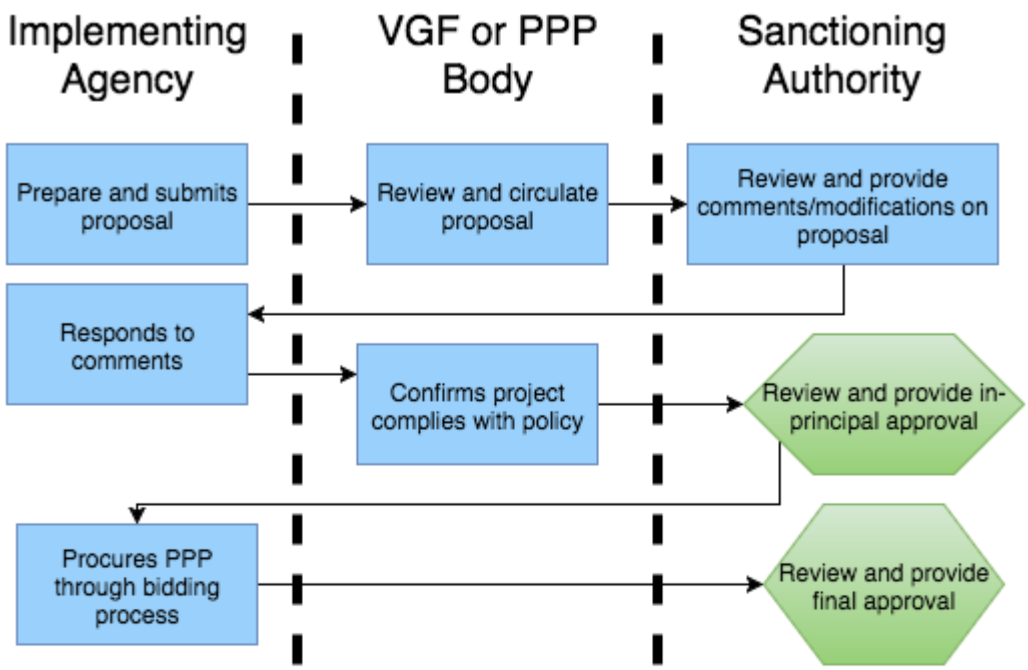

Figure 2.2.6a: Typical institutional structure for VGF, based on international best practices.

2.2.7 Key lessons learned from different VGF structures

The study identifies six key lessons for officials to consider when designing VGF mechanism for PPPs.

1. Fund appropriation- creating a dedicated VGF management body with a clear funding commitment from the government. VGF should not be funded in an ad hoc manner. A strong government commitment to funding VGF in a consolidated manner is needed. This allows for a more streamlined and simplified VGF approval process, attracts attention and increases awareness, increases the number of infrastructure projects done as PPPs and enhances better policies and decision criteria. A good example is India, with its VGF scheme where the processes for assessing and approving VGF grants are clear, providing security to investors with policies that ensure funding is available to meet government's commitments under the program. Other countries, such as Columbia, are beginning to follow this lesson.[16]

2. Designated agency responsible for the assessment and approval of VGF. The assistance provided by the agency in charge of the subsidy program varies, depending on the specific institutional arrangement and the amount of experience with PPPs.[17] The responsible agency responsible for managing the VGF program in the three study countries are:

[16] World Bank Institute, Best practices in public private partnership financing in Latin America, p 16.
[17] World Bank Institute, Best practices in public private partnership financing in Latin America, p 16-17.

- A PPP Unit of the Ministry of Finance in each of India and Indonesia.
- The PPP Center in the Philippines.

The study countries vary a little as to who reviews and approves requests for subsidies. Perhaps more significant than who reviews requests for subsidies is making sure that the staff managing subsidies are involved in the PPP structuring process and applying clear eligibility criteria and assessment methodologies. For VGF approval, it is common for officials from finance and economic planning agencies to be involved, which ensures subsidies being consistent with the country's broader fiscal and economic priorities.[18] Those appraising VGF requests need the technical skillsets to independently assess project needs using clear criteria (below) without undue political influence.

3. Adopting clear, concrete project eligibility criteria. Clear eligibility criteria ensure that only well prepared, economically viable projects receive subsidies. They also increase the amount of private investment mobilized per dollar of subsidy by filtering out weaker projects in favor of more financial sustainable projects. On the other hand, where unclear eligibility criteria exist, projects can be pushed through based on political pressure, as such projects tend to be prioritized on a more *ad hoc* basis rather than the basis of objective criteria. A positive example is India. India has adopted clear criteria for deciding which projects are eligible to receive subsidies and caps the percentage (40%) of total project costs that can be paid by subsidies.

4. Setting a VGF cap or limit subsidization through competitive procurement. Setting the amount of VGF through competitive procurement minimizes the amount the government pays. Competitive pressure (when PPP contracts are openly and competitively tendered) drives private investors to request the minimum amount of subsidy to make a project financially viable. The extreme example of that is where bidders may offer negative VGF, meaning bidders offer a 'premium' to the government if the discounted cash flow indicates that a project is independently financially viable without VGF. This creates an additional source of revenue and ensures the government maximizes value. For example, in the case of India, negative VGF paid by the private investor to the government has proven to be very successful.[19]

5. Disbursement of VGF funds. Using output- or performance-based milestones to trigger disbursement strengthens the incentives for the private proponent to meet its contractual obligations as well as ensure that projects are completed on time and the service standards defined in the PPP contract are met.[20]

6. Monitoring. A key benefit of a centrally managed VGF system is that it assists government to monitor the costs of VGF to the State. The optimal monitoring policy depends on the institutional arrangement in the particular country. In India the lead financial institution is responsible for monitoring and evaluation and performance related to disbursement of VGF that it makes. There are usually three different approaches, each with different advantages and generally countries combine at least two approaches:

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[18] World Bank Institute, Best practices in public private partnership financing in Latin America, p 17.
[19] World Bank Institute, Best practices in public private partnership financing in Latin America, p 18-19.
[20] World Bank Institute, Best practices in public private partnership financing in Latin America, p 19.

- lead private financial institution as the proxy monitor (as in India)
- staff of the subsidy fund or PPP unit assists or leads monitoring (e.g. in India and Indonesia, also in Brazil, Colombia and Mexico) and/or
- an independent agency monitors subsidies (e.g. in Brazil and Colombia).[21]

Additionally, it is considered as best practice to have a separate agency manage VGF apart from other indirect fiscal support (e.g. guarantees) or make support policies non-discretionary. This reduces conflicts of interest and reduces tendency to structure projects with more implicit subsidies. However, for the holistic policy approach, evaluating direct subsidies together with indirect fiscal support ensures that the entire fiscal impact of the project does not exceed its net economic benefits. Publicly and regularly disclosed documents and information on projects receiving subsidies on a website can improve transparency and public awareness and increase the interest, participation and confidence of private investors. Following open and competitive procurement processes for allocating subsidies also increases transparency and is, therefore, widely accepted as best practice.[22]

[21] World Bank Institute, Best practices in public private partnership financing in Latin America, p 20.
[22] World Bank Institute, Best practices in public private partnership financing in Latin America, p 19.

2.3 Country examples

2.3.1 India

2.3.1.1 Legal framework and objectives

Since July 2005, the Government of India has in place a *Scheme for financial support to infrastructure projects that are to be undertaken through Public Private Partnerships*.[23] This scheme applies to PPP projects posed by the Central Ministries, State Governments and Statutory Authorities. VGF, under this Scheme, means a grant one-time or deferred with the objective of making a project commercially viable.

India's VGF program's main underlying objectives are to meet India's infrastructure needs, attract private sector expertise to mobilize additional finance, make PPP projects commercially viable, improve efficiencies, control timing and cost and develop projects through an 'inclusive' approach that does not neglect geographically or economically disadvantaged regions.[24]

2.3.1.2 Institutional structuring

India's VGF program is administered by the PPP Cell in the Ministry of Finance, Department of Economic Affairs.[25] The two sanctioning authorities, an Empowered Committee and Empowered Institution,[26] are responsible for approving financial assistance to PPP projects which satisfy all the eligibility criteria indicated in the Scheme.[27] See Figure 2.3.1.2a below for the process and key features of the scheme.

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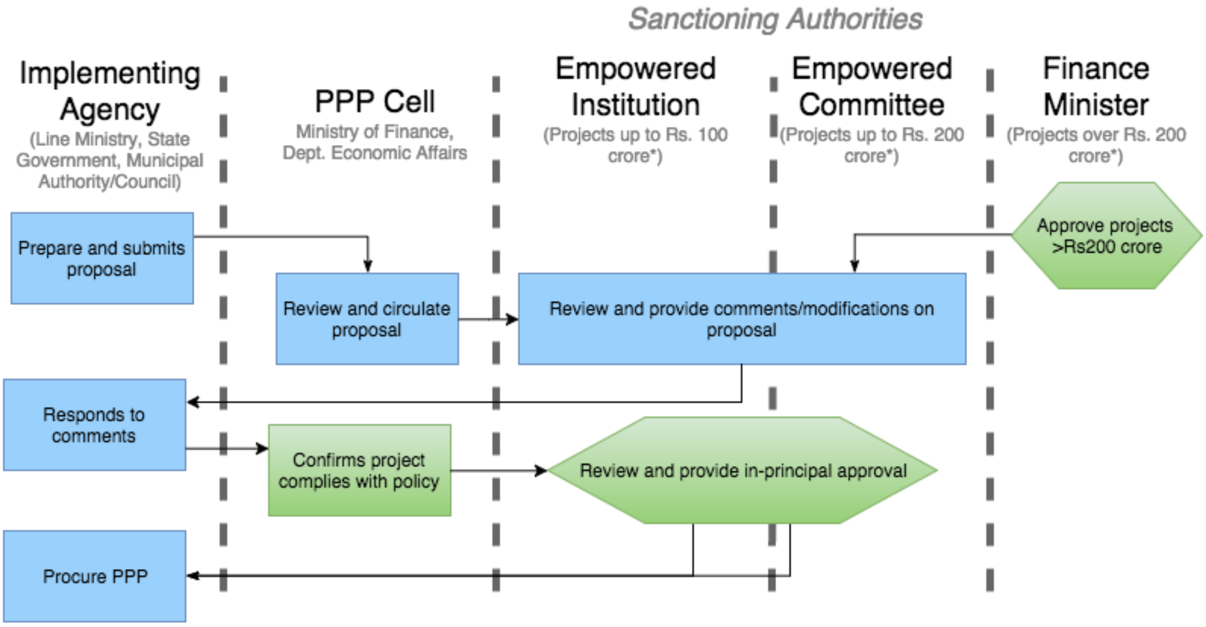
[23] Government of India, Ministry of Finance, Department of Economic Affairs, PPP Cell, Scheme and Guidelines for Financial Support to Public Private Partnerships in Infrastructure, Annex I Scheme for Financial Support to Public Private Partnerships in Infrastructure, 2008, pp 5-9.

[24] **Note:** Allocating VGF would allow the interstate highway network to be developed on a geographically or demographically inclusive basis, allowing economically disadvantaged and remote regions with poor infrastructure, a lower ability to pay cost recovery tolls, and higher construction costs, to access subsidies to make local road investment financially viable. *Source:* Japan International Cooperation Agency (JICA), PricewaterhouseCoopers Co., Ltd., India Study on Basic Information Collection on promoting Foreign Direct Investment to PPP Infrastructure in India Final Report, January 2012, p 1-36, available at: http://open_jicareport.jica.go.jp/pdf/12048427.pdf.

[25] Government of India, Ministry of Finance, Department of Economic Affairs, PPP Cell, Scheme and Guidelines for Financial Support to Public Private Partnerships in Infrastructure, Viability Gap Funding Scheme, 2008, pp 1-4; Government of India, Ministry of Finance, Department of Economic Affairs, PPP Cell, Scheme and Guidelines for Financial Support to Public Private Partnerships in Infrastructure, Annex I Scheme for Financial Support to Public Private Partnerships in Infrastructure, 2008, pp 5-9.

[26] **Note:** *Empowered Committee* means a Committee under the Chairmanship of Secretary (Economic Affairs) and including Secretary (Planning Commission), Secretary (Expenditure) and the Secretary of the line ministry dealing with the subject. *Empowered Institution* means an institution, company or inter-ministerial group designated by the Government.

[27] Public Private Partnerships in India, Ministry of Finance, Government of India, available at: http://www.pppinindia.com/VGF_Home.php.



Source: Retrieved and amended from World Bank Institute, Best practices in public private partnership financing in Latin America, p 91.
Note: *Rs. 100 crore is equal to roughly USD14.75 million (JPY1.74 billion). Rs. 200 crore is equal to roughly USD29.5 million (JPY3.49 billion).28

Figure 2.3.1.2a: Diagram of India's VGF Process.

Annual budget appropriation. Since 2005, India's VGF funds are appropriated on an annual basis in the national budget and normally in the form of a capital grant at the stage of project construction. The amount of VGF to be provided under this Scheme shall be determined through the competitive bidding process, with the VGF amount as the single financial bid variable. The amount of VGF shall be equivalent to the lowest bid for capital subsidy, but subject to a maximum of 20% of the total project cost. If the sponsoring Ministry/State Government/statutory entity proposes to provide assistance over and above the said VGF, it shall be restricted to a further 20% of the total project cost. Therefore, the cap of VGF cannot exceed a total of 40%.[29]

Revolving fund to support project development. There is also USD29.55 million (JPY3.48 billion) in a revolving fund provided by the Finance Ministry to the Empowered Institution to make disbursements to projects for project development ((e.g. a project development facility (PDF) fund structure)), which is later replenished by the Ministry of Finance. VGF for India's National Highway Development Program is appropriated separately.[30]

[28] Exchange rate is based on IND/USD 0.01475026 as of 22/01/2016, retrieved from: http://www.x-rates.com/average/?from=INR&to=USD&amount=1&year=2016.
[29] Rule 4.1 and 4.2 and Rule 5.1 of the Scheme.
[30]**Note:** Starting in 2006 a portion of road user tax revenue in the Central Road Fund is for VGF purposes. The amount of funds for VGF is determined annually by the Planning Commission with input from the Ministry of Finance and the Ministry of Shipping, Road Transport, and Highways. Source: World Bank Institute, Best practices in public private partnership financing in Latin America, p 91-92.

2.3.1.3 Assessment

- Identification and preparation of project proposals. Implementing agencies prepare and submit project proposals.

- Review of project proposals. After the PPP project has been prepared, a proposal is submitted to the PPP Cell in the Ministry of Finance for review. Central government line ministries, state government agencies and municipal councils and authorities that own the relevant PPP project or associated asset are eligible implementing agencies to receive VGF.[31]

    - Eligible sectors. The following sectors are eligible for VGF:

        - roads and bridges, railways, seaports, airports, inland waterways
        - power
        - urban transport, water supply, sewerage, solid waste management and other physical infrastructure in urban areas
        - infrastructure projects in Special Economic Zones and
        - international convention centers and other tourism infrastructure projects.[32]

        Note: The Empowered Committee may, with approval of the Finance Minister, add or delete sectors/sub-sectors from this list.

    - Applicability. The proposal under VGF Funding Scheme shall be considered for providing VGF, one time or deferred, with the objective of making a PPP project commercially viable. Proposals shall relate to a PPP project for delivering an infrastructure service on payment of user charges which is based on:

        - a contract or concession agreement between a Government or statutory entity from one side and
        - a private sector company[33] on the other side.

    The project shall provide a service against user charge or payment of a pre-determined tariff.[34]

    This VGF Funding Scheme applies only if the contract/concession is awarded in favor of a private sector company in which minimum of 51% of the subscribed and paid up equity is owned and controlled by a private entity.

[31] World Bank Institute, Best practices in public private partnership financing in Latin America, p 92.
[32] Government of India, Ministry of Finance, Department of Economic Affairs, PPP Cell, Scheme and Guidelines for Financial Support to Public Private Partnerships in Infrastructure, Annex I Scheme for Financial Support to Public Private Partnerships in Infrastructure, 2008, pp 6-7.
[33]**Note:** *Private Sector Company* means a company in which 51% or more of the subscribed and paid up equity is owned and controlled by a private entity.
[34] Rule 3.1 of the Scheme.

A private sector company shall be eligible for VGF only if it is selected on the basis of open competitive bidding and takes up the responsibility of financing, construction, maintenance and operation of the project during the concession period.[35]

Government/statutory entity shall certify the following:

- the tariff/user charge cannot be increased for elimination or reduction of the viability gap of the PPP
- the project term cannot be increased to reduce the viability gap and
- the capital costs are reasonable and based on the standards and specifications normally applicable to such projects and the capital costs cannot be further restricted for reducing the viability gap.[36]

2.3.1.4 Approval

In India, a two-tier approval process is required prior to provide VGF.

'In principle' approval. Projects that are economically essential yet not financially viable must first receive 'in principle' approval by the Empowered Institution in order to be eligible for VGF. The proposal shall be first sent by an implementing agency to the PPP Cell of the Department of Economic Affairs to be circulated to all members of the Empowered Institution for their comment which shall be returned to the implementing agency by the PPP Cell. The Empowered Institution will either approve the proposal 'in principle' or advise the concerned implementing agency to provide additional clarifications/information or to make necessary changes for further consideration.[37]During this stage, the implementing agency will have estimated the VGF needs of a project when requesting the in principle approval. However, it is assumed that the 'in principle' approval applies for the maximum allowable VGF (e.g. 20% from Central funds and 20% from the State or Ministry funds).

Final approval. Approval of projects is in the hands of the following two sanctioning authorities depending on the size of a project:

- The Empowered Institution annually approves VGF up to USD14.75 million (JPY1.6 billion), projects with a limitation of the value of approvals to ten times its annual appropriations for the VGF.

- The Empowered Committee sanctions VGF between USD14.75 million (JPY1.6 billion) and USD29.55 million (JPY3.2 billion) for each project subject to the budgetary ceilings indicated by the Finance Ministry.

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[35] Rule 3.1 of the Scheme. Government of India, Ministry of Finance, Department of Economic Affairs, PPP Cell, Scheme and Guidelines for Financial Support to Public Private Partnerships in Infrastructure, 2008, p 1.
[36] Government of India, Ministry of Finance, Department of Economic Affairs, PPP Cell, Scheme and Guidelines for Financial Support to Public Private Partnerships in Infrastructure, Annex I Scheme for Financial Support to Public Private Partnerships in Infrastructure, 2008, p 7.
[37] Government of India, Ministry of Finance, Department of Economic Affairs, PPP Cell, Scheme and Guidelines for Financial Support to Public Private Partnerships in Infrastructure, 2008, p 2.

- The Empowered Committee with the approval of Finance Minister may be sanctioned by amounts exceeding USD29.55 million (JPY3.2 billion).[38]

As of 2015, a total of 198 projects with the total amount of funding of USD14,065.1 million (JPY1.6 trillion) have been approved in principle to receive VGF, with the majority in the roads sector. One project in the capacity building sector did not get the total VGF approved with the total amount of this funding being USD31.9 million (JPY3.5 billion). Merely 56 projects in total received final approval to receive VGF worth just below INR 53 billion (JPY68.68 billion). See Table 2.3.1.4a below.

[38] Public Private Partnerships in India, Ministry of Finance, Government of India, available at: http://www.pppinindia.com/VGF_Home.php; World Bank Institute, Best practices in public private partnership financing in Latin America, p 91-92.

Table 2.3.1.4a: Sectoral Spread of VGF Proposals (USD million) as of 2015.

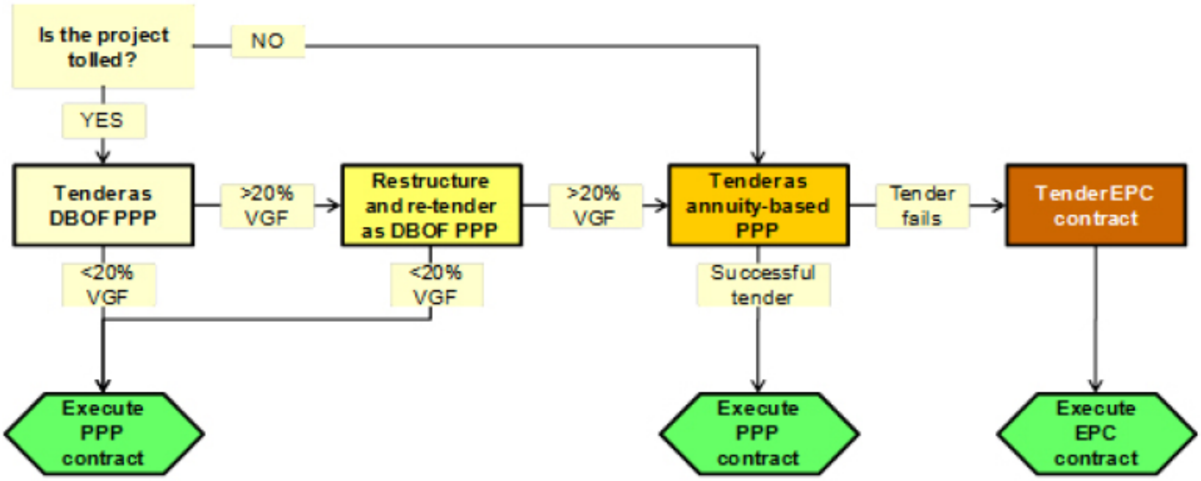
In-principle*: Total Projects: 198, TPC: USD14,065.1 million (JPY1.6 trillion), VGF Approved: USD 2,467.9 million (JPY2.7 trillion).*
Final: *Total Projects: 56, TPC: USD 4,690.1 million (JPY5.1 trillion), VGF Approved: USD 777.9 million (JPY8.5 billion).*

	Sector	In-principle				Final			
		No. of Projects	Total Project Cost USD million	Total VGF Approved	% of VGF	No. of Projects	Total Project Cost	Total VGF Approved	% of VGF
1	Airport	1	52.3	10.5	20.00%	-	-	-	-
2	Capacity Building	1	31.9	0.0	0.00%	-	-	-	-
3	Education	25	69.3	7.5	10.80%	-	-	-	-
4	Health	2	96.4	19.3	20.00%	-	-	-	-
5	Metro	2	2,872.5	574.4	20.00%	1	1,742.6	215.1	12.34%
6	Port	1	579.7	0.0	0.00%	-	-	-	-
7	Power	4	387.2	69.8	18.02%	2	98.0	19.6	20.00%
8	Road	151	9,903.2	1,771.7	17.89%	46	2,795.7	535.4	19.15%
9	Silos	10	44.9	9.3	20.65%	6	26.1	2.2	8.58%
10	Water Supply & Sanitation	1	27.7	5.5	20.00%	1	27.7	5.5	20.00%
	Total	**198**	**14,065.1**	**2,467.9**	**17.55%**	**56**	**4,690.1**	**777.9**	**16.59%**

Source: Retrieved and amended from PPP Cell, Department of Economic Affairs, Ministry of Finance; Mahapatra, A., Sharing India's PPP Experience, UNESCAP Policy Dialogue on PPPs in Infrastructure Kathmandu, PPP Cell, Ministry of Finance Government of India, 22 September 2015, slide 22, available at: http://www.unescap.org/sites/default/files/Day%201%20-%20Session%202.2%20-%20India%20PPP.pdf.

After the final approval, the implementing agency conducts the procurement process and certifies that it conforms to the procurement rules.[39]

India has in place a unique explicit decision rule when it evaluates and approves VGF for PPPs in the transport sector, as follows:



Source: World Bank Institute, Best practices in public private partnership financing in Latin America, p 95.

Figure 2.3.1.4b: Decision rule for approving VGF and PPP projects in the transport sector.

Revenue-generating (e.g. tolled) PPPs have to be structured and bid out with the private company accepting all main functions- designing and building, operating and financing the project. The technical design of a project is part of a private bidder's proposal.[40] If the first tender is successful and less than 20% VGF and 20% funding from another government entity is required then a contract is executed. Otherwise, the project must be restructured and retendered.[41] See Figure 2.3.1.4b above for a more detailed decision rule.

Note: there is no detailed feasibility study or economic cost-benefit analysis included in the request for VGF.[42]

[39] World Bank Institute, Best practices in public private partnership financing in Latin America, p 92; Tony Blair Associates, Memorandum Viability Gap Financing: Enabling Public-Private Partnerships, p 8.
[40] *Note: This places the burden of the feasibility study on the private sector player, which is not the process adopted by Vietnam under Decree 15. The Vietnam PPP cycle would allow VGF to be assess on the basis of a complete feasibility study.*
[41] World Bank Institute, Best practices in public private partnership financing in Latin America, p 95.
[42] World Bank Institute, Best practices in public private partnership financing in Latin America, p 94-96.

2.3.1.5 Disbursement

Prior to disbursement, the Empowered Institution, the Lead Financial Institution[43] and the private sector company enter into a Tripartite Agreement.[44] India's VGF funds are generally paid as cash to cover part of upfront capital costs.[45] In some cases the subsidies are paid later (e.g. during the construction period or during initial years of operation) to meet debt service when initial revenues are low. VGF shall be disbursed only after the Private Sector Company has subscribed and expended the equity contribution required for the project and will be released in proportion to debt disbursements remaining to be disbursed thereafter. The Empowered Institution shall release the VGF to the Lead Financial Institution as and when due, and obtain reimbursement from the Finance Ministry.[46]

India's disbursement scheme has several benefits:

- helps to ensure that money is actually being invested in a project before the government makes a payment and
- with all equity invested first and debt being invested proportionally to VGF, the government is never the most financially exposed party. [47]

2.3.1.6 Monitoring

The Lead Financial Institution is responsible for regular monitoring and periodic evaluation of project compliance with agreed milestones and performance levels, particularly for the purpose of disbursement of VGF and shall send quarterly progress reports to the Empowered Institution which will make a consolidated progress report once every quarter for review by the Empowered Committee.[48]

As the subsidy is tied to senior debt in India, senior lenders act as the proxy monitoring agent for the VGF contribution, and throughout the life of the project, on behalf of the government. This way the burden of monitoring is delegated to the third-party investor with a strong financial incentive to check that construction is completed on time and to adequate quality, and that performance standards are being met.[49]

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[43] **Note:** *Lead Financial Institution* means the financial institution that is funding the PPP project and in case there is a consortium of financial institutions, the financial institution designated as such by the consortium.
[44] Rule 8.3 of the Scheme.
[45] ***Note:*** *India's VGF funds are generally for project development costs, not for the actual CAPEX or OPEX needs. This is different from the needs of Vietnam.*
[46] Rule 8.1 of the Scheme.
[47] World Bank Institute, Best practices in public private partnership financing in Latin America, p 100.
[48] Government of India, Ministry of Finance, Department of Economic Affairs, PPP Cell, Scheme and Guidelines for Financial Support to Public Private Partnerships in Infrastructure, Annex I Scheme for Financial Support to Public Private Partnerships in Infrastructure, 2008, p 9.
[49] World Bank Institute, Best practices in public private partnership financing in Latin America, p 99.

2.3.1.7 Investment impact

According to the PPP Cell, PPP Approval Committee approved 287 proposals in the Central Sector (from 2006-07 to 2015-16) valued at USD4.8 billion (JPY534 billion).[50]

Table 2.3.1.7a: Sectoral Spread of PPP Approval Committee's Proposals.

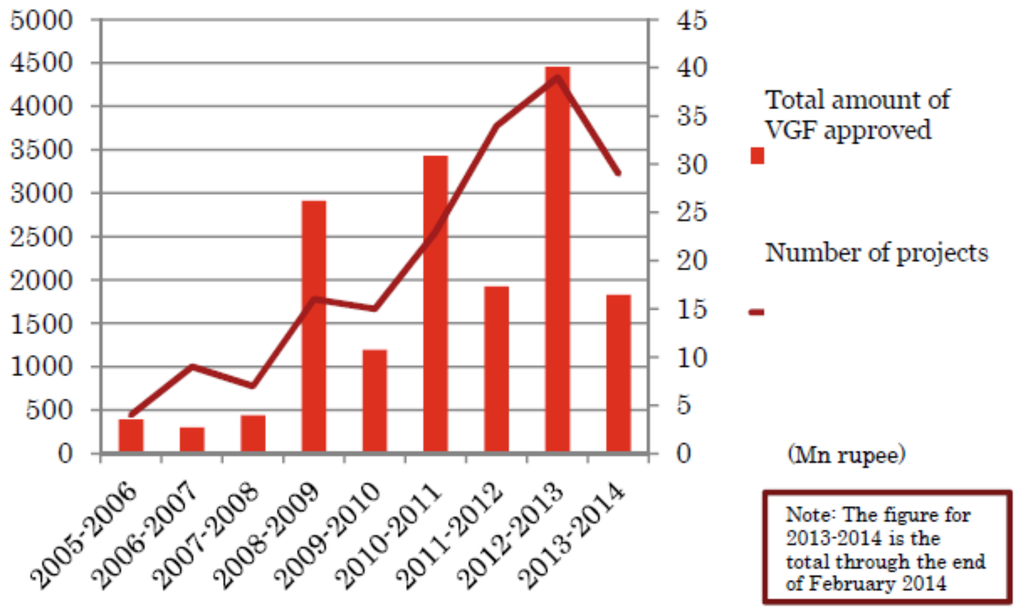
	No of Projects	Total Project Cost (USD millions)
Civilian Aviation	2	-
Housing	8	1,076.65
Ports	34	6,604.54
Railways	1	1,253.77
Roads	236	39,305.53
Sports	5	-
Tourism	1	21.96
Total	**287**	**48,262.45**

Source: Retrieved and amended from Mahapatra, A., UNESCAP Policy Dialogue on PPPs in Infrastructure Kathmandu, Sharing India's PPP Experience, 22 September 2015, PPP Cell, Ministry of Finance Government of India, slide 18, available at: http://www.unescap.org/sites/default/files/Day%201%20-%20Session%202.2%20-%20India%20PPP.pdf.[51]

[50] Mahapatra, A., UNESCAP Policy Dialogue on PPPs in Infrastructure Kathmandu, Sharing India's PPP Experience, 22 September 2015, PPP Cell, Ministry of Finance Government of India, slide 18, available at: http://www.unescap.org/sites/default/files/Day%201%20-%20Session%202.2%20-%20India%20PPP.pdf.

[51] **Note:** FX based are updated to reflect JPY/USD rate of 111.1 as of 30/05/16, retrieved from: http://www.x-rates.com/

As of February 2014, 176 projects were approved to receive VGF with the total amount of funding being USD2.47 billion (JPY300 billion).[52] Since 2006, when the program became operational, 23 PPP projects with a total investment of USD3.5 billion (JPY389 billion) have received subsidies or VGF funds for a total investment of USD115.8 billion (JPY12.9 trillion).43 PPPs with a total capital investment cost of USD5.4 billion have been approved or are under review.[53] As of March 2011, around 40 projects with a total project cost of USD2.4 billion (JPY267 billion) (total VGF sought USD470 million (JPY52.3 billion)) have receive the 'in-principle' approval. Approximately 75% were in the roads & highways sector. Another 25 project proposals are under consideration with the total project cost of USD4.3 billion (JPY478.5 billion).[54] See Figures 2.3.1.7b, 2.3.1.7c, 2.3.1.7d and 2.3.1.7e below.



Source: METI, Basic research of laws and regulations for getting into markets of emerging countries, p 123.

Figure 2.3.1.7b: Total amount of project approved annually to receive VGF versus the number of PPP projects.

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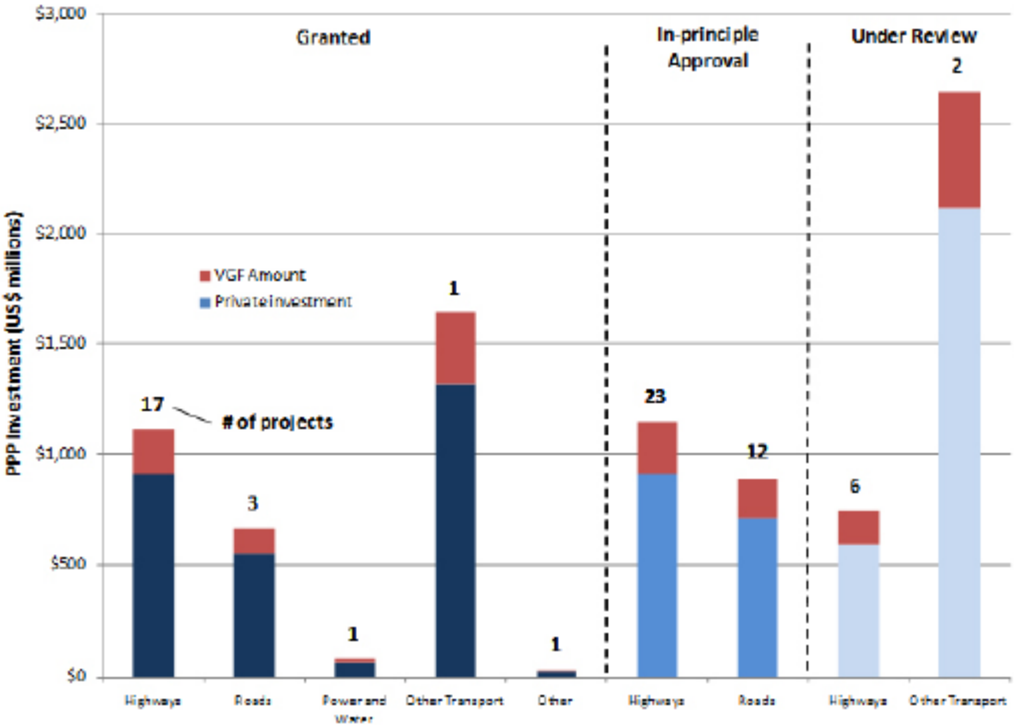
[52] Basic research of lows [laws] and regulations for getting into markets of emerging countries, Final Report (Executive Summary), March, 2014 Ministry of Economy, Trade and Industry, p 124, available at: http://www.meti.go.jp/meti_lib/report/2014fy/E003946.pdf [hereinafter METI, Basic research of lows [laws] and regulations for getting into markets of emerging countries].

[53] World Bank Institute, Best practices in public private partnership financing in Latin America, p 86, 90, 100; Ministry of Planning and Investment/Ministry of Finance, Government of Viet Nam, TA-8313 REG: Developing PPP Government Support and Risk Management Systems, Final Report, 21 January 2015, p 7-8; Tony Blair Associates, Memorandum Viability Gap Financing: Enabling Public-Private Partnerships, p 8.

[54] Japan International Cooperation Agency (JICA), PricewaterhouseCoopers Co., Ltd., India Study on Basic Information Collection on promoting Foreign Direct Investment to PPP Infrastructure in India Final Report, January 2012, p 1-36, available at: http://open_jicareport.jica.go.jp/pdf/12048427.pdf.



Source: World Bank Institute, Best practices in public private partnership financing in Latin America, p 101.

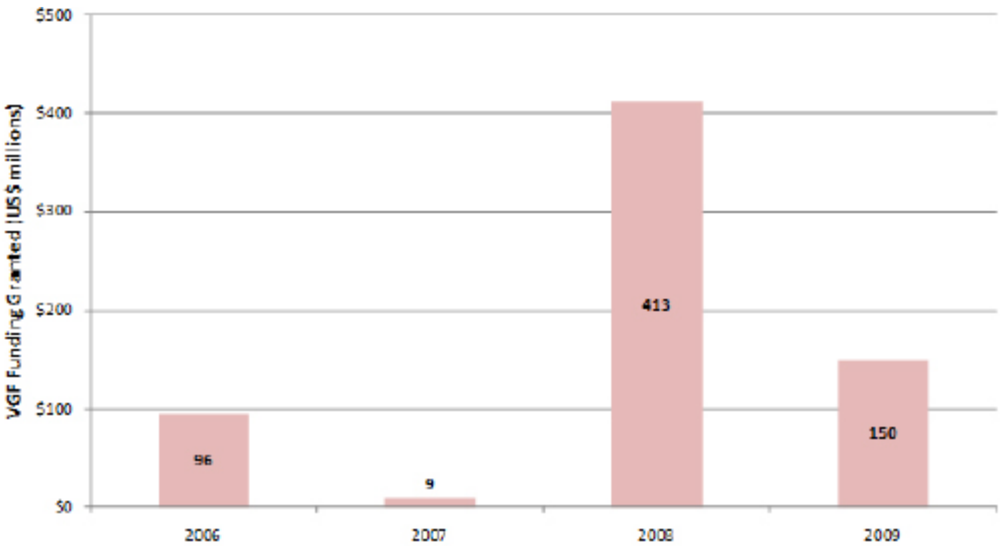
Figure 2.3.1.7c: VGF Projects in India.

Table 2.3.1.7d: Total VGF Projects considered in India. (in USD millions).

No.	Particulars	No of Projects	Total Project Cost	Total VGF Approved (in principle)	Total VGF Approved (Final)
1	Approved Projects	199	14,166.10	2,467.95	779.34
2	Projects Under Consideration	1	191.55	0.00	0.00
3	Other Proposals	7	1,678.51	0.00	0.00
	Total Proposals	**208**	**16,036.16**	**2,467.95**	**779.34**

Source: Retrieved and amended from Public Private Partnerships in India, Ministry of Finance, Government of India, Viability Gap Funding (VGF) Projects, available at: http://www.pppinindia.com/VGF_Projects_Level1.php.[55]

[55]**Note:** FX based are updated to reflect JPY/USD rate of 111.1 as of 30/05/16, retrieved from: http://www.x-rates.com/

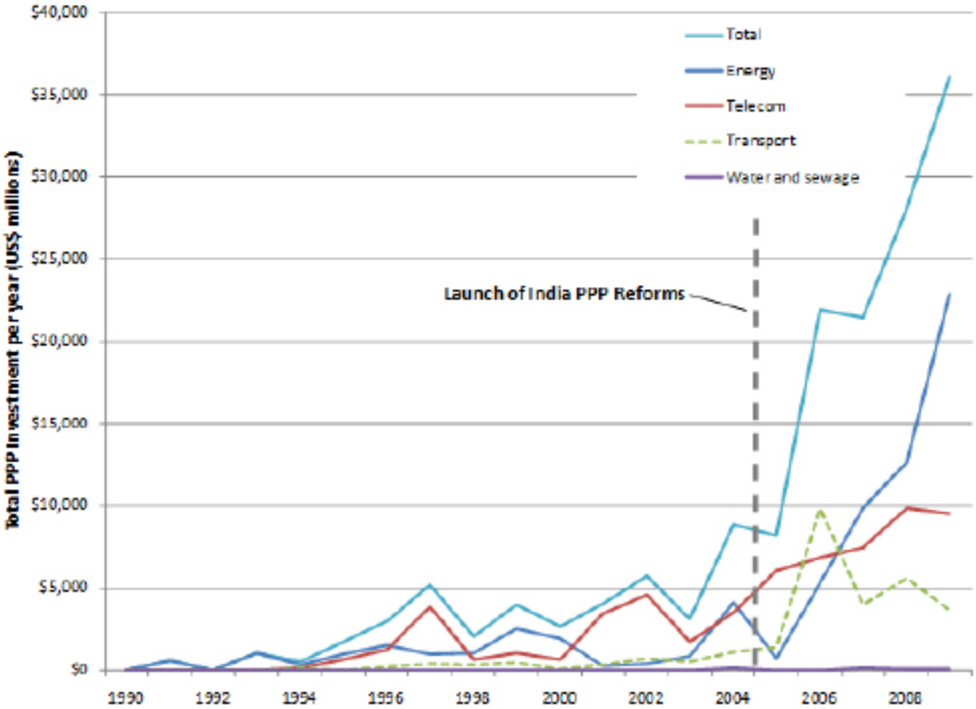


Source: World Bank Institute, Best practices in public private partnership financing in Latin America, p 101.

Figure 2.3.1.7e: VGF Funds Granted in India by Year (2006-2009).

The average amount of VGF granted to PPP projects requesting subsidies has been close to the 20% cap. The majority of projects have been financially viable without needing subsidies. In the transport sector, over 80% of projects received no VGF or paid a negative VGF to the government.[56]

[56] World Bank Institute, Best practices in public private partnership financing in Latin America, p 102.



Source: World Bank Institute, Best practices in public private partnership financing in Latin America, p 102.

Figure 2.3.1.7f: Time Series of Total PPP Investment in India.

The statistics shows that over the period of 2005 to 2009, total investment in projects receiving VGF (USD3.5 billion, equivalent to JPY388 billion) has been just 3% of total private investment in core infrastructure (USD115.8 billion, equivalent to JPY12.9 trillion). The private finance to VGF mobilization ratio is over 170—meaning every dollar of subsidies is associated with 170 dollars of private finance for subsidies through the VGF program. See Table 2.3.1.7g.

Table 2.3.1.7g: Investment Impact in India (2005 – 2009).

Indicator	India (2005-2009)
USD investment in PPP projects receiving VGF	USD3.5 billion
Average VGF to project value	20%
USD value of all PPP projects	USD115.8 billion (USD23.1 billion/year)
Total annual investment in PPP project/GDP	1.6%
VGF/PPI (inverse = mobilization effect)	0.6% (170 X)

Source: Retrieved and amended from World Bank Institute, Best practices in public private partnership financing in Latin America, p 103.[57]

[57]**Note:** FX based are updated to reflect JPY/USD rate of 111.1 as of 30/05/16, retrieved from: http://www.x-rates.com/

2.3.2 Indonesia

2.3.2.1 Legal framework and objectives

The Government of Indonesia issued Presidential Regulation No. 32 of 2011 regarding The Master Plan for the Acceleration and Expansion of Indonesia's Economic Development (MP3EI) 2011-2025.[58]Presidential Regulation No. 67 of 2005 on PPP in Infrastructure Development and its revision through Presidential Regulation No. 13 of 2010 were adopted by Indonesian government as a basis of PPP frameworks. In November 2012, the Ministry of Finance issued a revised version of detailed regulations related to VGF in Ministry of Finance Regulation No. 223/PMK. 011/2012. According to Regulation Number 223/2012, the objectives of VGF are to increase the financial viability of the project, increase certainty of infrastructure project provision (in accordance to the designed quality and timing) and to increase the public services provision through the infrastructure with affordable tariff. Further detailed regulations on VGF schemes are in Ministry of Finance Regulation 143/PMK.011/2013. The Ministry of Finance is currently developing detailed regulatory framework for VGF. The National Development Planning Board, Economic Coordination Minister's Office, the Ministry of Finance and the National Land Agency are also looking into establishing a new organization to promote infrastructure development.[59]

Additional relevant regulations:

- Presidential Regulation No. 56/2011, concerning the Infrastructure Provision through Public-Private Partnership, allowing Government to provide government support and guarantee
    - Section 17A (4): according to which Minister of Finance may approve the provision of Government support in the form of tax incentives and/or financial contribution based on the proposal from the Government Contracting Agency (Minister/Head of Institution/Head of Local Government)
- Minister of Finance Regulation Number 223/2013 concerning Construction Cost Contribution for Public Private Partnership Project.[60]

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[58] Ministry of Finance Republic of Indonesia, Government Fiscal & Financial Support on Infrastructure Project Fiscal Policy Office, World Export Development Forum, 15 October 2012, Jakarta, slide 4.
[59] METI, Basic research of lows [laws] and regulations for getting into markets of emerging countries, p 128; Saragih, F. R., Indonesia Infrastructure Development, Ministry of Finance, The Republic of Indonesia, Director of Government Support and Infrastructure Financing Management Ministry of Finance, The Republic of Indonesia, slide 9, available at: http://www.iesingapore.gov.sg/~/media/IE%20Singapore/Files/Events/iAdvisory%20Series/Indonesia_29Apr15/420Opportunities20in20Indonesias20PPP20sector.pdf.
[60] Saragih, F. R., Role of Ministry of Finance to promote PPP Infrastructure Development, Ministry of Finance, The Republic of Indonesia, Centre for Fiscal Risk Management Fiscal Policy Office 1, Head of Center for Fiscal Risk Management, Fiscal Policy Office, Ministry of Finance the Republic of Indonesia, Tokyo, January 2013, slide 5, available at: http://www.jica.go.jp/press/2012/ku57pq000012e8t8-att/20130124_02_04.pdf.

Objectives of VGF, under MOF Regulation Number 223/2012, are to increase the financial viability of the project, increase certainty of infrastructure project provision in accordance to the designed quality and timing and enhance the public services provision through the infrastructure with affordable tariff.[61]

2.3.2.2 Institutional structuring

Indonesia's VGF program is administered by the PPP Unit in Ministry of Finance. It was set up under the Ministry of Finance for project preparation and enabling environment to accelerate the PPP Agenda. Among one of the mandates of the PPP Unit is to coordinate all public finance instruments so project has a single financing/guarantee support package.[62] Two institutions are in charge of the financing and in particular the VGF of projects whilst answering to the Risk Management Unit- the Indonesian Infrastructure Financing Facility and Sarana Multi Infrastruktur.[63] Sarana Multi Infrastruktur provides local financing complementary to that of the international banks and implements VGF where projects are considered borderline viable and thus not entirely bankable.[64]

Annual budget appropriation. Indonesia has modeled its VGF scheme after India's. VGF is defined as the government fiscal policy to support the infrastructure provision through the PPP scheme. VGF in Indonesia is one of several tools used to facilitate the development of PPP projects and comes in the form of capital grants for construction costs. VGF is used to reduce capital costs and does not include operating costs.[65] VGF is only allowed to be used if it is the last option to make an economically important but financially unviable project happen and, when utilized, becomes the only bidding parameter.[66] There is no dedicated VGF fund. VGF is allocated by the Government through State Budget, taking into consideration state budget ability, fiscal sustainability and fiscal risk management.[67] The VGF is provided as a one-off cash injection to support up to 40% of construction costs, granted there is no other practical alternative to making the project viable. According to the Minister of Finance

[61] Saragih, F. R., Indonesia Infrastructure Development, Ministry of Finance, The Republic of Indonesia, Director of Government Support and Infrastructure Financing Management Ministry of Finance, The Republic of Indonesia, slide 9, available at: http://www.iesingapore.gov.sg/~/media/IE%20Singapore/Files/Events/iAdvisory%20Series/Indonesia_29Apr15/420Opportunities20in20Indonesias20PPP20sector.pdf.

[62] Pakpahan, R., New approaches in financing infrastructure, Ministry of Finance, Republic of Indonesia, at the Asia-Pacific High Level Consultation on Financing for Development, Jakarta, April 2015, slide 7, available at: https://www.unescap.org/sites/default/files/Session%203%20Robert%20Pakpahan.pdf.

[63] Sarana Multi Infrastruktur operates in terms of Government Regulation 75 of 2008 and is a conduit to channel funds into the PT IIFF, which is a private entity in which the World Bank, the IFC, Asian Development Bank, KfW and DEG hold shares.

[64] OECD Reviews of Regulatory Reform, Indonesia, PPP Governance: Policy, Process and Structure, p 16, available at: http://www.oecd.org/gov/regulatory-policy/Chap%206%20PPPs.pdf.

[65] METI, Basic research of lows [laws] and regulations for getting into markets of emerging countries, p 128.

[66] The Economic Research Institute for ASEAN and East Asia (ERIA), PPP Country Profile: Indonesia, available at: http://www.iesingapore.gov.sg/~/media/IE%20Singapore/Files/Events/iAdvisory%20Series/Indonesia_29Apr15/420Opportunities20in20Indonesias20PPP20sector.pdf.

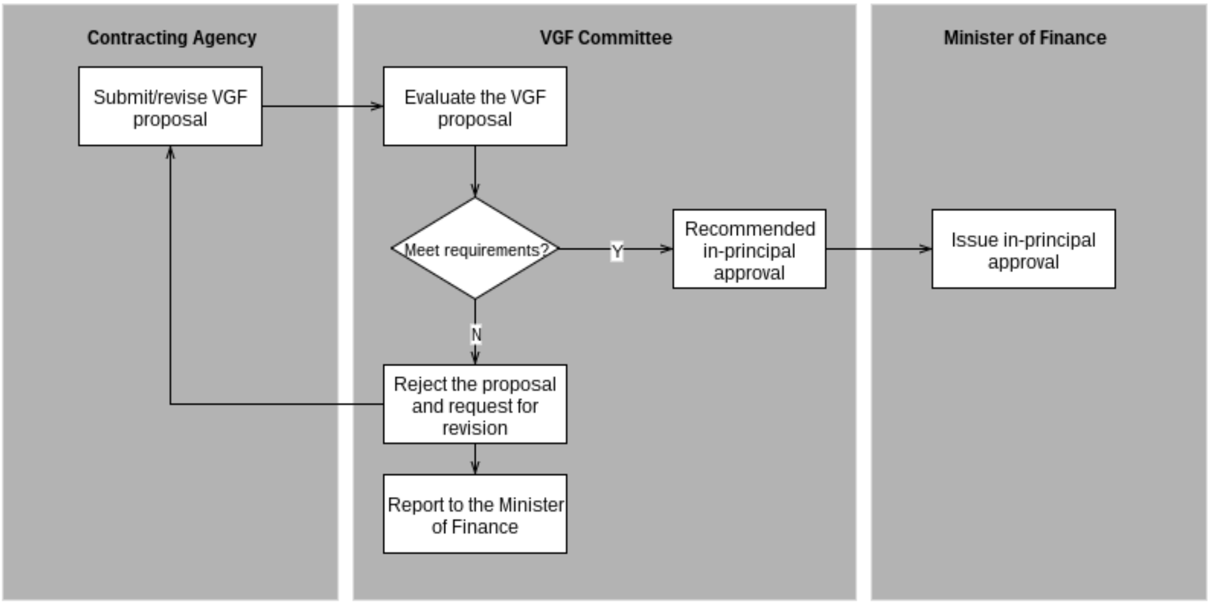
[67] Saragih, F. R., Ministry of Finance, The Republic of Indonesia, Role of Ministry of Finance to promote PPP Infrastructure Development, Centre for Fiscal Risk Management, Fiscal Policy Office 1, Head of Center for Fiscal Risk Management, Fiscal Policy Office, Ministry of Finance the Republic of Indonesia, Tokyo, January 2013, slide 7, available at: http://www.jica.go.jp/press/2012/ku57pq000012e8t8-att/20130124_02_04.pdf.

Regulation 143/2013 the support is limited to 20% of construction costs unless the project is proposed by the sponsoring government agency, which can warrant an additional 20%.[68] However, VGF does not dominate the financing of the project construction cost.[69] The ultimate decision on the need for VGF lies with the Indonesian VGF Unit created by the Ministry of Finance.

2.3.2.3 Assessment

Identification, preparation and review of project proposals. The provision of VGF is a process involving the contracting agency and the VGF Committee of the Ministry of Finance. It starts with a proposal submission to the VGF Committee by the Contracting Agency, which then evaluates the substance and completion of documents, the rationale, the submission procedures and the requested amount of VGF support. If any of these criteria are not met, the VGF Committee rejects the proposal and requests a revision from the contracting agency and reports to the Minister of Finance. If the VGF proposal meets all the requirements, the VGF Committee will send the Minister of Finance a recommendation for an 'in-principal' approval.[70] The final decision then ultimately rests with the Minister of Finance.

Figure 2.3.2.3a below is a simplified process for approving VGF funding grants.



Source: Amended and retrieved from Akintoye, A., Beck, M. and Kumaraswamy, M., Public Private Partnerships: A Global Review, 2015.

Figure 2.3.2.3a: Indonesia's VGF approval procedure (simplified).

68 Akintoye, A., Beck, M. and Kumaraswamy, M., Public Private Partnerships: A Global Review, 2015.
69 Saragih, F. R., Role of Ministry of Finance to promote PPP Infrastructure Development, Fiscal Policy Office Ministry of Finance the Republic of Indonesia, Tokyo, January 2013, slide 7, available at: http://www.jica.go.jp/press/2012/ku57pq000012e8t8-att/20130124_02_04.pdf.
70 Akintoye, A., Beck, M. and Kumaraswamy, M., Public Private Partnerships: A Global Review, 2015.

- Eligible sectors. Eligible sectors subject to VGF are the same as those subject to PPP as stipulated under the Presidential Decree 67/2005, Chapter 2, Article 4 and PR No. 56/2011 which are the following:

  - transport infrastructure (railroad, ports/harbors, airports, roads, etc.),
  - irrigation equipment
  - waterworks facilities
  - communication facilities
  - electric power infrastructure (power generators, distribution equipment, etc.)
  - oil and gas related facilities and
  - other equipment related to these fields.[71]

- Applicability. The conditions for receiving VGF disbursement are:

  - economically viable but not financially feasible project
  - VGF financed projects are Build-operate-transfer (BOT) and user-pay principle contracts
  - minimum investment of approximately USD10 million (JPY1.1 billion), equivalent to RP100 billion
  - the cooperation agreement should set up the asset transfer and/or asset management scheme from the investors to Government Contracting Agency at the end of concession period
  - private capital selected following open and competitive bidding process following PPP regulations where VGF amount is the only financial bidding parameter and
  - feasibility study should show the optimal risk allocation between investors and Government Contracting Agency and that the project is economically viable and becomes financially feasible with VGF support.[72]

2.3.2.4 Approval

In Indonesia, a three-tier approval process is required prior to provide VGF.

- 'Principle' approval. This is a pre-approval for the VGF grant, before prequalification. Private company prepares the principle proposal, including the feasibility study. Principle appraisal and principle recommendation are done by VGF Commission to the Finance Minister who gives principle approval.

- Approval of VGF amount. This follows pre-qualification. Private company prepares the VGF amount proposal which shall be appraised by VGF Commission who also gives

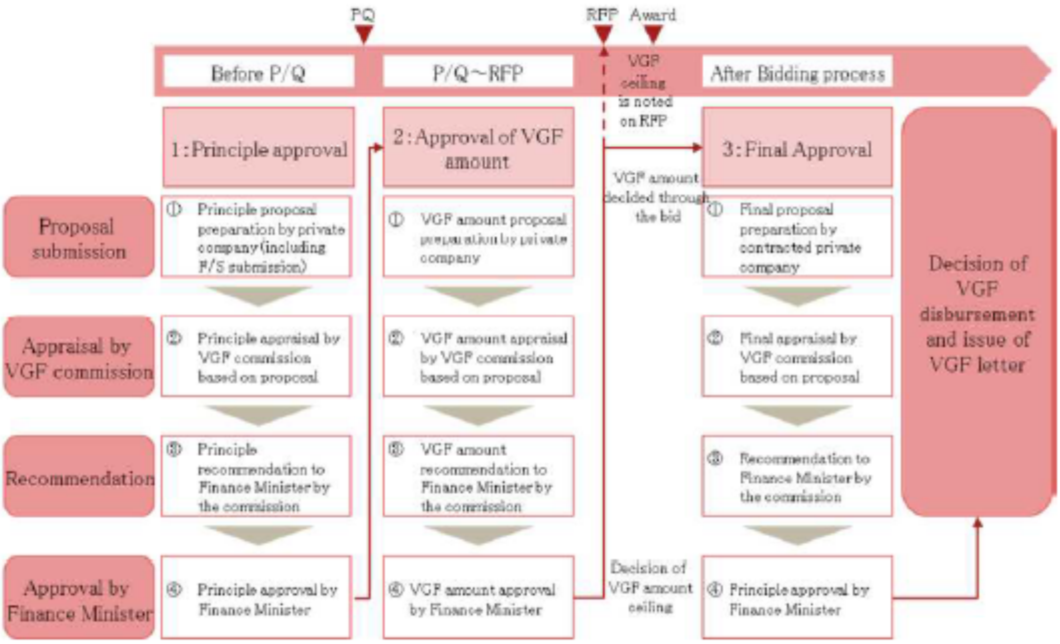
[71] METI, Basic research of lows [laws] and regulations for getting into markets of emerging countries, p 129.
[72] METI, Basic research of lows [laws] and regulations for getting into markets of emerging countries, p 129; Saragih, F., Role of Ministry of Finance to promote PPP Infrastructure Development, January 2013, available at: http://www.jica.go.jp/press/2012/ku57pq000012e8t8-att/20130124_02_04.pdf.

recommendation to Finance Minister. Finance Minister has the mandate to approve the VGF amount.

- Final Approval. Final approval takes place after bidding process and the selection of a private-sector contractor. The contracted private company prepares the final proposal. VGF Commission gives final appraisal and recommendation to Finance Minister. Finance Minister has the mandate to give principle approval after which the decision of VGF disbursement and issue of VGF letter follow.[73]

The following process must be carried out to gain approach at each stage.

- developers submit proposal prior to the prequalification stage- a proposal and pre-feasibility study must be submitted simultaneously
- screening by the VGF committee
- VGF committee makes a recommendation to the Minister of Finance and
- Minister of Finance approves the amount of the VGF grant.



Source: METI, Basic research of [laws] and regulations for getting into markets of emerging countries, p 130.

Figure 2.3.2.4a: Indonesia's VGF approval procedure (in detail).

2.3.2.5 Disbursement

The Ministry of Finance assesses the requirement of VGF of each project. The study team has been unable to verify any VGF payments that have actually been disbursed. There is evidence of proposed

[73] METI, Basic research of lows [laws] and regulations for getting into markets of emerging countries, p 130.

VGF projects[74] but no concrete figures pointing towards any actual VGF disbursements or number of projects.

Indonesia's VGF is expected to be provided in installments with the exact timing provided at set stages during the construction period or after the start of operations, or a combination. The sponsor must contribute a minimum of 20% of the investment in the project, as a condition of the VGF, and the first payment must be made out of the investment money from the lender.[75]

2.3.2.6 Monitoring

PPP Unit, acting on behalf Minister of Finance, monitors contract implementation for VGF.[76]

2.3.2.7 Investment impact

VGF in Indonesia is one out of several tools used to enable PPPs, including the Land Fund, Guarantee Fund and Infrastructure fund. It is maintained that VGF support is only to be utilized as a last resort to make PPP projects financially viable.

Table 2.3.2.7a: List of PPP Projects in Indonesia.

PROJECT	TOTAL PROJECT (IDR)	UPDATED STATUS
POWER SECTOR		
Central Java Power Plant	40 trillion	Finalizing the rest of land acquisition (handled by PLN)
Mine Mouth 9-10, South Sumatera	54 trillion	Final tender documents has been issued on Des 2014 and GCA will hold Bid submission on Mei 2015
Oil Refinery, Bontang	Approx. 60 trillion	Minister of MEMR has informally pointed Pertamina as CA
WATER SECTOR		
Umbulan Water Supply	2 trillion	Processing VGF proposal
Lampung Water Supply	1 trillion	Waiting for VGF nominal approval from MOF
West Semarang Water Supply	765 billion	Waiting for VGF "in principle" approval from MOF
TRANSPORTATION		
Airport Railway-Soekarno Hatta International Airport	24 trillion	Completing PQ's documents (VGF proposal)
Manado-Bitung Toll Road	4.3 trillion	Determined as PPP Project
Balikpapan-Samarinda Toll Road	11.4 trillion	Determined as PPP Project

[74] Saragih, F. R., Indonesia Infrastructure Development, April 2015, available at: http://www.iesingapore.gov.sg/~/media/IE%20Singapore/Files/Events/iAdvisory%20Series/Indonesia_29Apr15/420Opportunities20in20Indonesias20PPP20sector.pdf.
[75] METI, Basic research of lows [laws] and regulations for getting into markets of emerging countries, p 131.
[76] Saragih, F. R., Indonesia Infrastructure Development, April 2015, slide 7, available at:http://www.iesingapore.gov.sg/~/media/IE%20Singapore/Files/Events/iAdvisory%20Series/Indonesia_29Apr15/420Opportunities20in20Indonesias20PPP20sector.pdf.

Source: Saragih, F. R, Indonesia Infrastructure Development, April 2015, slide 11, available at:http://www.iesingapore.gov.sg/~/media/IE%20Singapore/Files/Events/iAdvisory%20Series/Indonesia_29Apr15/420Opportunities20in20Indonesias20PPP20sector.pdf.

2.3.2.8 Areas for growth

The government of Indonesia is considering providing VGF for waterworks projects (e.g. Bandar Lampung waterworks project, West Sumatra water supply project) which is currently uncharted area for VGF. According to interviews carried out by Ministry of Economy, Trade and economy, there are certain cases where it would be necessary to provide VGF to cover more than 50% of the project cost to ensure commercial viability. Therefore, the government is beginning to examine the possibility of additional expenditures by local governments and the use of an availability payment approach.[77]

Indonesia's VGF scheme is still in initial stages and it will be necessary for the government to issues detailed regulations on project management to ensure the immediate achievement of stable, efficient, and effective operations. Government needs to secure a stable funding source. The Economic Coordination Minister's Office, National Development Planning Board and other agencies are working to develop a comprehensive system for promoting infrastructure development. Collaboration with the Ministry of Finance, ministry in charge of supervising the scheme design and management of VGF, is essential.[78]

2.3.2.9 Snapshot of Indonesia's VGF Scheme

The following table provides an overview of VGF in Indonesia:

[77] METI, Basic research of lows [laws] and regulations for getting into markets of emerging countries, p 131.
[78] METI, Basic research of lows [laws] and regulations for getting into markets of emerging countries, p 131.

Table 2.3.2.9a: Snapshot of Indonesia's VGF.

Item	Comment
Source of funds	Government annual budget allocations
Party identifying, preparing and procuring projects	Implementing agency
Reviews requests	VGF Commission under the Ministry of Finance
Approves requests	Minister of Finance
Project requirements	• economically viable but not financially feasible project • VGF financed projects are BOT and user-pays contracts • private capital selected following open and competitive bidding process following PPP regulations where VGF amount is the only financial bidding parameter • Presidential Regulation 67/2005, Presidential Regulation 56/2011 and any subsequent amendments dictates the sectors available for VGF support • minimum investment of approximately USD 10 million (JPY1.1 billion) (RP 100 billion) • feasibility study should show that the project is economically viable and becomes financially feasible with VGF support
Determines VGF amount	Competitive and open bidding process
Time of VGF payment	Unclear/No record exists
Sectors	• transport infrastructure (railroad, ports/harbors, airports, roads, etc.) irrigation equipment • waterworks facilities • communication facilities • electric power infrastructure (power generators, distribution equipment, etc.) • oil and gas related facilities and • other equipment related to these fields
Ceiling	40% (limited to 20% unless the project is proposed by the sponsoring government agency, which warrants an additional 20%)
Form of disbursement	Cash
Approved projects	No record exists
Approved funds	No record exists
Costs VGF can cover	Only construction costs

Note: FX based are updated to reflect JPY/USD rate of 111.1 as of 30/05/16, retrieved from: http://www.x-rates.com/

2.3.3 The Philippines

2.3.3.1 Legal framework and objectives

The agency responsible for handling VGF schemes in the Philippines is the PPP Center under NEDA. The Philippines has PPP program regulated by Revised BOT Law (The Republic Act No. 7718) and its Implementing Rules and Regulations (IRR). Section 2a of Republic Act No. 7718 stipulates the provision of VGF as government aid. Section 13.3a and Section 13.3c of this Act stipulates a variety of possible project financial aid to solicited projects, among others cost sharing[79] and direct government subsidy.[80] Government support is, therefore, broader term than Government Share of Project Cost. VGF program will need to consider General Appropriations Act, National Expenditure Program 2015 and Department of Budget Management National Budget Circular.[81]

According to the Ministry of Economy, Trade and Industry there is an additional working paper titled *Policy Brief Government Share of PPP Project Costs and Risks,* created via a technical cooperation with Asian Development Bank (ADB), which is still at the draft stage as of January 2015 on VGF schemes.[82]

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[79] The Implementing Rules and Regulations for Amended BOT Law, Section 13.3c defines *Cost Sharing* - This shall refer to the Agency/LGU concerned bearing a portion of capital expenses associated with the establishment of an infrastructure development facility, such as, the provision of access infrastructure, right-of-way, transfer of ownership over, or usufruct, or possession of land, building or any other real or personal property for direct use in the project and/or any partial financing of the project, or components thereof, Provided, that such shall not exceed fifty percent (50%) of the Project Cost, and the balance to be provided by the Project Proponent. Such government share may be financed from direct government appropriations and/or from Official Development Assistance (ODA) of foreign government or institutions.

[80] The Implementing Rules and Regulations for Amended BOT Law, Section 13.3c, defines **direct government subsidy** as follows:
an agreement whereby the Government, or any of its Agencies/Local Government Units will:
(a) defray, pay for or shoulder a portion of the Project Cost or the expenses and costs in operating or maintaining the project
(b) contribute any property or assets to the project
(c) in the case of LGUs, waive or grant special rates on real property taxes on the project during the term of the contractual arrangement and/or
(d) waive charges or fees relative to business permits or licenses that are to be obtained for the Construction of the project, all without receiving payment or value from the Project Proponent and/or Facility operator for such payment, contribution or support.

[81] Final Draft (Post Consultation) -Policy Brief: Government Share Incorporating VGF as of 16 January 2013, prepared for Center Manila, Philippines, Under Asian Development Bank's Capacity Building Technical Assistance "Strengthening Public-Private Partnerships in the Philippines" (TA7796-PHI) (co-financed by the Government of Australia and the Government of Canada), By GHD Pty Ltd Canberra, Australia, p 13, available at: https://ppp.gov.ph/wp-content/uploads/2015/01/Government-Share-Incorporating-VGF-Final-Draft-asof-16Jan2013.pdf [hereinafter Final Draft Policy Brief: Government Share Incorporating VGF].

[82] Final Draft Policy Brief: Government Share Incorporating VGF, p 1, 10; METI, Basic research of lows [laws] and regulations for getting into markets of emerging countries, p 134; Sections 2a, 13a and 13c of the Republic Act No. 7718, Revised BOT Law & Implementing Rules and Regulations. **Note:** according to the before-mentioned sources the document was still at the draft stage as of February 2014, however, to the knowledge of the study team it is currently still at the draft stage.

The objectives of the VGF scheme are to facilitate reasonable returns for private sector and to allow users to take advantage of the infrastructure services at acceptable price levels.[83]

2.3.3.2 Institutional structuring

Annual budget allocation. Government makes use of funds, such as the PPP Strategic Support Fund,[84] which may have appropriations approved by Congress, with actual cash funding thereof by the Department of Budget and Management subject to approved project requirements, budgetary exigencies and cash management. Strategic Support Fund must commit within one year of Congressional appropriation and must disburse appropriations over a two-year period. However, this availability period is insufficient for PPP projects requiring VGF, which may require periods of up to five years to prepare, tender, arrive at financial close and disburse for construction. VGF program might need to consider an exception to the limitation on the two-year obligation and disbursement requirement, imposed by Department of Budget and Management in its National Budget Circular. Issuance of a new Circular which exempts PPPs from this general requirement and allows disbursement of public funds for PPP projects up to 5-years from appropriation is recommended. Note that many developing countries have the same appropriation issues as does the Philippines.[85]

The DBCC[86]of the NEDA Board is in charge to guarantee that amounts requested for appropriation by Congress for the Strategic Support Fund should position the fund to meet VGF requirements for the following fiscal year for the budget availability. The level of VGF support and its terms and conditions would be a bid parameter in future projects. VGF amounts are not confirmed until each project requiring such assistance is approved for tender by the Investment Coordination Committee. And even so, the VGF amount may not be determined until the tender is completed and the award is made. VGF grants can be provided in cash or by way of hybrid projects with the aim to improve project-oriented financial terms with the project reimbursing the government over time. However, valuing the actual cost of such support to hybrid projects is complex. Under Revised BOT Law IRR Section 13a, the valuation is the initial cost of the assets injected into the project. Such support does not take into account of how the government finances the acquisition of such assets. Any funds to be disbursed, are subject to prior appropriation by Congress. Appropriations by Congress for infrastructure run maximum for two years during which the appropriation must be obligated and disbursed. To date, the government has fulfilled its contractual obligations and the Congress has appropriated the funds.[87] According to Section 13.3a of Revised BOT Law IRR, government share, such as cost sharing, may be financed from direct government appropriations and/or from Official Development Assistance (ODA) of foreign government or institutions.

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[83] METI, Basic research of lows [laws] and regulations for getting into markets of emerging countries, p 134.

[84]**Note:** *Strategic Support Fund* is an appropriation lodged in the budget of IAs (under Department of Budget and Management Circular 538, March 22, 2012) to pay for the Government Share of PPP project components. Discrete components including project preparation and VGF. It is is subject to time constraints on incurring obligations and disbursing funds.

[85] Final Draft Policy Brief: Government Share Incorporating VGF, p 6, 12.

[86]**Note:** *The Development Budget Coordination Committee (DBCC)* consists of the key economic agencies that meet regularly to co-ordinate budget formulation and implementation activities.

[87] METI, Research for Facilitation of Infrastructure that Utilizes PPP in the Republic of the Philippines, p 6.

To achieve objectives of the VGF scheme for PPPs, the Philippines government has policy in place to provide "affordability" subsidies in cases where economic and social returns, but not returns on equity, are attractive and the government needs private initiative. The term "affordability" subsidies refer to VGF. The term VGF is not yet formally used in the Philippines. VGF is a part of government share/government support and refers to a non-remunerated grant made by government to a PPP project to enable the project to charge affordable tariffs to the public while producing a satisfactory financial return for the investor. Affordability support is considered when the overall EIRR of a project is attractive but the likely financial internal return to investors (FIRR) is insufficient to meet their requirements without some degree of Government subsidy. Other support, including both financial and risk sharing as well as general assistance such as provision of security, are needed. [88]

VGF in the Philippines can take several forms, namely:

- outright extension of funds to cost-share implementation of a PPP project, capital costs or operating subsidies of a PPP project[89]
- "hybrid" arrangements by which the government provides financing for equipment or other assets for use by PPPs (e.g. the rail cars in LRT 1 South Extension project) and
- any contribution of real property.[90]

The objective of VGF is to improve affordability, but in some cases also to accelerate the development of critical infrastructure. For "hybrid projects" the objective may be making the project attractive to investors and consumers through the infusion of government-based special financing facilities.[91]

The Agency/Local Government Unit may offer any one or more government undertakings depending on a project, which shall be pre-cleared in writing by the department, bureau, office, commission, authority, agency, government-owned and-controlled corporations,[92] or Local Government Unit or any other government entity that will grant the same as mandated by law. However, the total government undertakings shall not exceed 50% of the total project cost. The government undertakings shall be based on the approved risk allocation matrix issued by the Approving Body/the Investment Coordination Committee.

Section 13.3c of the IRR also permits operating subsidies. Government of the Philippines is providing operating subsidies for some projects where the future call on the budget is not easily known. Operating subsidies should be carefully planned to create reasonable incentives for proponents, tied to tangible/measurable outputs and should expire after a fixed term and amount, so as to allow renegotiation if appropriate. If the subsidies are uncapped and are not always subject to systematic, they defeat the purpose of whole of life costing and value for money (VFM) analysis and create fiscal

[88] Final Draft Policy Brief: Government Share Incorporating VGF, p 1, 10.

[89] **Note:** Right-of-way acquisition grants have a similar effect, although GHD agrees with the observations that emanated from recent Stakeholder Consultation that ROWA could be excluded from the 50% ceiling.

[90] Final Draft Policy Brief: Government Share Incorporating VGF, p 10.

[91] Final Draft Policy Brief: Government Share Incorporating VGF, p 14.

[92] **Note:** *Government owned and controlled corporations* are corporations owned and controlled by the Executive Branch created by special charter or law in the interest of the common good and subject to the test of commercial sustainability. GOCCs are attached to the appropriate Department, with which they have allied functions, for policy program coordination and for general supervision.

risk. Therefore, in general operating subsidies without setting a finite cap are not advisable. Government share proposals should attempt to limit VGF to capital subsidies, operating subsidies (mainly to toll roads, hydroelectric power plants and the EDSA MRT line) should only be used for projects with very high EIRR that have low implementation costs.[93] The Philippines VGF framework allows "cash, contribution in kind (equipment and other assets) and real estate" as the forms of VGF.[94] In the broad sense rolling stocks, provided in the LRT1 Line South Extension Project, could be considered VGF in the broad sense.[95]

Table 2.3.3.2a: International definitions for government share.

	Direct "Obligation in any event." But may vary for reason known in advance, agreed formulae	**Contingent** Obligation arises if a particular event happens. It includes at Government level, performance undertakings in respect to Government-owned and controlled corporations, sub Governments
Explicit Created by law or contract	**Cost Sharing, Direct Government Subsidy, 4** although amount may not be predetermined **Investment incentives, 5** **Direct Government Equity, 6**	**-Credit Enhancements 1,2** **-Direct Government Subsidy** which may be contracted as contingent **-Legal, security support, 7**
Implicit "Political" obligations re-affecting public pressures, Government need for project to "succeed"	Generally would be implemented through **Direct Government Subsidy, 4** and create recurring fiscal draws	**Direct Government Subsidy, 3** (which may be in the form of price controls with the Government covering the resulting financial losses) **Extra-budgetary assurances of support 8**

Source: Retrieved and amended from Final Draft Policy Brief: Government Share Incorporating VGF, p 41.
Note*: references to Section 13.3e of the Implementing Rules and Regulations (IRR) of the BOT Act and RA7718.
Note:** GOCC refers to government owned and controlled company

93 Final Draft Policy Brief: Government Share Incorporating VGF, p 11, 23.
94 The Implementing Rules and Regulations for Amended BOT Law, Section 13.3.
95 METI, Research for Facilitation of Infrastructure that Utilizes PPP in the Republic of the Philippines, p 13, 31.

Table 2.3.3.2b: Government Support Instruments for PPPs.

Objective/Instrument (at GPH level)	Direct Cost Can be budgeted although with some degree of uncertainty in some cases	Contingent or Indirect Cost Can be statistically valued but estimates are much more useful for budgeting	Philippine current use/IRR reference
1. Lower Implementation costs			
VGF (Capital Investment subsidies)	Yes	No	13.3a
2. Minimize Operating Uncertainties			
VGF, Other subsidies	Yes	No	13.3c
Output Based Assistance	Yes	No	No
Other Performance Undertakings	No	Yes	13.3b/e
• Formal Revenue Deficiency Guarantees	No	Yes	Regulatory action assurance
• Shadow Tolls	No	Yes	No
3. Mobilization of Capital			
"Hybrid" projects incl. GFI loans	No	Yes	13.3a

Source: Retrieved from Final Draft Policy Brief: Government Share Incorporating VGF, p 4.
Note*: Capital subsidy refers to a VGF grant provided to a project by GPH during its construction period.
Note:** Operating subsidy refers to a grant, or grants, provided to a project during its operating period in the form of a revenue deficiency guarantee, a ridership guarantee or a defined multi-year grant to cover defined operating expenses.
Note*:** Output Based Assistance (OBA) references to a development aid strategy that links the delivery of public services in developing economies to targeted performance related subsidies.
Note**:** Performance undertaking refers to a legally binding commitment to undertake a specific obligation on behalf of a separate party, if the latter fails to do so. See Contingent Liabilities and Indirect Guarantees.
Note***:** Shadow toll is a subsidy arrangement under which the government pays the PPP project company a fee for each use of a Concession PPP.
Note****:** Hybrid project in the Philippines is a PPP to which the government, a government entity or an LGU provides assets other than right of way authority (ROWA) or services related to those assets as part of the overall transaction. Hybrid projects often allow for the injection of concessional international financing or ODA into a structural which cannot be obtained directly by the PPP project. In other countries, the term is used more broadly to refer to a PPP transaction.
Note****:** GFI refers to Government Financial Institutions.

To the knowledge of the study team, the decisions have not yet been made on the following:

- whether the funding will subsidize capital or operating costs and
- what form aid will be provided: cash or contribution in kind.

In case of the funding for capital costs, the scheme will be quicker and simpler. According to the working paper, the ceiling for funding is recommended to be set at 50% of a project's total capital cost.

2.3.3.3 Assessment

Identification, preparation and review of project proposals. Suitable PPP projects that are adjudged by PPP Center and implementing agency but requiring VGF are identified with an estimate of the required amount. PPP Center compiles the complete list of all candidate PPP projects requiring VGF and submits the list to the DBCC for clearance. DBCC conducts preliminarily review and clears for budget purposes only those projects which require VGF and are in conformity with the reasonableness of the amount estimated to be required. DBCC determines whether the aggregate amount for the VGF is based on its budget prioritization parameters. PPP projects proposed for VGF support need to be cleared from its preliminary economic analysis that it is likely to meet SCBA minimum required EIRR threshold. Project Development and Monitoring Facility[96] will be used to fund the prefeasibility or feasibility study, requirements of PPP projects and VGF.[97]

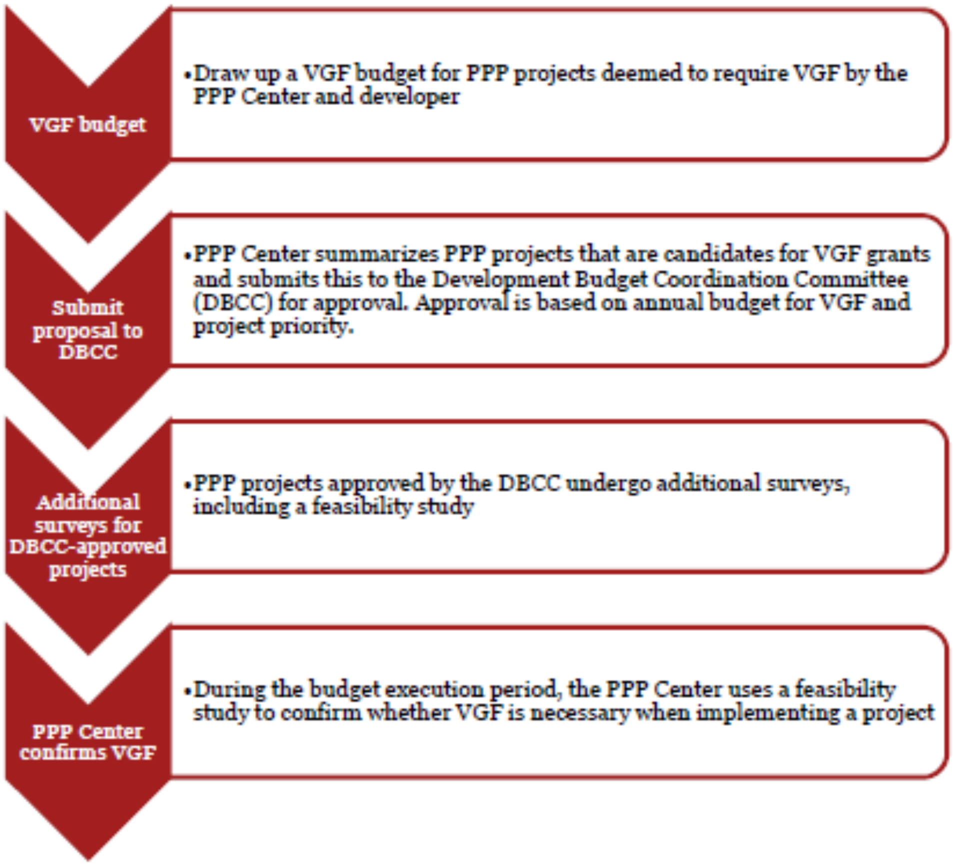
- Applicability. The following criteria needs to be met for receiving VGF:
    - projects shall in principle be based on a concession agreement
    - company shall be selected via competitive bidding
    - company in which private sector ownership exceeds 51%
    - An EIRR of more than 15%.[98]
- Eligible sectors. Section 2a of Republic Act No. 7718 prescribes the eligible sectors for PPP which are also eligible sectors for VGF:
    - power plants
    - highways
    - ports and airports
    - canals, dams, hydropower projects, water supply, irrigation
    - telecommunications
    - railroads and railways, transport systems, land reclamation projects
    - industrial estates or townships, housing, government buildings
    - tourism projects

[96] **Note:** *Project Development and Monitoring Facility*, under Executive Order No 8s, 2010 and National Budget Circular 538, March 22, 2012, is a Fund managed by the PPP Center that pays for various activities such as feasibility studies and transaction advisory engagements relative to PPP project development, negotiation and management.
[97] Final Draft Policy Brief: Government Share Incorporating VGF, p 15.
[98] METI, Basic research of lows [laws] and regulations for getting into markets of emerging countries, p 135.

- markets, slaughterhouses, warehouses
- solid waste management
- information technology networks and database infrastructure
- education and health facilities
- sewerage, drainage, dredging and
- other infrastructure and development projects as may be authorized by the appropriate agency or local government unit.[99]

2.3.3.4 Approval

PPP Center and a procuring entity estimate the required amount of VGF and then present it to the DBCC.[100]PPP projects approved by the DBCC undergo additional surveys. PPP Center confirms VGF.



Source: METI, Basic research of lows [laws]and regulations for getting into markets of emerging countries, p 135; PwC based on PPP Center Working Paper.

Figure 2.3.3.4a: The Philippines VGF approval procedure.

[99] Section 2a of the Republic Act No. 7718, Revised BOT Law & Implementing Rules and Regulations.
[100] METI, Research for Facilitation of Infrastructure that Utilizes PPP in the Republic of the Philippines, p 31.

2.3.3.5 Disbursement

Any funds to be disbursed are subject to prior appropriation by Congress. Strategic Support Fund must disburse appropriations over a two-year period. However, it must be noted that this availability period is insufficient for PPP projects requiring VGF, which may require periods of up to five years to prepare, tender, arrive at financial close and disburse for construction. VGF program might need to consider an exception to the limitation on the two-year obligation and disbursement requirement, imposed by Department of Budget and Management in its National Budget Circular. Note that many developing countries have the same appropriation issues as does the Philippines.[101]The study team has been unable to verify any VGF payments that have actually been disbursed.

2.3.3.6 Monitoring

Department of Finance has the overall responsibility for monitoring Government Share, particularly the risk of any contingent liabilities or long-term commitments.[102]

2.3.3.7 Areas for growth

Regulations are yet to be established for VGF schemes. The major areas for growth are designing the schemes, creating regulations, implementation guidelines and beginning to operate a VGF scheme, as well as reviewing details (e.g. confirming target projects and how to guarantee the capital that is provided).[103] Issuance of a new Circular which exempts PPPs from this general requirement and allows disbursement of public funds for PPP projects up to 5-years from appropriation is recommended. Any special provision for the budget shall be included in the budget notes of the annual National Expenditure Plan and the General Appropriations Act. Another recommendation could be a deferral of payment of VGF subsidies until all of the private sector equity has been invested.[104]

2.3.3.9 Snapshot of the Philippines VGF Scheme

The following table provides an overview of VGF in the Philippines:

[101] Final Draft Policy Brief: Government Share Incorporating VGF, p 6, 12.
[102] Final Draft Policy Brief: Government Share Incorporating VGF, p 22; Executive Order 8, 2010 and the Revised PPP BOT Law IRR.
[103] METI, Research for Facilitation of Infrastructure that Utilizes PPP in the Republic of the Philippines, p 136.
[104] Final Draft Policy Brief: Government Share Incorporating VGF, p 6, 12-13.

Table 2.3.3.9a: Snapshot of VGF in the Philippines.

Items		Philippines	
		Republic act No. 7718	**Final draft of Policy Brief**
Laws and Regulations	Laws and Regulation	Republic act No. 7718	Final draft of Policy Brief is published on PPP center's HP
	Management Organizations	PPP center	
Purpose		Section 2a, in this Act, stipulates the provision of VGF as government aid	Facilitate reasonable returns for private sector and to allow users to take advantage of these infrastructure services at acceptable price levels.
Institution	Regulation Arrangement	NEDA	NEDA
	Management	PPP center	PPP center
Fund	Source	Government budget	Government budget
	Scale	No data available	No disbursement record exists
Way of operation	Objective	Project costs	Decisions have not yet been made on whether the funding will go to subsidize capital or operating cost
	Objective sectors	roadways and railroad, ports/harbors, airports, electric power infrastructure, communications, IT, irrigation, water infrastructure, education, land reclamation, real estate development for industry/tourism, government buildings, warehouses, meat processing plants, fishing ports, and environmental and waste treatment facilities	Examples of infrastructure sectors expected to receive VGF are railroads, ports/harbors, and airports.

Items		Philippines Republic act No. 7718	Final draft of Policy Brief
	Form of disbursement	Cash	Cash or contribution in kind
	Ceiling	Cover up to 50% of project costs	Cover up to 50% of project costs
	Eligible projects for disbursement	Private investors are selected through open and competitive bidding under PPP regulations	Recommended condition ・ In principle, projects based on a concession agreement ・ Company selected via competitive bidding ・ Company in which private sector ownership surpasses 51% ・ EIRR of more than 15%
Funding trends	approved amount	No data available	No disbursement records exist
	Major approved sectors	No data available	No disbursement records exist
Challenges		Regulations have yet to be established for VGF schemes, so the major issue going forward is how to design the schemes.	Details of regulation have to be discussed and stipulated

Source: Retrieved and amended from Ministry of Economy, Trade and Industry, Basic research of lows [laws] and regulations for getting into markets of emerging countries Final Report (Executive Summary), March, 2014, p 29, available at: http://www.meti.go.jp/meti_lib/report/2014fy/E003946.pdf.

2.4 How VGF systems may face constraints in implementation

VGF failure occurs when the intended VGF project fails to be implemented or falls outside the intended scope of VGF. For VGF to be implemented successfully, there are a number factors to consider:

- The country needs to be committed to implementing PPP including having a strong political commitment to budget for and provide VGF.
- There needs to be an adequate legal framework to support VGF implementation. A sound legal structure leaves no doubt regarding the requirements for VGF and is needed to provide a legal basis for any subsidy allocation.
- This allocation, in turn, requires a budget appropriation system or separate VGF fund to provide confidence, security and ability to disburse VGF in a timely manner.
- For a project to be eligible for VGF in the first place, clear criteria are needed to filter out weaker projects.
- Many systems introduce a competitive bidding for VGF to help the State get the best possible deal from the private sector.
- To ensure that it all comes together, a clear institutional framework with a specific PPP or VGF agency is required to assist in, or provide, the appropriate documentation, review and assessment. When these requirements are not met, projects run the risk of failing to secure VGF.

2.4.1 Risks and causes for failure

Legal failure occurs when the legal framework in place is not adequate enough to provide a legal basis for PPPs or VGF in a consistent manner. The issue can stem from too many intersecting laws, resulting in complexity and deters the pursuit of VGF projects. Too strict legal requirements that impose greater risk on the private investor may also see lack of participation, as they will look for less strict or risky arrangements elsewhere.

Funding failure comes in many forms. Firstly, if there is no separate and capitalized VGF fund, lack of capital required may follow failed state appropriation procedures. If the state budget does not allow, for whatever reason, subsidy allocation, projects may fall through and investors lose confidence. Even if there is a VGF fund, if the subsidies are not disbursed in time, both lenders and investors will be hesitant of future projects and lender rates might increase as a result of the uncertainty, ultimately increasing the cost of the project.

Lack of clear criteria can lead to confusion in requirements for all parties involved and may result in the private sector being deterred to participate as the grounds are not clear, or even the collapse of tender procedures.

No competitive bidding process can result in a situation where the government is taking on too high of a risk, and too high of a capital investment. Utilizing competitive bidding is one of the core justifications for utilizing VGF and harnessing the efficiencies of the private sector. Sole-sourced contracts for example have displayed a tendency of leaving a greater risk and capital exposure on the government, with a handful of firms yielding high returns at no risk.

Institutional failure in the context of VGF happens when there is a lack of institutions (e.g. PPP agency, VGF fund) or when the institutions do not act in accordance with VGF goals or lacks motivation to do so. For example, if there is no specific time limit on a procedure in the VGF decision making process, the project decision can take years to come through, at which point various conditions may have changed, and the private sector will be less likely to invest.

2.4.2 Examples

Colombia has one of the highest levels of private investment in infrastructure in Latin America, with the majority of it in toll roads. Colombia does not have a specific PPP or concessions law, which has resulted in criticism regarding significant contract variations. According to Law 1150 the implementing agency can, at any time, increase the duration or value of a concession contract by up to 60%. This has resulted in allegations of agencies using this provision to bypass additional procurement by adding tasks to existing contracts. Since 1994, through four generations of toll road concession projects, 24 four contracts have been signed. During the first generation's procurement process, 7 out of 10 failed. The failed contracts were later sole-sourced with VGF amounts up to as high as 98%.[105] The high failure rate, along with volatile variations of VGF amount, can be blamed on an insufficient legal framework, lack of VGF agency and no clear project criteria.

Indonesia. Although there is a strong VGF framework in place, modeled after India's notably successful VGF scheme, Indonesia has failed to disburse any VGF subsidies. One could argue that one of the reasons for the lack of results is due to one of the main differences between the Indonesian VGF structure and the inspiring model of India:

> Where in India, the Minister of Finance has to personally give approval only to projects over a threshold amount, the Minister of Finance of Indonesia has to approve *every single project*. In India there are specified time limits on the different steps of the approval process, whereas in Indonesia there are no time limits on some key procedures. Thus, the process in Indonesia is overly cumbersome. For example in 2013 a USD1.65 billion (JPY183 billion) railway project failed, with the Indian investor citing permit issues and rise in construction cost.
>
> Some have argued that another contributing factor is how VGF funds have to be used within a 12 month state budget approved window and funds needed for construction after 12 months requires a third party guarantee, usually cash-collateralized bank guarantees, which adds a negative carrying cost and will add to total project cost.[106]

Although modeled after a very successful system, the current institutional structure of Indonesia has failed to show any results.

Mexico launched the National Infrastructure Fund (FONADIN) in 2008 with an initial capitalization of USD3.3 billion (JPY366 billion). Its aim is to mobilize private sector

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[105] World Bank Institute, Best practices in public private partnership financing in Latin America, p 54-55.

[106] Smith. K, Public or Private: Indonesia's recipe for investment, 2014, available at: http://www.railjournal.com/index.php/financial/public-or-private-indonesias-recipe-for-investment.html.

investment by providing subsidies to make PPPs financially viable and to procure new contracts for highway concessions. FONADIN is both a success story and an example of how a well structured program faces implementation failures.

The Good: Mexico's *Fondo Nacional de Infraestructura* or National Infrastructure Fund (FONADIN) was established, under the National Development Bank of Mexico to procure new contracts for highway concessions. The initial capitalization of FONADIN was USD3.3 billion. FONADIN offers two types of financial services:

- reimbursable services: being, financial services that generate returns, such as risk capital, subordinated debt, and guarantees; and

- non-reimbursable support, such as subsidies and subsidies for project feasibility studies (similar to Vietnam's project development facility). This fund is revolving, where the returns from the reimbursable part of the fund's portfolio determine the amount that is available for the non-reimbursable part. With this structure, FONADIN does not require yearly disbursements from the Secretary of Finance to fund PPP subsidies.

By having structured the fund through an initial capitalization of USD3.3 billion (JPY366 billion) obtained from the dissolution of two state owned enterprises, the subsidies disbursed through FONADIN are off-budget. The fund does not require annual funding from Mexico's National Treasury. (This differs from other examples, such as Russia's Investment Fund which obtains annual funding through a line item allocation from the country's national budget to support PPPs.[107])

FONADIN subsidizes projects is by providing grants to make proposed PPP projects financially viable. It provides financial support to projects through a number of other mechanisms, including risk capital, subordinated debt, guarantees and funds for infrastructure studies.

The Constraint: Although FONADIN approved USD1.3 billion (JPY183 billion) in subsidies in its first two years, it has struggle to make any disbursements on its VGF approvals.[108] FONADIN has faced challenges from the political behavior of Mexico's implementing agencies and from complexity in the legal system around PPP in Mexico. At a political level, some local government officials avoided developing infrastructure as PPPs with financial support from FONADIN and instead focused on publicly funded projects in the waste management sector. In addition to broader financial and political challenges, the staff of FONADIN have stated three main issues with the current PPP legal framework:[109]

[107] See, e.g. Yarmalchuk, Maria. "Public-Private Partnerships." *EBRD: Law in Transition Online* (2008): n. pag. Web.
[108] World Bank Institute, Best practices in public private partnership financing in Latin America, p 14.
[109] World Bank Institute, Best practices in public private partnership financing in Latin America, p 84.

- There are too many laws in Mexico applicable to PPP projects, resulting in complexity and deter both implementing agencies and the private sector from pursuing PPPs and VGF solutions.

- Project preparation has proven very burdensome and there is a shortage of necessary technical capacity. From the initial studies and impact assessments to the tender process there is a lack of experience and understanding, which can deter project implementation.

- The high pre-construction risks faced by the private sector from the challenges of competing bidders has demotivated many in the private sector.

FONADIN illustrates the need for political and legal support of a VGF scheme structure. Although it has the capital, it has struggled to actually disburse approved VGF. FONADIN's weaknesses can be summarized in general as a lack of technical expertise, difficult legal structure, and lack of confidence both from lenders and private partners. Thus, while good on paper, FONADIN faced realities for implementation that need to be overcome. To this end, Mexico has introduced a PPP Bill to at least clarify the legal ambiguities and hurdles facing the fund.

2.5 Lessons learned

The overall lesson to be learned is that for VGF to be utilized and distributed successfully, a holistic approach is required. Neglecting any of the key issues may result in failure as exemplified in Section 2.4 above. To improve the success of a VGF management system, the following commitments and components should be incorporated as a whole into the system:

- *clear government commitment to fund PPPs*: Although PPPs leverage private sector financing and shift significant risk on the private sector, they will give rise to various costs and public debt for the State when pursued on a large scale. Therefore, governments engaging in PPPs must be committed to make a trade-off of accepting and managing public debt in exchange for the infrastructure services to be delivered by the PPP projects. This entails ensuring there is high level political commitment to structure a comprehensive VGF management system rather than simply deal on an *ad hoc* basis with the VGF needs of individual projects. This government commitment must be clearly communicated from the top to the working levels of government so that the public sector is acting in a coordinated manner.

- *adequate and cohesive legal framework*: Where the laws and regulations of a country fail to contemplate PPPs or the VGF needs of PPPs—or where the legal framework is not cohesive (meaning where regulations conflict or have gaps) -- there will be confusion and project delay at the time of implementing projects. Regulatory inconsistencies lead to project delays and almost invariable give rise to greater costs to the public sector over time. Therefore, PPPs need a strong foundation in law or they need inconsistent laws and regulations to be amended to permit them to be implemented smoothly. Consistent treatment VGF funding is a core component to an overall PPP program and should not be left to *ad hoc* decision making.

- *a VGF fund and a VGF or PPP agency*: Similar to the need for consistent and cohesive regulations, VGF needs to be managed through a deliberately structured institutional framework. There simply must be a focal point empowered to assess, approve, disburse and monitor the VGF for PPP projects. Where VGF needs of a project are considered and managed only on a case by case basis, the State loses several efficiencies when compared to empowering a single focal point to handle VGF. For example, a VGF fund structure or agency can achieve the following greater efficiencies:

    - <u>Concentrated skills</u>: VGF assessment requires various technical skillsets that are not commonly found (or quickly developed) across various agencies of government. It is more efficient for a single body to concentrate those skillsets—and pay market rates for experienced PPP practitioners—than to diffuse those skills across various branches of government (who may end up competing for the same skilled practitioners).

    - <u>Consistent approach</u>: Related to the above, where a focal point has the requisite skillsets in house and is following a single set of procedures, there is a much higher degree of consistency across projects that is likely to be achieved where various agencies are relying on their own interpretation of the procedures.

    - <u>Independent assessment</u>: An independent (from the implementing agency) focal point is more likely to yield an assessment that is not influenced by political concerns, if it is permitted to apply clear assessment procedures and report to a higher level of government.

    - <u>Efficient and timely VGF disbursal</u>: A fund structure entrusted to manage sufficient public monies will be more likely capable of disbursing VGF grants at the timing contemplated in the approved PPP contract because it will not be as constrained by budget appropriation issues as an implementing agency (who may be seeking budget appropriation on a timing which does not match the project development cycle). See for example Figure 2.5a below.

    - <u>Public accountability</u>: By having a single focal point account to the State in a consistent manner for all VGF grants it manages, there will be a uniform approach to weighing the overall impact of all such PPPs on the State's budget. Simply said, having a single body that accounts for the costs to the State of PPPs is more efficient than having multiple agencies make their own accounting to then be consolidated and made consistent by a third agency.

    - <u>Efficient monitoring</u>: Similar to the above point, a single body may more efficiently and independent monitor the total impact of VGF on the State budget than multiple agencies.

- a functioning budget appropriation mechanism: A challenge in many countries is matching the timing of the budget appropriation system to the timing of when PPP projects need VGF to be approved and then disbursed. The most efficient system would allow for VGF to be approved at a budget level immediately upon completion of the feasibility study before investors are asked to bid on a project and then permit VGF to be paid out months or years during or after construction. The feasibility study of a project gives the implementing agency the most detailed assessment of the likely VGF needs for the project. Therefore, it is most efficient to base the VGF assessment on the feasibility study rather than to pre-guess the VGF needs or rely solely on requests from the private sector. *Note: it is also possible for an approval in principle based on a pre-feasibility study (e.g. a project proposal) to be given that is then later refined following the feasibility study*. In any case, where the budget appropriation model is adopted, it needs to work with the natural timing of assessing, approving, bidding on and then disbursing the VGF. This can be visualized as follows:

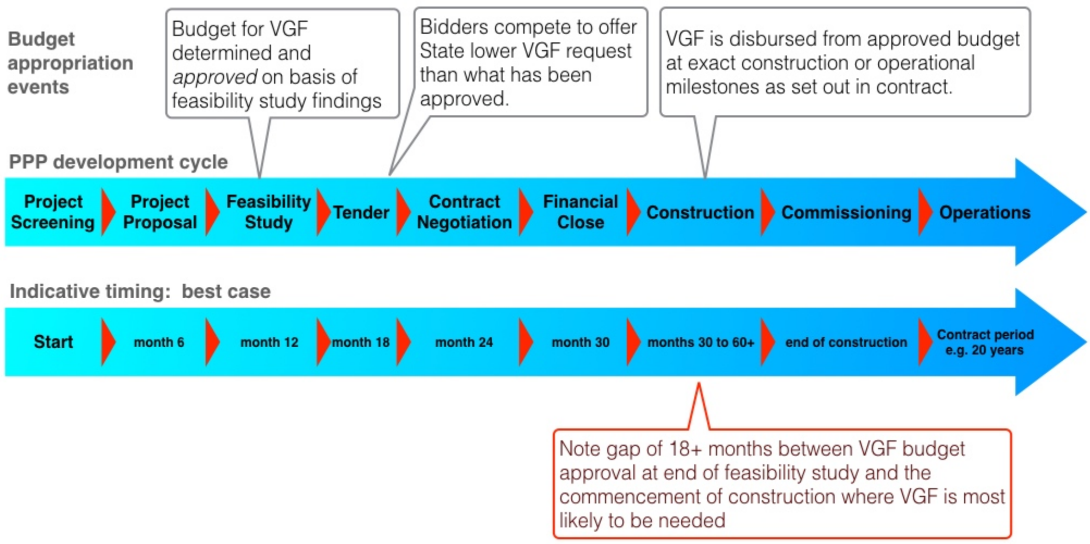

Figure 2.5a: Illustrating how budget appropriation would need to fit PPP project cycle

From the above, it can be seen that there is a significant period of time between when a budget approval would need to be made and when such budget is disbursed to the project as VGF. Thus, a budget appropriation system for managing VGF must (1) permit quick approval of the VGF on the basis of the feasibility study so as not to delay the start of bidding and (2) be capable of disbursing approved funds months or even years after the approval was made. Where the budget appropriation system cannot meet these conditions then it is advisable to look at a fund structure for managing VGF.

- *competitive bidding*: Competition for VGF has the potential to lower the cost to the State by requiring bidders to lodge the lowest VGF request possible in their financial proposals. Two main approaches can be seen. In the first, bidders are informed of the maximum approved VGF and therefore bid against it in their financial proposals. The benefit of this method is that it allows bidders to more accurately assess what the State will make available and therefore structure their financing around the approved VGF amount. Further, bidders will deem it more fair to know in advance the maximum extent of State support. In the second option, the State does not indicate the amount of VGF but instead requires bidders to respond with a VGF request representing the lowest VGF figure they can work with. The expected benefit of this option is that bidders will present the lowest possible VGF number. However, both options have merits and the selection should be based on the nature of the project, as typically advised by the implementing agency's transaction advisors.

- *clear criteria and procedures*: VGF assessment, approval, disbursement and monitoring require clear criteria and mandatory procedures to maintain the integrity and smooth functioning of the system. As discussed throughout this Chapter, *ad hoc* systems present significant inefficiencies and typically result in delay to projects. Each step of the VGF process should bind implementing agencies, VGF management bodies and the private sector to clear rules so as to avoid confusion or external influence to affect the decision to grant VGF. Importantly, the body assessing and approving VGF grants needs criteria for determining whether or not VGF will be given for one project over another.

- *specific time lines and schedules for the VGF process*: Related to the above, VGF should be assessed, approved and disbursed on clear time lines in order to prevent delays in (or possibly cancellation of) projects caused by confusion or lack of rules. Delay has been known to kill otherwise good projects. Particularly in infrastructure projects, a few months' delay can result in significant cost increases to a project because the underlying construction contracts are typically priced for only a limited period of time (and may have automatic price increases in case of delay). A significant risk will be faced by the implementing agency if delay arises during construction because of a failure of the agency to disburse approved VGF payments. In such case, delay compensation or penalties are likely to be triggered under the concession contract; and

- *an institutional structure that supports VGF procedures*: VGF involves a number of agencies of government who must act in a coordinate manner to assess, approve, disburse and monitor VGF. Where the institutional structure for VGF is not settled or where there are gaps or inconsistencies, PPP projects needing VGF cannot be efficiently pursued. Implementing agencies are typically not empowered to manage the entire VGF process on their own and therefore they need clear guidance on which institution within government will take a specific action in the VGF process. Therefore, clear institutional structures and guidelines are needed so that the various stakeholders each know their respective responsibilities and are empowered to act on such responsibilities.

To ensure confidence and reliability, the above key areas need to be considered for a successful VGF system to be put in place. Chapter 2.4 has demonstrated that were one or more of the above factors is not effective, PPP projects can come to a stop. It is the public who ultimately suffers in such cases as needed infrastructures services are not being delivered.

3. VGF Fund Proposal

This Chapter 3 of the Study comprises the summation of the study of VGF systems in three countries and the legal context for VGF in Vietnam, as contemplated under tasks 6.2 and 6.3 of the TOR for the Study. This *VGF Fund Proposal* was presented to Government on 22 February 2016 and discussed in three subsequent meetings with the VGF Working Group (as defined in Chapter 4).

A PPP allows the capital cost of a public-sector Facility to be spread out over its life, rather than requiring it to be charged immediately against the public budget. This costs is then either (for Concession Model) paid for by users instead of paying taxes, or (for the PFI Model) charged to the public-sector budget over the life of the PPP Contract, in either case through the payment of Service Fees.[110]

E.R. Yescombe

3.1 Introduction and overview of study

Vietnam has developed significant experience in implementing infrastructure projects under its build-operate-transfer (BOT) scheme (under the former Decree 108[111]), but the country's basic infrastructure needs have not been met quickly enough under such scheme. The country has turned to PPPs as the preferred modality to attract private sector investment in infrastructure services. Over the past two years the Government has pursued broad based legal reform, including the promulgation of specific regulations (particularly Decree 15 and Decree 30) for PPPs, aimed at building the foundation for a robust PPP program. Now, to attract private sector interest participation in PPPs, projects must either be viable on their own or made viable with State support. Given the rather low tariffs for public services in Vietnam (e.g. power prices, highway tolls and water tariffs), many proposed projects for PPP are simply not financially viable without support. Therefore, VGF for these projects will be essential if Vietnam truly seeks to leverage private sector investment and financing under the PPP modality. Given the difficulties faced to date in determining State support of clearly needed infrastructure projects, is doubtful how Vietnam would successfully progress its PPP program without a well structured VGF management scheme.

[110] Yescombe, E. R. *Public-private Partnerships: Principles of Policy and Finance*. Amsterdam: Elsevier, 2007. Print. **Note:** PFI stands for Private Finance Initiative.

[111] Decree 108/2009/ND-CP.

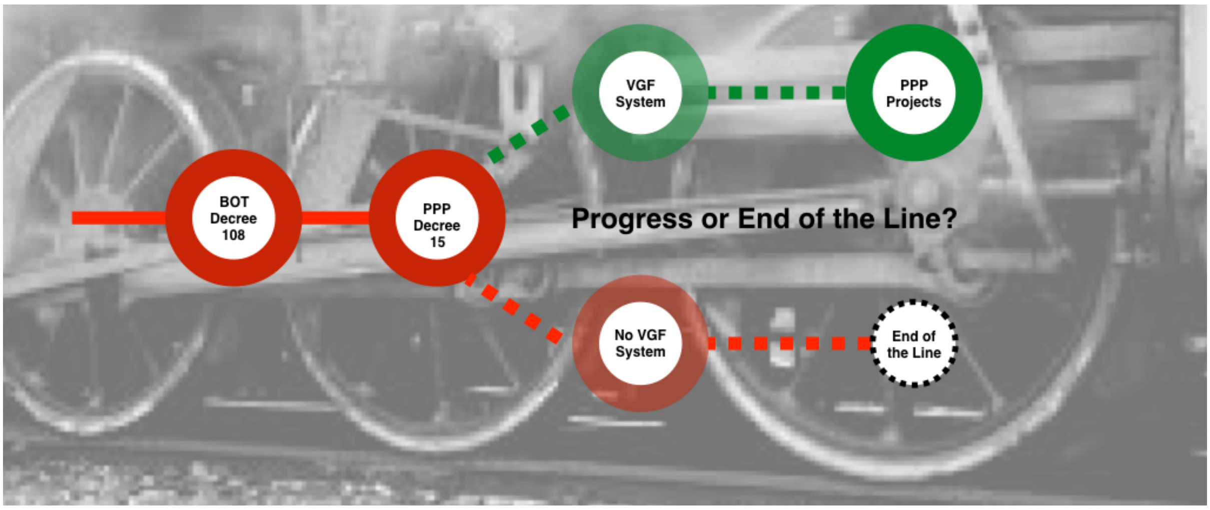

Figure 3.1a: Next stop, VGF management.

3.1.1 Lessons learned from background study

This proposal identifies a VGF management scheme based on international practices, tailored to the Vietnamese context. It is prepared for the benefit of the Government of Vietnam as it assesses its options for managing VGF for its nascent PPP program. This proposal is built upon the study team's research of international practice for managing VGF in several countries, particularly India, Indonesia and the Philippines.

An international practices study entitled, *International Practices for Managing Viability Gap Funding*,[112] (International VGF Study) has been prepared for the Ministry of Planning and Investment and the Ministry of Finance of Vietnam, as a ready reference document to support this proposal. The International VGF Study concludes that when developing a VGF management scheme a government should consider the following six core elements:

1. Fund appropriation- creating a dedicated VGF management body with a clear funding commitment from the government. VGF should not be funded in an ad hoc manner. A strong government commitment to funding VGF in a consolidated manner is needed. This allows for a more streamlined and simplified VGF approval process, attracts attention and increases awareness, increases the number of infrastructure projects done as PPPs and enhances better policies and decision criteria. A good example is India, with its VGF fund, providing security to investors with policies that ensure funding is available to meet government's commitments under the program. Other countries, such as Columbia, are beginning to follow this lesson.[113]

2. Designated agency responsible for the assessment and approval of VGF. The assistance provided by the agency in charge of the subsidy program varies, depending on the specific institutional

[112] *International Practices for Managing Viability Gap Funding: a comparison of the systems of India, Indonesia and Philippines*, Frontier Law & Advisory Ltd., 8 February 2016.
[113] World Bank Institute, Best practices in public private partnership financing in Latin America, p 16.

arrangement and the amount of experience with PPPs.[114] The responsible agency responsible for managing the VGF program in the three study countries are:

- A PPP Unit of the Ministry of Finance in each of India and Indonesia.
- The PPP Center in the Philippines.

The study countries vary a little as to who reviews and approves requests for subsidies. Perhaps more significant than who reviews requests for subsidies is making sure that the staff managing subsidies are involved in the PPP structuring process and applying clear eligibility criteria and assessment methodologies. For VGF approval, it is common for officials from finance and economic planning agencies to be involved, which ensures subsidies being consistent with the country's broader fiscal and economic priorities.[115] Those appraising VGF requests need the technical skillsets to independently assess project needs using clear criteria (below) without undue political influence.

3. Adopting clear, concrete project eligibility criteria. Clear eligibility criteria ensure that only well prepared, economically viable projects receive subsidies. They also increase the amount of private investment mobilized per dollar of subsidy by filtering out weaker projects in favor of more financial sustainable projects. On the other hand, where unclear eligibility criteria exist, projects can be pushed through based on political pressure, as such projects tend to be prioritized on a more *ad hoc* basis rather than the basis of objective criteria. A positive example is India. India has adopted clear criteria for deciding which projects are eligible to receive subsidies and caps the percentage (40%) of total project costs that can be paid by subsidies.

4. Setting a VGF cap or limit subsidization through competitive procurement. Setting the amount of VGF through competitive procurement minimizes the amount the government pays. Competitive pressure (when PPP contracts are openly and competitively tendered) drives private investors to request the minimum amount of subsidy to make a project financially viable. The extreme example of that is where bidders may offer negative VGF, meaning bidders offer a 'premium' to the government if the discounted cash flow indicates that a project is independently financially viable without VGF. This creates an additional source of revenue and ensures the government maximizes value. For example, in the case of India, negative VGF paid by the private investor to the government has proven to be very successful.[116]

5. Disbursement of VGF funds. Using output- or performance-based milestones to trigger disbursement strengthens the incentives for the private proponent to meet its contractual obligations as well as ensure that projects are completed on time and the service standards defined in the PPP contract are met.[117]

6. Monitoring. A key benefit of a centrally managed VGF system is that it assists government to monitor the costs of VGF to the State. The optimal monitoring policy depends on the institutional arrangement in the particular country. In India the lead financial institution is responsible for monitoring and evaluation and performance related to disbursement of VGF. There are usually three different approaches, each with different advantages and generally countries combine at least two approaches:

[114] World Bank Institute, Best practices in public private partnership financing in Latin America, p 16-17.
[115] World Bank Institute, Best practices in public private partnership financing in Latin America, p 17.
[116] World Bank Institute, Best practices in public private partnership financing in Latin America, p 18-19.
[117] World Bank Institute, Best practices in public private partnership financing in Latin America, p 19.

- lead private financial institution as the proxy monitor (as in India)
- staff of the subsidy fund or PPP unit assists or leads monitoring (e.g. in India and Indonesia, also in Brazil, Colombia and Mexico) and/or
- an independent agency monitors subsidies (e.g. in Brazil and Colombia).[118]

Additionally, it is considered as best practice to have a separate agency manage VGF apart from other indirect fiscal support (e.g. guarantees) or make support policies non-discretionary. This reduces conflicts of interest and reduces tendency to structure projects with more implicit subsidies. However, for the holistic policy approach, evaluating direct subsidies together with indirect fiscal support ensures that the entire fiscal impact of the project does not exceed its net economic benefits. Publicly and regularly disclosed documents and information on projects receiving subsidies on a website can improve transparency and public awareness and increase the interest, participation and confidence of private investors. Following open and competitive procurement processes for allocating subsidies also increases transparency and is, therefore, widely accepted as best practice.[119]

In parallel with the research on international practices, the study team examined Vietnamese law and practice related to state budget management, establishment of fund structures by Government, annual and medium term budget appropriations and ODA funding and on-lending, as well as other relevant laws. The underlying Vietnam legal study is reflected in the structuring of VGF management system proposed in this document.

3.1.2 Structure of proposal

The remainder of this proposal is structured as follows:

- Section 3.2 sets out a basic overview of the proposed VGF management scheme and concludes a fund structure is more advantageous for Vietnam than attempting to pay for VGF via annual budget allocations from authorized state agencies (ASAs).

- Section 3.3 outlines the rationale for a fund structure (versus annual budget appropriations). In particular section provides detailed discussion of the annual budget appropriation system to illustrate why it cannot be made to serve PPP projects without significant legal amendment.

- Section 3.4 examines the proposed institutional structure for managing VGF. In particular it highlights existing fund structures in Vietnam that may serve as examples of how to structure a fund type VGF management system.

- Section 3.5 proposes a mechanism for funding the VGF management system, including both seed funding to initiate the system and ongoing annual funding to allow the system to grow and operate over time.

- Section 3.6 introduces the need for mandatory criteria and procedures under which all projects served by the VGF management scheme would be assessed and approved (if approved) in order to maintain consistency and integrity in the system.

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118 World Bank Institute, Best practices in public private partnership financing in Latin America, p 20.
119 World Bank Institute, Best practices in public private partnership financing in Latin America, p 19.

- Section 3.7 proposes an option for how VGF would be approved in a manner that closely fits the requirements of Vietnam law, particularly the Law on Public Investment.

- Section 3.8 closes this proposal by outlining open issues that the study team recognizes remain to be discussed and resolved. Many of these are policy decisions to be made by Government.

3.1.3 Notes and assumptions

The study team makes the following notes and assumptions in respect of this proposal:

- This document sets out a *discussion draft* of the proposed VGF management scheme. It is based on the study teams' understanding of international best practice and actual project development experience in Vietnam. This discussion draft is intended to facilitate discussion on the most appropriate pathway for managing VGF in Vietnam. There may be other options for structuring a VGF management scheme than those presented herein.

- The study team has considered the issue of a decentralized PPP scheme in Vietnam and believes that decentralization can work with the scheme proposed in this document. In short, a provincial ASA may elect to obtain VGF funding through the central scheme proposed herein or may make its own budget allocations if centralize funding is not needed. Election to use the proposed VGF funding would be similar to an ASA's choice to use the Project Development Facility overseen by MPI.
- This study has been supported by technical assistance from the JICA. The views set forth herein are those of the authors and do not necessarily reflect the position of JICA or the Japanese Government in respect of the subject matter discussed below.

3.2 Basic overview of VGF Scheme

3.2.1 Scheme options

This section very briefly summarizes the proposed VGF management scheme (VGF Scheme) for Vietnam based on a review of international practices, particularly those of India, Indonesia and the Philippines, as well as a review of Vietnamese laws on public investment, laws on State budget and debt management laws and institutions. Detailed elements of the VGF Scheme are presented in later sections.

As discussed with MOF and MPI during the 16 November kick-off meeting, the Government is well aware that two main options are typically adopted to manage VGF for PPP projects, as follows:

- Annual budget appropriation: The first option involves annual budget allocations (based on medium-term public investment and State budget plans) to cover the VGF needs of specific projects. In the context of Vietnam, this would require each authorized state agency (ASA) to plan VGF needs 5 years ahead. In addition, each ASA must plan and calculate the VGF needs of specific projects to receive grants of VGF in the following year(s).

- Centralized VGF management fund: The second option involves concentrating State capital for VGF into a centralized fund structure that assesses requests for VGF, approves (directly or indirectly) and disburses the grant of VGF. In Vietnam's context, this would require the creation of a fund entity that would hold State capital and account for its usage across all projects receiving VGF.

3.2.2 VGF Fund

Both scheme options have been deeply considered by the study team, starting with options for using the annual budget appropriation system of ASAs to fund VGF. For reasons detailed in section 3.3, the study team concluded that Vietnam's system of annual budget appropriations does not meet the PPP project development cycle and timing needed by projects in order to disburse VGF at the correct time. To make the annual budget appropriation system work for VGF, a new budget appropriation pathway specific to VGF would need to be introduced, requiring significant amendments to Vietnam's budget laws.

The proposed VGF Scheme entails the creation of a hybrid VGF management fund (VGF Fund) financed by a combination of ODA and State capital seed funding coupled with annual budget allocations by ASAs (and/or the State budget).

The VGF Fund should operate as a corporatized entity under professional management. The VGF Fund must be structured to permit the hiring of skilled professionals capable of managing the VGF Fund using the discipline and techniques found in private sector investment funds.

3.2.3 Structure of VGF Fund

The VGF Fund should be established as a State financial institution under the authority of MOF with a high degree of autonomy and a fully independent management team. Examples of similar funds already exist in Vietnam including:

- VEPF established by the Prime Minister under the form of a State financial institution under the Ministry of Natural Resource and Environment;
- National Foundation for Science and Technology Development established by the Government under the Ministry of Science and Technology; and
- Local Development Infrastructure Funds established by the People's Committee of some provinces.

The basic relationship between the VGF Fund, MOF and ASAs may be visualized as follows:

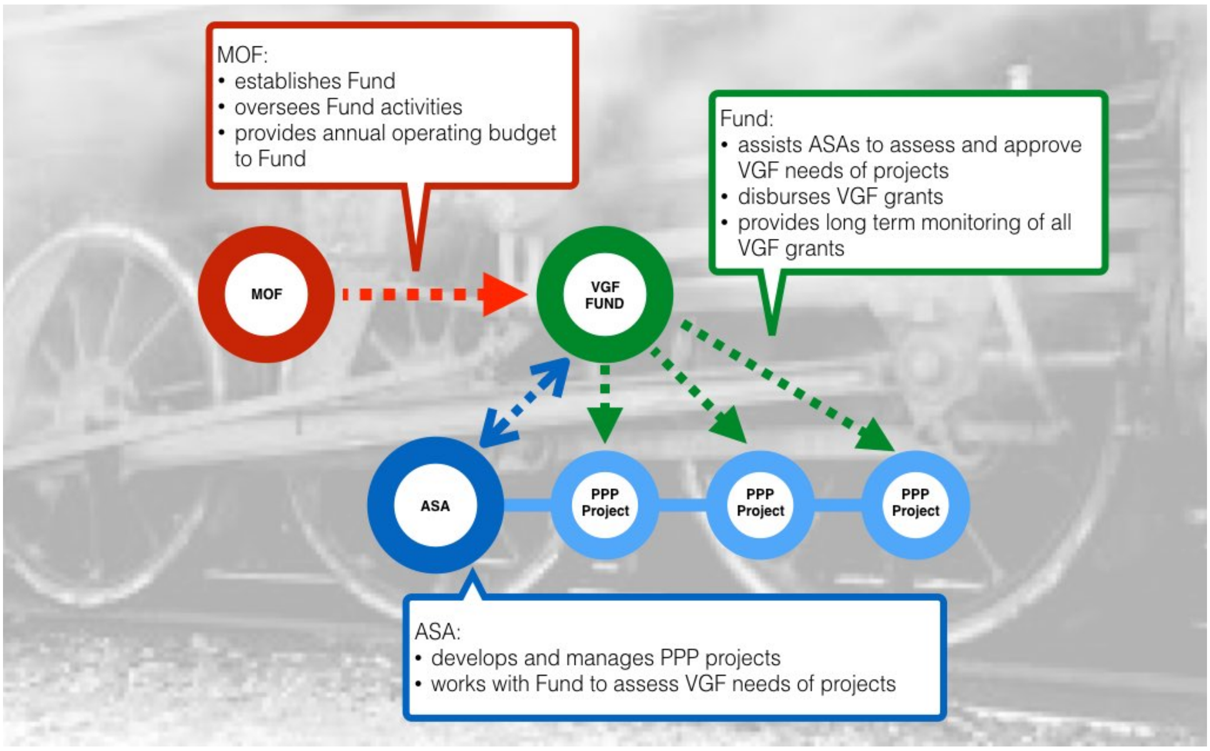

Figure 3.2.3a: Snapshot of VGF Fund.

Details of the institutional structure of the VGF Fund are provided in Section 3.4 below.

3.2.4 Core functions of VGF Fund

The VGF Fund would conduct the following activities:

- It would aggregate and account for the use of ODA and State capital to provide VGF grant funding to selected PPP projects.
- It would conduct independent evaluation of the VGF needs of projects for which ASAs request VGF.
- It would apply consistent evaluation methodologies and criteria in evaluating the ASAs' requests for VGF.
- It would recommend to an executive committee (referred to as the "Approval Committee") for initial and final approval of the quantum, form, disbursement schedule and conditions for VGF grants using the funds under its management.
- It would disburse VGF grants in accordance with the approved disbursement plan for projects to receive VGF. The approved disbursement plan would be reflected in the PPP project contract between the ASA and the investor.
- It would provide annual accounting and medium to long term projections to Government of the aggregated ODA funding and State capital used for VGF support of PPPs and the projected impact on State debt management.
- It would consolidate project monitoring data and create a comprehensive database for Government of projects receiving VGF support.

3.2.5 Use of State capital by the VGF Fund

The VGF Fund would be entrusted to manage State capital, originating from both the State and ODA, to be used for VGF grants to approved projects. The VGF Fund would be required to manage such State capital with transparency, accountability and professionalism on par with the best practices of professional fund managers. The basic funding structure of the VGF Fund comprises:

- Seed Funding: It is contemplated that the initial capital to establish the VGF Fund and be used for the initial projects would originate largely from ODA sources. This seed funding should be sized to permit VGF grants to several pathfinder projects to test and demonstrate the functions of the VGF Scheme.

- Annual Budget Allocations: On-going VGF needs would ultimately original from ASA budget allocations entrusted to the VGF Fund for management and disbursement in accordance with the needs of the projects. Importantly, monies allocated by ASAs to the VGF Fund would be ear-marked for the projects of such ASA.

Details of the financing structure of the VGF Fund are provided in Section 3.5 below.

3.3 Rationale for the VGF Fund versus annual budget allocations

This Study concludes that a standalone VGF Fund presents a more efficient VGF Scheme for Vietnam than either the current status quo or reliance upon annual budget allocations by ASAs seeking to fund the VGF needs of projects under their control. This Study finds the following reasons as being most compelling for the establishment of the VGF Fund:

3.3.1 Reason 1: Timing of PPP development cycle

The grant and disbursement of VGF must match the actual development cycle of a project to help the country obtain the timely benefits of investment in needed infrastructure and services. The current state budget allocation system does not match the PPP project development cycle and would consequently delay PPP projects.

3.3.1.1 PPP project cycle

Decree 15 contemplates a stepwise cycle for preparing and implementing projects by ASAs (PPP Cycle), as follows:

> Phase 1: ASAs screen projects under their sectoral competence for possible development as PPPs.
>
> Phase 2: An ASA or a potential investor (as a project proponent of an unsolicited proposal) conducts a **Project Proposal** to initially assess the suitability of the project as a PPP. The Project Proposal should inform the ASA of the basic technical, financial and contractual parameters of the project, including initial estimates of the VGF needs (if any) of the project. See Decree 15, Articles 16.2(h) and 17.2.
>
> Phase 3: If the Project Proposal is approved the ASA or a potential investor (as a project proponent of an unsolicited proposal) conducts a **Feasibility Study** to assess in detail the technical outputs, financing options, financial viability, contractual structure and projected investment rate of return (amongst other factors) of the project. A quality Feasibility Study will yield a fairly accurate assessment for an ASA of the costs, return on investment and need for VGF of a project. The ASA then seeks approval of the Feasibility Study and investment structure of the project as a PPP. See Decree 15, Articles 25.1(h) and 26.3(c).
>
> Phase 4: Following approval of the Feasibility Study, **Investor Selection** is assumed to be conducted through competitive bidding in accordance with the Bidding Law, with limited exceptions for direct negotiation and unsolicited proposals. Competition during investor selection is a hallmark of PPP project development. A robust bidding process involves fully informing potential investors of the technical, financial and legal (contractual) terms for the project, which may include the approved level of State support (e.g. the maximum permissible VGF available to the project). One of the financial evaluation methods is that the bidder would compete for VGF, meaning that the bidder with the lowest VGF requirement receives the highest score in its financial proposal. The only way this can happen is if the VGF is pre-approved by Government before the project tender. See Decree 30, Article 27.2 and Decree 15, Article 29.

Phase 5: Following Investor Selection the ASA and Investor **negotiates the PPP contract**. Ideally, the Investor will have bid on a pre-approved contract (typically a standard form contract tailored to the project) thereby reducing the need for extensive negotiations after the contract award. Similar to Phase 4, this phase implicitly requires that the key terms of the contract--including the level of government support--be pre-approved by Government before the start of tender so that bidders will have had an opportunity to comment on any major issues in the contract before the contract is awarded. See Decree 15, Article 30 and Decree 30, Article 26.2(b).

Phase 6: After the contract is signed and the investment certificate has been issued the project moves to **financial close** and **construction** begins. During this project implementation phase, VGF should be disbursed pursuant to the disbursement schedule in the project contract. Lenders will require a clear commitment of government on all support issues before financial close can be achieved. Therefore, similar to the above phases, the level of government support needs to be approved in advance to avoid delays to the project.

The PPP Cycle contemplated under Decree 15 may be visualized as follows illustrating (in grey) the anticipated actions of ASAs to prepare for VGF:

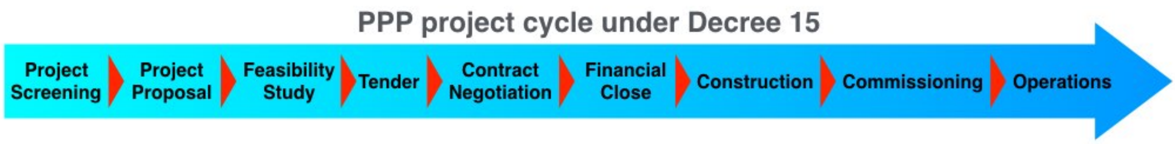

Figure 3.3.1.1a: PPP project cycle.

3.3.1.2 Fitting VGF into Project Cycle

Other countries, such as the Philippines who use a similar stepwise project development cycle benefit from higher investor and lender confidence in the process and shorter project development periods. For example, it has been reported that the Philippines' PPP transactions could move from tender to financial closure in as little as 18 months as a result of clear project development procedures. By comparison, the authors' experience in Vietnam has been that projects can take more than five (5) years to go from investor selection to signing of the project documents. After signing, projects can take another 15 months to achieve financial close, which must occur before any construction can begin. The above PPP Cycle has been developed with a goal to reducing project development from 5+ years to hopefully 18 months or less to go from commencement of the project proposal to signing the contract with the selected investor.

The public investment plan and annual budget allocation systems does not match the PPP project cycle contemplated under Decree 15, leading to high risk of delay because of the mismatched timelines in how ASAs plan their budget and how a project moves through the development cycle. It should be a goal of the Government that PPP projects move from identification/screening to signing within 18 months, followed by achieving financial close and commencement of construction within 12 months of signing. The need for and amount of VGF would normally not be accurately identified until after the feasibility study is completed. Bidders should be informed of the level of VGF available and should compete to reduce the level of VGF they would request. If a project relies on State budget allocations, the ASA would not be able to confirm to bidders at the tender stage the level VGF that is approved unless the tender stage is delayed until after the ASA completes the relevant annual budget plan.

The natural steps that *should* occur for preparing VGF for a project in line with the PPP development cycle under Decree 15 may be visualized as follows:

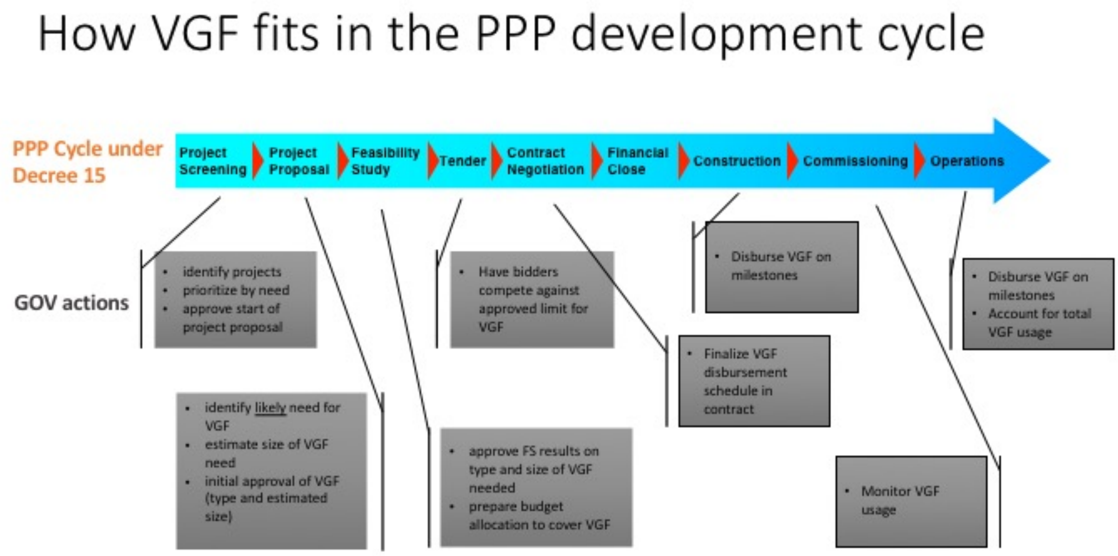

Figure 3.3.1.2a: fitting VGF into PPP project cycle.

3.3.1.3 Mismatch of Budget Allocation and PPP Cycle

The above illustrates what needs to happen to determine and prepare VGF for a project. If State budget could be allocated for a PPP project based on the feasibility study of such project, as recommended in the International VGF Study, then the budgeting process would look more like this:

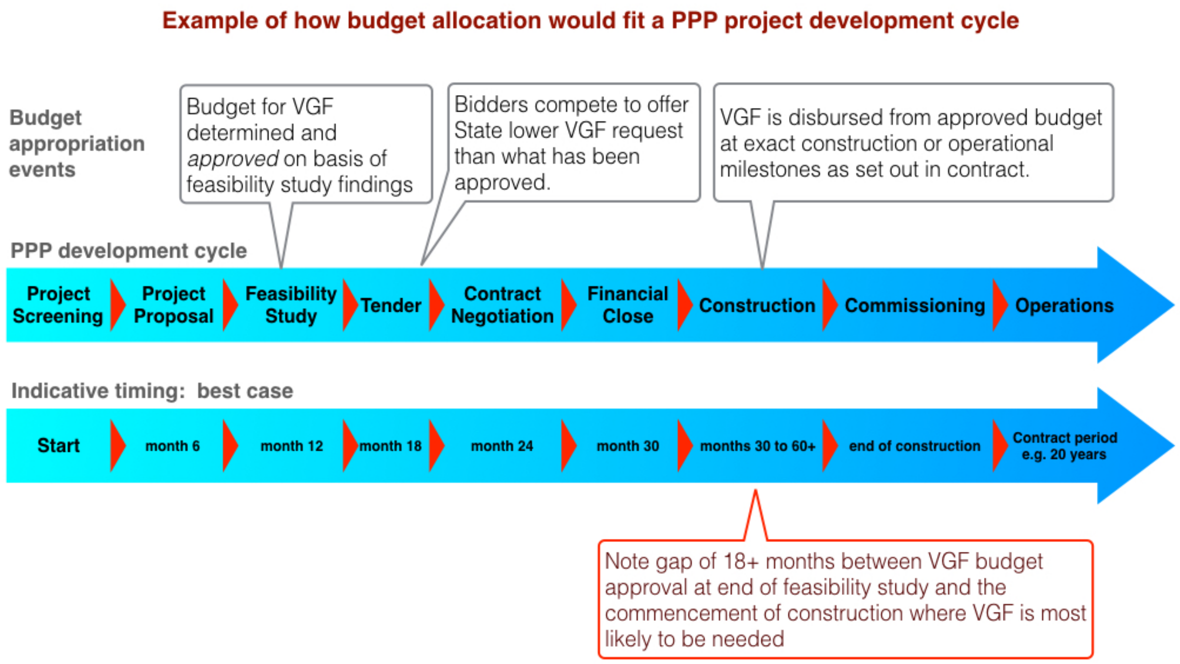

Figure 3.3.1.3a: Fitting budget allocations within PPP development cycle.

As can be seen above, if a budget allocation could be approved following the feasibility study (where the project's VGF needs would be most clearly determined) there will still be a gap of more than 18 months between such approval and the actual timing of disbursements, with some disbursement possibly being required years after the budget approval. This clearly will not work with the current budget laws. At best, a budget appropriations approval process would interrupt the PPP cycle after either the completing of the feasibility study or the award of the contract, as follows:

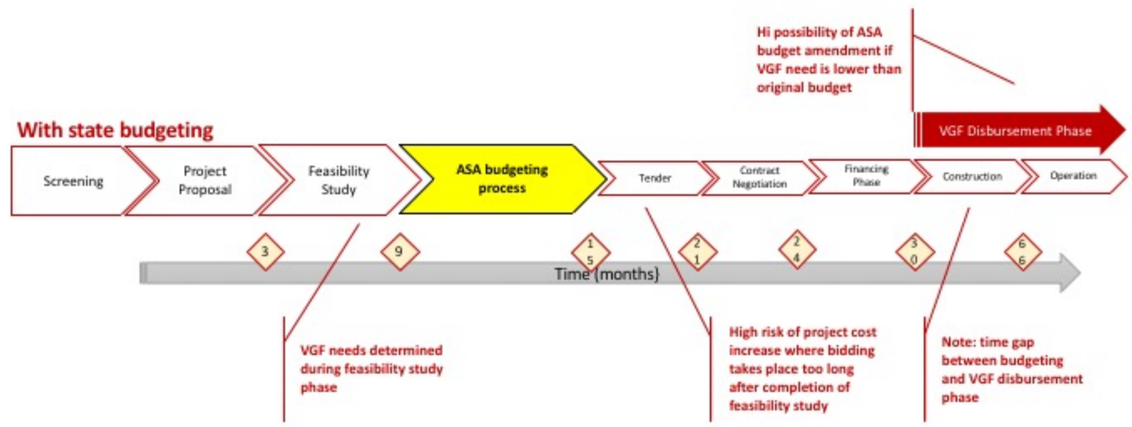

Figure 3.3.1.3b Interrupting PPP Cycle for Budget Approval.

Such interruption would create a number of problems including: (1) the possibility of a significant cost increase in the project due to inflation and start of construction delays[120] and (2) the risk of a failure of an ASA to obtain VGF budget approval after contract award would make such projects must less

[120] Please refer to the discussion of cost increases from project delay in the International VGF Study (Chapter 2), Section 2.4.2, page 56.

attractive. Please note the failures of VGF disbursal in Indonesia where the VGF budget approval system is fraught with delay.[121]

3.3.1.4 Effect of Law on Public Investment

The Law on Public Investment[122] and Decree 15 require the ASAs to prepare in advance the plan for the use of VGF needed for PPP projects within their medium-term (5 years) investment plan. The preparation of annual public investment plan and annual budget estimate must be based on the medium-term public investment plan of each ASA. Therefore, in order for a project to be allocated with annual State budget, it needs to be included in the medium-term public investment plan of the relevant ASA. That means the ASAs must prepare their public investment plans five years ahead. Meanwhile, under Decree 15, a project can only be included in the 5-year public investment plan after the project proposal is approved and the project is published. As a result, for a project which is developed and proposed during the five-year period and was not included in such five-year plan, the ASA may have to wait several years to include it in the next 5-year plan. There is high possibility of delay in project preparation for the reason that even when the ASA completes the feasibility study for a project, the ASA cannot put it in tender because the project has not yet been included in the plan and the ASA cannot secure annual budget allocation for the VGF needed to support the project.

The following paragraphs summarize the processes for the preparation of public investment plans and annual budget allocation.

3.3.1.5 Public Investment Planning process

The use of State investment capital in PPP projects must be prepared within public investment plans in accordance with the procedures set out in the Law on Public Investment. Under the Law on Public Investment, there are annual public investment plans and medium-term public investment plans.[123] Medium-term public investment plans are prepared for a five-year period, in conformity with 5-year socio-economic development plans.[124] Annual public investment plans are prepared to implement the medium-term public investment plans.[125] Only projects that are within the medium-term public investment plans may be allocated capital within annual public investment plan, except for emergency projects[126].[127] In addition, for newly construction projects, the allocation of investment capital shall be made only after the investment procedures of the projects have been completed.

At the beginning of the fourth year of each five-year period of the medium-term public investment plans (i.e. before 31 March), the Prime Mininister shall issue the regulations specifying the objectives, directions and specifically assign tasks relating to preparation of the medium-term public investment

[121] See International VGF Study, (Chapter 2), Section 2.4.2,page 56.
[122] Law on Public Investment No. 49/2014/QH13 passed by the National Assembly on 18 June 2014 (Law on Public Investment).
[123] Law on Public Investment, Article 49.1.
[124] Law on Public Investment, Article 49.1.
[125] Law on Public Investment, Article 49.1(b).
[126]Emergency projects are projects for responding timely the natural incidents or other force majeure cases (Article 33.1 of the Law on Public Investment).
[127]Law on Public Investment, Article 56.1.

plans for the next five-year period.[128] Based on these regulations, the MPI shall issue detailed guidelines on the objectives, requirements, contents, timelines and term for preparation of the plans.[129]

- Preparation at the level of Ministries and central government agencies

  On the basis of the regulations of the Prime Minister and the guidelines of MPI, each of the Ministries and central government agencies, central bodies of Vietnam Father Lands Front and of other socio-political organizations (Ministries and Central Government Agencies) shall assign investment management agency under them to provide guidance on preparation of medium-term investment plans; and assign the agencies directly under their management, which use the public investment capital, to prepare the medium-term public investment plans within their assigned tasks.[130] The investment management agencies are also responsible for appraising the prepared medium-term public investment plans before consolidating and submitting these plans of the Ministries and Central Government Agencies to the MPI and MOF before 31 December of the fourth year of each five-year period.[131]

- Preparation at the locality level

  Similarly, based on the regulations of the Prime Minister and guidelines of MPI, each provincial-level People's Committee (PC) shall assign agencies directly under its management, which use the public investment capital, to prepare and appraise the medium-term public invesment plans within their assigned tasks and the public investment capital sources under their management.[132] The Department of Planning and Investment under the provincial-level PC is in charge of appraising the medium-term public investment plans of departments under such PC and consolidating all medium-term plans of the province before submitting it to the PC for consideration. The PC shall obtain the opinions of the People's Council of the province about these medium-term plans, including the detailed list of projects using public investment capital and the amount of capital allocated to each project, and then finalize the plan of the province before submitting it to MPI and MOF. Such plan of the province must be submitted to MPI and MOF before 31 December of the fourth year of each five-year period.[133]

  The People's Committee of districts and communes shall prepare and appraise, or assign the bodies specialized in investment management under them to prepare and appraise their medium-term public investment plans and obtain the opinions about these plans from the People's Councils at the same level before submitting the plans to the People's Committee at upper level.[134]

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[128]Law on Public Investment, Article 58.1.
[129] Law on Public Investment, Article 58.2.
[130]Law on Public Investment, Article 58.3.
[131] Law on Public Investment, Article 58.3.
[132]Law on Public Investment, Article 58.4.
[133]Law on Public Investment, Article 58.4.
[134]Law on Public Investment, Article 58.5.

- Appraisal by MOF and MPI

  After receiving all medium-term investment plans submitted by the Ministries and Central Government Agencies and the People's Committee of provinces, MOF shall be responsibile for and coordinate with MPI on estimation of the revenues and expenses of the State budget during the next 5 year period and ability to mobilize capital from State bonds and Government bonds.[135] From 1 February to 30 April of the fifth year of each five-year period, the MPI appraises the plans for State budget allocation for the next 5 years.[136]

- Finalization of medium-term public investment plans

  After obtaining the appraisal opinions from the MPI, the Ministries and Central Government Agencies, the provincial-level PCs shall finalize their medium-term public investment plans based on such opinions and then submit the finalized plans to the MPI and the MOF before 30 June of the fifth year of the five-year period.[137] The PC of different levels shall report to the People's Council at their level before submitting the finalized plans to the MPI and the MOF. The MPI shall consolidate the submitted plans and report to the Government before 31 July the fifth year of each five-year period.[138]

For public investment plans using capital from State budget, State bonds or Government bonds, after receiving the report from the Government and prior to 10 November of the fifth year of each five-year period, the National Assembly shall decide the medium-term public investment plan for the next 5 years, including the total amount of investment capital from State budget and total amount of State bonds and Government's bonds. The Government then assigns the plans to Ministries and Central Government Agencies and localities. The MPI assigns the detailed plans to those agencies before 31 December.[139]

The figure below illustrates the process for preparation of medium term (five-year) public investment plan.

[135]Law on Public Investment, Article 58.6.
[136]Law on Public Investment, Article 58.7.
[137]Law on Public Investment, Articles 58.8 and 58.9.
[138]Law on Public Investment, Article 58.10.
[139]Law on Public Investment, Article 65.

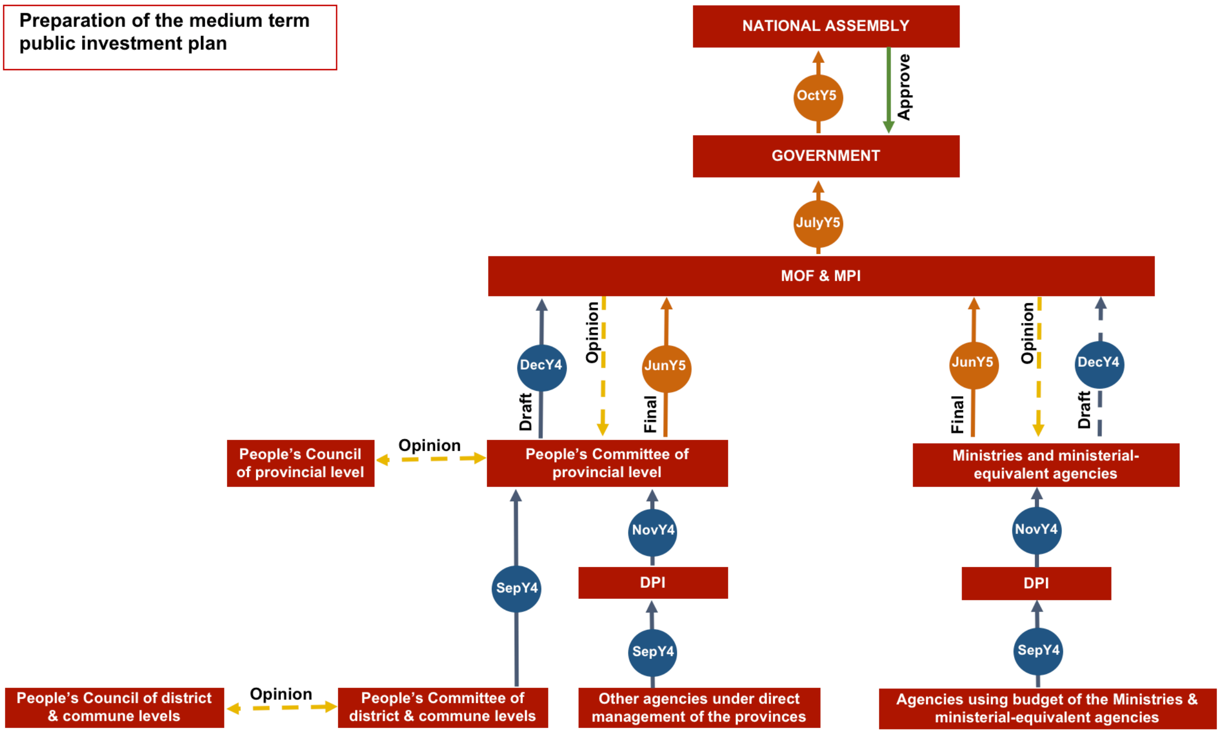

Figure 3.3.1.5a: Medium term public investment plan

The annual public investment plan shall be made for the year following the year when the plan is made and based on the five-year public investment plan. That means only projects that were included in the five-year plan are eligible for the State capital use planning within annual plan. The process and agencies involved in the preparation of annual public investment plan are similar to the five-year investment plan. Within annual plan, the detailed plan for the use of State investment capital for each project shall be approved and assigned to each implementing agency responsible for carrying out the project by the end of the year when the annual plan is made.

3.3.1.6 State Budget Estimate and Allocation process

The State budget estimate and allocation processes are governed by the laws on State budget. The Law on State Budget 2002[140] is currently the effective law. However, this law will be replaced by the Law on State Budget 2015 from 1 January 2017. Therefore, for the sake of efficiency, in this Report, the Study Team will only discuss the provisions and implications of the Law on State Budget 2015[141], which will likely be the applicable law at the implementation stage of the VGF Scheme.

The annual State budget estimate, including the budget estimate for the use of State capital for PPP projects shall be prepared based on the medium term public investment plan. Similar to the process of public investment plan, the annual state budget estimate is prepared and submitted through a bottom-up process, as follows:

[140] Law on State Budget No. 01/2002/QH11 passed by the National Assembly on 16 December 2002 (Law on State Budget 2002).
[141] Law on State Budget No. 83/2015/QH13 passed by the National Assembly on 25 June 2015 (Law on State Budget 2015).

- At the commune level, the annual budget estimate of a commune shall be prepared by the People's Committee based on annual estimates of local agencies of the same level. Then, the annual budget estimate needs to be approved by the People's Council before being submitted to the People's Committee at district level.

- At higher levels (district level and provincial level), each People's Committee shall prepare an annual budget estimate for its own locality based on annual estimates of local agencies of the same level and annual estimates prepared by the People's Committee of the lower level. Any annual estimates shall be approved by the People's Council of the same level before being submitted to the People's Committee at higher level. At the provincial level, after being approved by provincial People's Council, the consolidated annual budget estimates of the province shall be submitted by the People's Committee to the MOF and MPI.

- At the central level, each ministry or ministerial-equivalent agency shall be responsible for preparing its annual budget estimate based on annual estimates of agencies using the budget of such ministry or ministerial-equivalent agency. Then, annual budget estimates of ministries or ministerial-equivalent agencies have to be submitted to the MOF and MPI.

- The MOF shall coordinate with MPI and other related ministries (if necessary) to summarize annual budget estimates of various agencies and formulate the consolidated State budget estimate, then submit it to the Government. The Government, after discussing and commenting on the State budget estimate formulated by the MOF, will submit the annual State budget estimate to the National Assembly.

- National Assembly shall approve the annual State budget estimate for the subsequent year no later than 15 November. Upon such approved annual State budget estimate, the annual budget estimate of each unit using State budget will be approved and assigned through a top-down process, specifically:

    - The Prime Minister shall assign the subsequent year’s budget estimates to each ministry, ministerial-equivalent agency and provinces;
    - People’s Councils at multiple levels shall decide annual budget estimates of their own localities. Then, based on such approved annual budget estimates, People's Committees shall assign annual budget estimates of the subsequent year to each agency of the same level and to People's Committees of the lower level (if any).
    - Ministry, ministerial-equivalent agencies shall assign annual budget estimates of the subsequent year to each agency using the budget of such ministry or ministerial-equivalent agency.

The figure below illustrates the process for estimation and allocation of annual budget.

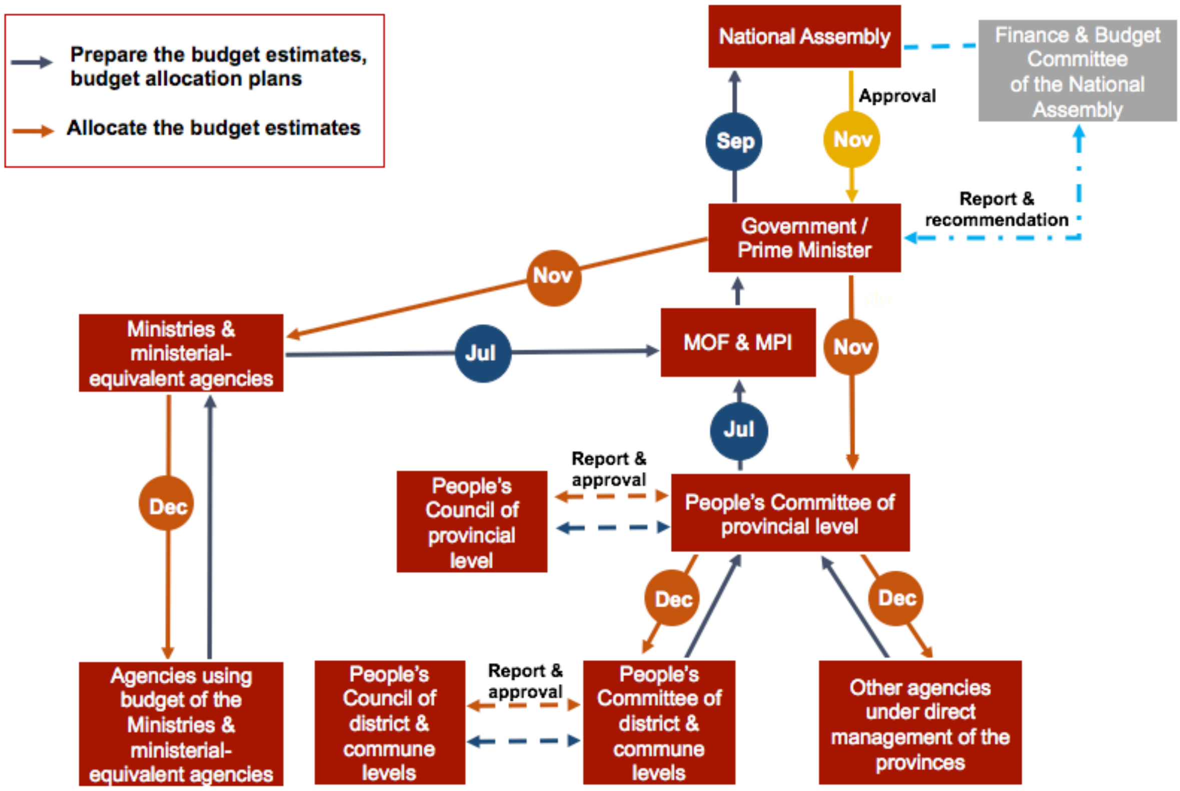

Figure 3.3.1.6a: State annual budget estimation process.

3.3.1.7 Conclusion

The proposed VGF Scheme must be designed to match the PPP Cycle and thereby:

- allow the determination of a project's VGF needs to be based on a completed Feasibility Study,
- ensure that the approval of the VGF grant is made prior to tender,
- ensure that disbursements are timed to match equity injection by the investor and drawdown of loans from the lender(s), and
- by matching the PPP Cycle, speed up the development of needed PPP projects.

In short, the VGF Scheme should be designed with a goal that projects go from Project Proposal to contract execution in less than 18 months by reducing the delay and risk associated with a mismatch between the PPP Cycle and State budget planning rules. The conventional state budget allocation process will not work to achieve these goals. However, if funded as a financial institution, the VGF Fund can be designed to match the timing of PPP project development and VGF disbursal needs. The VGF Fund, if adequately funded with a reserve account or ODA stand-by commitments, can practically eliminate the timing risk associated with the aforementioned budget allocation system.

3.3.2 Reason 2: the need for longer term VGF disbursements

The current budget planning system for ASAs is limited to one year and five year plans, which would prevent longer term disbursement of VGF. Further, an ASA's inability to ensure a budget commitment beyond one year introduces significant funding risk to a project. Lenders are reluctant to assume the *risk that their loans will not be matched by needed VGF on time and may refuse to lend to projects where such funding risk exists. As a general rule, where there is unmitigated risk in a project, the cost of capital for the project will be higher, thereby undermining the efficiencies and VFM that should be sought for PPP projects.*

3.3.2.1 One Year Budget Limitations

ASAs can budget only on one and five-year plans which may not match the VGF needs of a project. Many projects require 24-36 months to complete construction. A common form of VGF is CAPEX support at key milestones during the construction phase. There is significant delay or Government side breach in a project where an ASA would agree to provide support beyond the first year of construction but fails to have the budget appropriation approved or disbursed on time. For instance, if a budget allocation for VGF needed at month 24 of the construction period were not achieved on time, it could trigger various delay penalties or compensation events under the concession contract that would need to be borne by the ASA. Because timely payment of VGF is important at construction and/or operational milestones, the VGF Fund would be better suited to ensure such payments are achieved on time in accordance with the concession contract.

The VGF Fund, if financed with a sufficiently large reserve or backed by ODA stand-by commitments, it will be able to disburse at the timing contemplated the concession agreement, thereby alleviating the risk of Government default where VGF disbursement is delayed.

3.3.2.2 Conclusion

The Proposed Scheme would be designed to permit a longer term approach to VGF grant disbursements by shifting the VGF budgeting risk away from ASAs and onto the VGF Fund which would be seeded and annually topped up with sufficient funding to meet the aggregated long term VGF commitments of the country.

3.3.3 Reason 3: Need for consistent VGF management approach

Under the current system VGF would be identified and managed by various ASAs on a project to project basis, requiring ASAs to estimate VGF needs without a consistent approach or ability for long term planning. This system is inefficient and significantly increases the difficulty of the Government to accurately predict and account for state debt management across all projects. A centralized VGF management system would improve the efficiency and accuracy of the State's accounting for the impact of VGF across the PPP program.

3.3.3.1 Risks associated with multiple ASA management of VGF

If VGF is managed by each ASA (using annual expenditures), then there is a very high risk of:

- ASAs each taking an inconsistent approach to assessing and calculating VGF;
- difficulty in staffing the ASAs assessment team with experienced, skilled team members where each ASA needs to build such team from the start;
- difficulty of central government to fully account VGF commitments across various ministries (and inconsistencies in how such accounting is made);
- difficulty disbursing on time to match project construction or operation milestones; and

- a lack of an independent assessment of the need and appropriate level of VGF for a project because the ASA will have a natural interest to promote its own projects.

3.3.3.2 Conclusion

The VGF Fund on the other hand will be independent of ASA influence and will be able to employ experienced experts in a unified team that uses a consistent, independent assessment approach across all projects. By having a single team of skilled PPP financing specialists concentrated in one professional unit, the VGF Fund achieves a level of efficiency that is not possible for ASAs to achieve by:

- concentrating a team of specialists in one entity rather than requiring multiple ASAs to seek equivalent skill sets,
- applying a uniform, transparent approach to evaluating VGF needs across all project types rather than a scattered approach if evaluation is dependent on the varying experience level of different ASAs,
- being able to pay market rate for skilled professionals and thereby being capable of hiring the best qualified candidates who already have skills and experience (rather than needing time and effort to retrain civil servants), and
- being capable of delivering to Government a single consolidated accounting of VGF across all projects rather than risking error and delay by relying on various ASAs to plan and account for their respective VGF budgets.

3.3.4 Reason 4: Lack of clarity or flexibility for adjusting approved budgets

There is no clear mechanism for adjusting the approved medium-term public investment plans financed by the state budget after they have been set. This means that even if bidders will require lower VGF there would be a budget discrepancy. This when multiplied across a number of PPP projects would create significant difficulty assessing and administering the final budget.

3.3.4.1 The need to adjust VGF will certainly arise after approval

It should be expected that the actual VGF needs of a project will be revised between (i) the project proposal and feasibility study and (2) again at the time of bidding. The mechanism for adjusting an approved medium-term public investment plan is unclear, once the plan has been approved. The public investment plan for a project would be approved in principle on the basis of the project proposal. The project proposal is only an initial assessment of the costs and needs of a project and is typically refined significantly during the feasibility study. It should be noted that a project proposal (essentially a pre-feasibility study) would only be accurate to a much lesser degree (e.g. +/- 20-25% accuracy) than the feasibility study (e.g. often targeting +/- 10%-15% accuracy). In any event, both the project proposal and the feasibility study provide only estimates of the VGF requirements of a project. It is during the tendering phase that bidders will make their own financial analysis and come up with their own best estimates of their VGF needs. It is on the basis of such estimates that investors take the financial risk of the project. This is part of the rationale for an ASA to require investors to bid against the level of VGF approved for a project, thereby reducing the overall VGF cost to the State.[142]

Because the precise VGF needs of a project may not be determined until after the feasibility study or after the bidding is complete, there is a high likelihood that the VGF budget for a project will need adjusting after the award of the contract. Therefore, VGF disbursements are very likely to differ from the amount of VGF approved in principle which is the basis of the medium term public investment plan. This is further complicated when multiple projects are approved in principle but each requires the VGF to be reassessed following the feasibility study and the bidding phases of the project. *What remains unclear is how the current public investment planning could be adjusted post hoc to address the reality of how VGF is determined much later than the date of the approval in principle. This naturally raises the question of whether an approved VGF grant could only be amended by waiting until the next round of determining the medium term public investment plan. Clearly such a result would not be suitable for promoting PPP in Vietnam.*

The Public Investment Law simply does not contemplate how VGF needs of PPP projects will be determined on the basis of a completed feasibility study. The Public Investment Law treats the financial support of PPP projects as something that must be determine in advance in the 5-year medium term public investment plan. Therefore, there is clear inconsistency between the Public Investment Law and the reality of developing PPP projects.

3.3.4.2 Conclusion

If ASAs or the State plan annual funding to the VGF Fund instead of for individual projects, the budget planning (at the ASA and State level) would be simplified and not subject to the risk that budget allocation and disbursements fail to match. The Study needs to further explore how PPP project financial support going through the VGF Fund can be planned under the Public Investment Law to create a single recipient to manage VGF of projects. There is a clear need for a new mechanism under the Public Investment Law for PPP projects to be managed by the VGF Fund. That mechanism may need to be in the form of a Decree specific to the establishment of the VGF Fund and assessment and approval of budget for the VGF Fund to use on individual projects. Key to that mechanism will be the

[142] Note: Please note that under Decree 30 bidders may bid on the basis of VGF, bid against the service price and bid for the maximum social benefit to the State.

ability of ASAs and the VGF Fund to determine and approve the actual VGF needs of a project on the basis of a completed feasibility study rather than guessing on the probable needs years in advance.

Assuming that a mechanism is created under the Public Investment Law to allow the VGF Fund to manage the detailed assessment and disbursement of VGF grants, the VGF Fund could adjust the final approved level of State support to be different from the approval in principle made earlier on the basis of an inherently inaccurate project proposal.

The VGF Fund would manage the budget discrepancy by offsetting undisbursed funds against the following year's request for funding. This provides a value budget administration efficiency that is not achievable by multiple ASAs attempting to budget and account for VGF across multiple projects.

3.3.5 Reason 5: Greater flexibility in disbursement conditions and timing

Even if State budget appropriations were possible in time to meet the necessary disbursement cycle of a project, there is little flexibility in designing the payment conditions and terms for usage of State investment capital and very little room under Decree 15 for dealing with the VGF needs of unsolicited proposals.

3.3.5.1 Leaving space for unsolicited projects

Decree 15 permits VGF to only be used for unsolicited projects primarily in the case that the VGF funds originate under an ODA agreement that permits such usage. This restriction appears to make it quite difficult for ASAs to earmark money to possibly desirable but unsolicited projects. It is a reality in Vietnam that some of the ongoing PPP projects that are needed and have progressed their feasibility studies are of an unsolicited nature. Those projects may be orphaned by Decree 15 unless a more flexible mechanism can be developed.

3.3.5.2 Conclusion

A clear advantage of a VGF Fund is that it may earmark ODA funds to specific project types, including unsolicited projects, if the terms of the ODA loan provide for such usage. If the ODA loan agreement contemplates support of specific project types or seeks to qualify the kinds of bidders who qualify for usage of the VGF supported by such ODA monies, a VGF Fund structure can accommodate such requirements more flexibly than an ASA's budget allocation. It is recommended that some flexibility remain in the VGF Scheme to address unsolicited proposals, particularly where the projects are already well progressed in their feasibility studies. Some of those projects may be reasonable candidates for piloting the VGF system. Please see the discussion in Section 3.5 on how certain ODA funds may be directed to specific project types or investor qualifications.

3.4 Institutional Structure of VGF Fund

It is important that the VGF Fund be capable of operating independently of the ASAs proposing projects using VGF. ASAs may have a conflict of interest if they are permitted to both propose and approve the VGF budget for a project. Further, an ASA will be primarily focused on the usage of VGF for its own projects and will lack a comprehensive perspective on how all projects using VGF affect State debt. Therefore, an independent assessment body is necessary to prevent this conflict of interest and to provide a professional unbiased assessment to Government of the aggregated usage of VGF across all project types.

As explained in the International VGF Study, in many countries VGF is managed through an independent institution empowered to assess and recommend to an Appraisal Committee the grant of VGF from monies under its control. Such institution is typically structured as a financial institution which operates much like a private sector investment fund, managed by professional fund managers and staffed with PPP financing experts. Another benefit of this structure is that it permits the VGF management entity to hire expertise on the basis of market salaries rather than the civil servant pay scale. This is critical to attracting experience and adequately skilled talent.

3.4.1 VGF Fund as State Financial Institution

To preserve the independence of the technical assessment of VGF needs of projects and to consolidate the skillsets for VGF assessment into a professional body, the VGF Fund should be structured as a State financial institution under the authority of MOF. The operating costs of the VGF Fund would be planned in the annual budget estimate MOF. The VGF Fund could possibly charge fees for its services to ASAs and investors, but the VGF Fund would be a non-profit entity.

3.4.2 Examples of existing funds in Vietnam

Precedent already exists in Vietnam for the structuring of standalone independent fund structures attached to ministries and provinces that are empowered to manage public monies. Examples of such funds include:

- VEPF established by the Prime Minister under the form of a State financial institution under the Ministry of Natural Resource and Environment;
- National Foundation for Science and Technology Development (NAFOSTED) established by the Government under the Ministry of Science and Technology; and
- Local Development Infrastructure Funds (LDIFs) established by the People's Committee of some provinces.

The establishment, structure and operation of these funds are summarized in the table below.

Table 3.4.2a: Examples of existing funds in Vietnam.

	Vietnam Environment Protection Fund (VEPF)	National Foundation for Science and Technology Development (NAFOSTED)	Local Development Infrastructure Funds (LDIFs)
Legal basis for establishment	Law on Environment Protection 1993 (Article 115 of the Law on Environment Protection 2005 and Article 149 of the Law on Environment Protection 2014 then recognize the VEPF)	Law on Science and Technology 2000 (Article 39 of the Law specifically contemplates the establishment of the national fund by the Government)	Law on State Budget 2002 Law on Credit Institutions 1997 (as amended in 2004)
Authority approving the establishment	The Prime Minister under Decision No. 82/2002/QD-TTg dated 26 June 2002	The Government under Decree No. 122/2003/ND-CP dated 22 October 2003 (Decree 122)	People's Committee of each province (PPC) issues a Decision to establish a fund of the province
Organization and operation	• Under Decision No. 78/2014/QD-TTg dated 26 December 2014; and • Circular No. 132/2015/TT-BTC dated 28 August 2015 on the regime for financial management of VEPF	Under the Charter issued by Decree No. 23/2014/ND-CP dated 3 April 2014 (replaces the Charter issued under Decree 122)	Under Decree No. 138/2007/ND-CP dated 28 August 2007 of the Government (as amended by Decree No. 37/2013/ND-CP dated 22 April 2013)
Legal status of the fund	• A State financial institution under the direct management of the Ministry of Natural Resources and Environment (MONRE) • The fund has its own charter capital, seal and balance sheets and can open its account at the State Treasury and banks	• An autonomous non-business public unit under the direct management of the Ministry of Science and Technology (MOST) • The fund has its own charter capital, seal and balance sheets and can open account at the State Treasury and local banks	• A State financial institution of the locality • The fund has its own charter capital, seal and balance sheets and can open account at the State Treasury and commercial banks operating in Vietnam
Operational principle	• The fund operates as a not-for-profit organization but it must preserve the charter capital and bear its own management costs. • It is exempted from paying tax and other contribution to the State budget with respect to activities related to environmental protection	• The fund operates not-for-profit organization	• The fund operates under the form of a policy bank with not-for-profit purpose. • The fund must be financially independent and preserve and increase its capital. • The fund carries out both financial investment and development investment activities

	Vietnam Environment Protection Fund (VEPF)	National Foundation for Science and Technology Development (NAFOSTED)	Local Development Infrastructure Funds (LDIFs)
Charter capital	500 billion VND (JPY2.5 billion) allocated from the State budget when established and to be increased to 1000 billion VND (JPY5 billion) by 2017	500 billion VND (JPY2.5 billion) allocated from the State budget when established and to be supplemented each year from the State budget to preserve the charter capital	100 billion VND (JPY500 million) at a minimum allocated from the budget of locality
Capital source of the fund in addition to the charter capital	• Annual State budget allocation to spend on subsidization for environment protection project and supplement the operational capital of the fund; • Damages related to environment; • Fees for selling CERs from CDM projects in Vietnam; • Donations, contributions and trusted investment from domestic and foreign organizations or individuals	• Annual allocation of State budget for science and technology activities to maintain the charter capital and cover the operation of the fund (to be supplied in January and July annually in accordance with the approved financial plan); • State budget for carrying out loan guarantee for special science and technology tasks; • Other State budget capital; • Incomes from the fund activities: loan interest, fees for loan guarantee, income from money deposit; • Donations, contributions from domestic and foreign organizations or individuals	• The fund can raise capital from domestic and foreign organizations and individuals under the form of borrowing or issuance of bonds of the fund
Scope of operation	• Provide loans with preferential interest rates to environment protection projects; • Support the interest rate to environment protection projects which borrow from commercial banks; • Grand funding to environment protection activities • With respect to Clean Development Mechanism (CDM): collect fees for selling CERs and subsidize the price of products of CDM projects; • Subsidize the tariff of wind power projects connected to the national grid; • Provide financial support to projects for responding to climate change; • Appraise and approve the amount, duration and the form of financial support to projects using capital support from the fund	• Provide non-refundable or partly non-refundable subsidies to science and technology activities; • Provide loans without interest or with low interest to projects for applying the result of technology research to life; • Provide loan guarantee to special science and technology task as assigned by the Prime Minister (using a separated funding source); • Evaluate and select projects for lending or providing guarantee in accordance with the fund's criteria related to science and technology NOTE: The lending and loan guarantee activities above shall be carried out through trust banks (including domestic banks or branches of foreign banks)	• Conduct direct investment (i.e. being investor) into socio-economic infrastructure projects within the list of prioritized sectors for development issued by the PPC; • Provide investment loans to projects within the list of prioritized sectors issued by the PPC with the minimum interest rate issued by the PPC; • Contribute capital to establish enterprises engaging in developing socio-economic infrastructure;

	Vietnam Environment Protection Fund (VEPF)	National Foundation for Science and Technology Development (NAFOSTED)	Local Development Infrastructure Funds (LDIFs)
			• Entrust others to provide investment loans and recover debts; to be entrusted to manage investment capital, provide investment loans, recover debts, grant investment capital, and issue local government bond to raise capital for local budgets as authorized by the PPC
Organizational structure	• Management Board consists of: ○ Chairman: a Vice Minister of the MONRE; ○ Members: a representative of MONRE, MOF, MPI and SBV (at level of Department Head or Deputy Head) as appointed by the Minister of MONRE • Director, being the legal representative of the fund, is appointed by the Minister of MONRE • Inspection Committee: The head and members are appointed by the Minister of MONRE	• Management Board consists of 7 or 9 members, including full-time and part-time members, being scientists, managers and representatives of reputable enterprises with the term of 5 years. • Chairman, Vice Chairmen and other members of the Management Board are appointed by the Minister of MOST. • Director, being legal representative of the fund, is appointed by the Minister of MOST upon proposal of the Management Board. • Inspection Committee: The head and members are appointed by the Minister of MOST. • The Science and Technology Committee is established by the Management Board upon proposal of the Director to provide advice on the evaluation and selection of projects and tasks receiving subsidy, loans or loan guarantees from the fund; and on the evaluation of the result of the science and technology tasks funded by the fund. Members of the committee are high-profile scientists and managers, which are selected from the fund's database on experts	• Management Board consists of maximum 5 members • Chairman, Vice Chairman and other members of the Management Board are appointed by the Chairman of PPC • Director, being a member of the Management Board and legal representative of the fund, is appointed by the Chairman of PPC • Inspection Committee: The Head is appointed by the Chairman of PPC

3.4.3 Legal basis for the VGF Fund

According to Decree 15, MOF shall coordinate with MPI to provide guidance on disbursement of VGF (or State investment capital) for project implementation and prepare plans for the use of VGF in projects. However, Decree 15 is silent on the possibility of creating a fund to manage the State capital and its disbursement to projects.

As a result, it is necessary to create a separate legal framework for the establishment and management of the VGF Fund, instead of issuing a circular providing guidelines to implement Decree 15.

Based on our research on existing funds with similar functions in Vietnam (i.e. VEPF, NAFOSTED, and LDIFs) as described above, the Study Team recommends establishing the VGF Fund as a State financial institution under the authority of MOF. However, the VGF Fund should have a high degree of autonomy and a fully independent management team. Similar to the above funds, the establishment and operation of VGF Fund would require (i) a Decree of the Government, in similar form and content to Decree No. 122/2003/ND-CP dated 22 October 2003 on the Setting Up of NAFOSTED (as later partly replaced by Decree No. 23/2014/ND-CP dated 3 April 2014); (ii) or a Decision of the Prime Minister, in similar form to Decision No. 82/2002/QD-TTg dated 26 June 2002 on the Setting Up, Organization and Operation of VEPF (as later partly replaced by Decision No. 78/2014/QD-TTg dated 26 December 2014). Such a Decree or a Decision of the Prime Minister would be promulgated on the basis of a proposal of the Ministry of Finance. The Decree or Decision would provide for the legal status, functions, funding sources and mechanism for financial management of the VGF Fund. The charter on organization and operation of the fund can be attached to the Decree or Decision, or can be issued separately.

3.4.4 Key features of the VGF Fund

In order for the VGF Fund to perform its core functions efficiently, in addition to the charter on organization and operation of the VGF, the MOF will need to delegate, by way of ministerial guidelines on mechanism for financial management of the VGF Fund, sufficient authority to the VGF Fund to:

- manage State and ODA originated monies to be applied to grants of VGF on behalf of the MOF;
- receive State capital and ODA funding on behalf of Government for disbursement as VGF grants and to cover operating costs of the VGF Fund;
- arrange VGF support conditions in response to requirements of ODA loan agreements;
- assess all requests for grants of VGF for projects proposed by ASAs including to be in a position to issue independent opinions and recommendations on:
    - requests for VGF support from ASAs,
    - the quality and findings of Project Proposals submitted by ASAs;
    - the quality and findings of Feasibility Studies submitted by ASAs;
    - the VGF disbursement plans for projects using VGF;
    - the anticipated effect on the State budget of individual and aggregated grants of VGF;
    - the compliance of parties in the usage of VGF;

- liaise with ASAs, MOF, MPI, State Bank of Vietnam and other Government bodies in the performance of the VGF Funds' functions;
- liaise with development partners for the initial and continual funding of the VGF Scheme;
- appraise annual budget plans of ASAs in respect of proposed budget allocations for VGF grants to projects under their mandate;
- account to Government the aggregate annual and projected usage of State and ODA monies by the VGF Scheme;
- develop mandatory requirements and criteria for assessing, approving and monitoring the grant of VGF to projects;
- be permitted to receive and on-lend ODA funds to support PPP projects;
- be able to operate a bank account for its daily operations;
- be able to enter into contracts with third parties in respect of the grant and disbursement of VGF, including having its own seal; and
- establish a technical assessment team to assess requests for VGF and will recommend VGF grants to an inter-ministerial approving body for approval; and
- hire and manage its own management team and technical experts.

3.4.5 Merits of the VGF Fund Structure

Some key merits of structuring the VGF Fund as a financial institution described above include:

3.4.5.1 Compatibility with the PPP Cycle

The VGF Fund solves the problem of ASAs needing to time their budget estimates and allocation with the project development cycle of PPPs. The VGF Fund can assess the VGF needs of a project following the feasibility study phase and can recommend for approval the grant of VGF--completely separate from any considerations of the ASA to make budget appropriations for the project. Using the approval to grant VGF, the ASA will be able to prepare the bidding phase with clarity on how much state support can be offered to bidders. This facilitates the quickest timeline for developing a project because there should be no need for an ASA to interrupt the PPP Cycle to prepare the budget appropriation.

3.4.5.2 Efficiency in Disbursement

By allowing the VGF Fund to manage disbursements of the actual VGF grant money, the ASA can consolidate its annual budget allocation to a single recipient, the VGF Fund. The VGF Fund would then take that money and redirect it to the individual projects on behalf of the ASA. Thus the budget allocation is simplified for the ASA.

3.4.5.3 Concentrates Skills into a Center of Excellence

The VGF Fund will be able to recruit experienced PPP assessment professionals who will be concentrated into a single center of excellence. This relieves ASAs of the burden of needing to home grow PPP financial assessment skills from within their own ranks. The higher pay scale achievable by the VGF Fund, when compared to civil servant salary caps, will give it more flexibility to retain experts from the private sector. As a center of excellence, the VGF Fund can better ensure a consistent approach assessing the VGF needs of projects across all sectors.

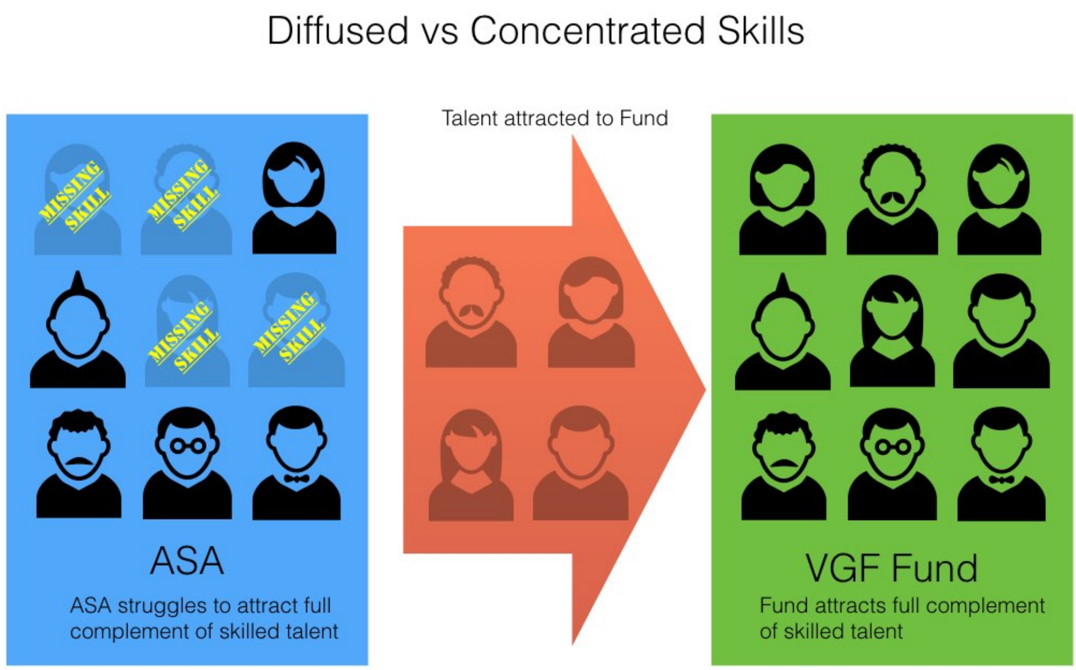

Figure 3.4.5.3a: VGF Fund attracts full complement of skilled talent.

3.4.5.4 Efficient approvals process:

As will be discussed in Section 3.7 below, the VGF Fund would comprise of technical experts who make a professional and independent assessment of an ASAs feasibility study and on that basis provide the Appraisal Committee the key technical assessments on the merits for granting of VGF for a project. This system would entail a clear pathway for identifying VGF needs and improve the efficiency in approving the grant. The proposed Approval Committee is independent of the ASA and meet regularly to sign-off on the appraisal of the VGF grants.

3.4.5.5 ODA On-Lending

The VGF Fund can be structured to provide on-lending of ODA loans at lower rates than commercial loans. Such on-lending capability has the potential to reduce the financing cost of a PPP project. Where on-lending is provided, it would be important to ensure that the on-lending assessment and approval remain independent of the VGF approval such as to prevent a potential conflict of interest.

3.5 Financing the VGF Fund

3.5.1 Basic Funding Structure

The proposed VGF Fund would be initially financed (seed funding) by a combination of ODA funding and State capital (i.e. in the form of initial charter capital of the VGF Fund). The seed funding should be an amount sufficient to cover the expected operational costs of the VGF Fund and the expected disbursements of VGF for the initial pathfinder projects. Following the seed funding, the VGF Fund should be financed each year by State budget appropriations in such amount to cover the current and subsequent years' expected VGF disbursements and operation costs (annual allocations). Annual allocations should be backed by ODA contingency funds in case the State budget allocation is not sufficient to cover the approved VGF grants. ODA backing of the VGF Fund will strengthen the credit rating and perceived integrity of the VGF Fund. It is proposed that annual allocations be made by:

- a central budget allocation through MOF's annual budget to cover continued operation costs of the VGF Fund;
- additional funding directly to the VGF Fund backed by ODA contingency funds (based on the reported aggregated VGF needs reported annually by the VGF Fund); and/or
- budget allocations from the ASAs themselves following the normal State budgeting rules and based on the ongoing and projected VGF grants for the projects of each ASA.

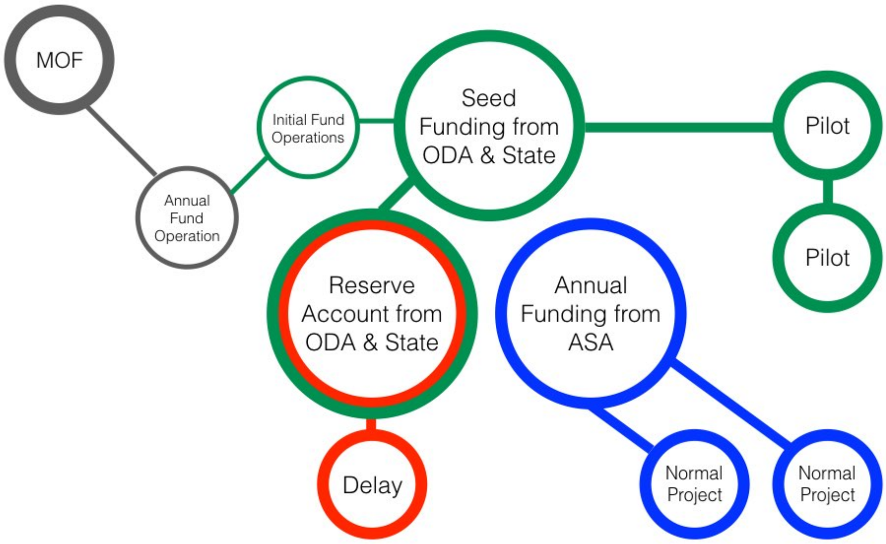

Figure 3.5.1a: Sources of financing of the VGF Fund

The above figure illustrates the three key sources of financing of the VGF Fund and the intended targets of such financing.

- As noted seed funding would largely originate from ODA support. These monies would be earmarked for the establishment of the VGF Fund, coverage of its early operation costs and disbursements for the early pathfinder projects until such time that ASAs are able to inject budget allocations into the VGF Fund. The green circles in the figure above illustrate this concept.
- ASAs would allocate their estimated VGF budget to the VGF Fund for managing the VGF grants to such ASAs' projects (on behalf of the ASAs). Those monies would be earmarked for the projects of the ASA who injected the funds. The rationale and efficiencies for such management were discussed above in Section 3.3 of this proposal. The ASAs' allocation to the VGF are marked by the blue circles in the figure above.
- A combination of ODA funding and State budget support would be set aside to handle contingencies, such as when an ASA is delayed on approving an annual budget allocation to the fund. A key function of the VGF Fund is to eliminate the risk of delays in the ASA budget allocation process and therefore a reserve amount is necessary. That reserve amount could be supported through stand-by ODA support. The red and green combined circle illustrates the reserve funding concept.
- It is assumed that MOF would allocate annual operational funds to the VGF Fund, as marked in grey above.

Note: This proposal does not yet propose a start up budget for the VGF Fund as such would be determined by a feasibility study of the structure approved by the Government following this Study. Factors to be considered in such feasibility study include:

- the current pipeline of pathfinder projects and their anticipated VGF needs;

- the priority sectors for PPP development in the short to medium term and the typical VGF needs of projects in those sectors;
- the optimal staffing of the VGF Fund and the associated running costs;
- the availability of ODA fund sources and State budget allocations at startup and subsequent operational years for the VGF Fund; and
- the need (and optimal quantum) for a contingency reserve to cover potential funding issues such as a failure of ASAs to allocate and disburse to the VGF Fund their anticipated annual contribution.

It is anticipated, however, that the VGF Fund should be sufficiently funded from the beginning to disburse at least two years of anticipated VGF grants as well as its own operations to ensure smooth startup and operations.

3.5.2 Seed Funding

Seed funding will be needed to bring the VGF Fund to life, allow it to hire professional managers and technical support staff and begin to assess the VGF needs of the pathfinder projects that are currently under development. As discussed in Section 3.3 on the rationale for the VGF Fund, project by project budget allocation by ASAs will not be an efficient or *timely* way for the State to assess, disburse and monitor its support of projects. The current PPP program faces a significant risk of delay or even coming to a standstill if a VGF Scheme is not in place by the time the pathfinder projects start the investor selection process. Ideally, the VGF Scheme would be fully committed by the completion of the Feasibility Studies of the pathfinder projects so that the ASAs managing those projects will have a solution to providing VGF. Thus, time is of the essence for the Government to agree upon the VGF Scheme and commence activities to procure seed funding for the VGF Fund.

As introduced above, seed funding may come from two sources: State capital and ODA funds.

3.5.2.1 State capital seed funding in the form of initial charter capital

The initial charter capital of the VGF Fund may be contributed from the central State budget as expenditure for investment in development. The amount of this initial charter capital should cover the initial costs for operation of the VGF Fund and to support some pathfinder projects.

3.5.2.2 ODA seed funding

In case State capital is not sufficient to support pathfinder projects for the initial 2-5 years, an additional source to be considered for seed funding is ODA. ODA may take the form of grants or concessional loans from development partners. ODA capital is listed in Decree 15 as one of the capital sources for VGF. Particularly, Decree No. 16/2016/ND-CP of the Government[143] on the management and use of ODA capital, provides that the private sector has access to ODA capital by participating in the implementation of PPP projects, to which the Government contributes by way of ODA capital.

3.5.2.3 Providing seed funding for VGF Fund as an ODA project

As a capital source of the central Government's budget, ODA capital (including grants and concessional loans from development partners) of the Government can be used in one of the following ways:

- Entirely grant to projects, programs which are incapable of directly recovering the capital and are the expenditure duties of the central State budget; or

- Partially grant and partially on-lend to projects, programs which are the expenditure duties of the local State budget; or

- On-lend to projects which are capable of directly recovering all or a part of the capital or the project which are not State expenditure duties.[144]

According to Circular 218/2013/TT-BTC dated 31 December 2013, specifically regarding PPP projects, other financial regimes might also be determined by the Prime Minister to apply to PPP projects.[145]

Under Decree 15, VGF, taking the form of the State investment capital contributed into PPP projects in order to guarantee the financial viability of the project, is a capital support provided by the State with no requirement to recover such capital. In the context of VGF Fund, the provision of seed funding would be considered as an independent project of the Government, which are incapable of directly recovering the capital. Therefore, such project would be eligible for receiving the ODA grants from the State.

[143]Decree 16/2016/ND-CP of the Government dated 16 March 2016 on management and use of ODA capital and concessional loans from donors (Decree 16).
[144]Decree 16, Article 8.
[145]Circular 218/2013/TT-BTC of the Ministry of Finance dated 31 December 2013 on financial management of projects, programs using ODA capital and foreign concessional loans from donors (Circular 218), Article 3.1(c) provides that regarding projects which has special capital disbursement and capital recovery mechanism such as PPP project, the Prime Minister might consider and decide on a special financial regime. However, it is notable that Circular 218 is an implementing circular of Decree 38/2013/ND-CP which was replaced by Decree 16. Therefore, it is expected that this Circular would be replaced soon by a new regulation.

Under the regulations on borrowing and management of ODA capital, the simplified procedures for mobilizing and receiving ODA capital from foreign donors (or development partners) for a specific project can be demonstrated by the following diagram.[146]

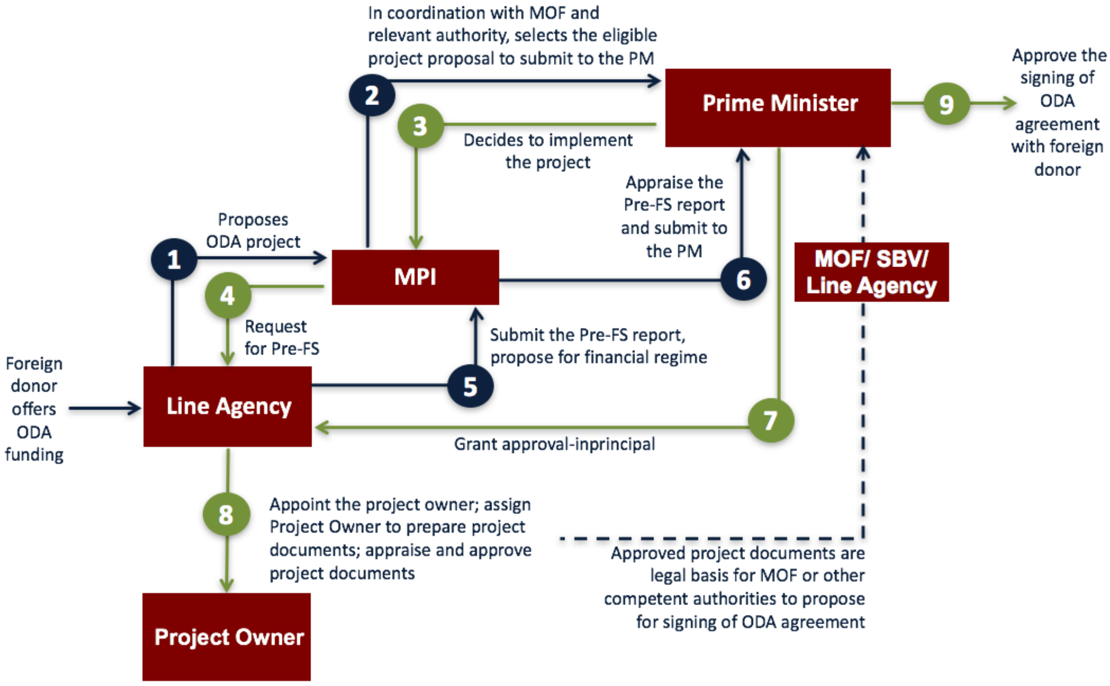

Figure 3.5.2.3a: Simplified procedures for mobilizing and receiving ODA capital from foreign donors.

The above diagram demonstrates simplified procedures that, in general, will apply to most typical ODA projects with certain exceptions (such as national important projects or national target program). According to Decree 16, a typical project using ODA capital is required to obtain the approval-in-principal from the Prime Minister. Contents of such approval shall include the financial regime applicable to the project (e.g. ODA grant or ODA on-lending), the capital amount, the Line Agency of the project (i.e. the agency proposing for implementation of the project)[147].[148] That said, almost all PPP projects that uses the ODA capital will require approval of the Prime Minister except for certain particular cases.[149] Therefore, for the sake of efficiency, if the seeding funding of VGF Fund is to be established as an ODA project, its components should include a certain number of pilot PPP projects so that the specific contents of such pilot PPP projects would simultaneously be approved by the Prime Minister at once.

[146]Decree 16, Chapter 2, 3, 4 and 5.
[147]In case the VGF Fund is established as an ODA project, its Line Agency would likely to be the Ministry of Finance.
[148]Decree 16, Article 20.
[149]According to Decree 16, Article 12, the national target program and national importance program shall require approval-in-principal from the National Assembly and target programs will require approval-in-principal from the Government. The Prime Minister shall have the authority to grant approval-in-principal to most other ODA projects.

This is to avoid the need for obtaining separate approvals for these pilot projects, which can result in a delay in initiating the operation of the fund. Similarly, this might spare the need for signing several ODA agreements with foreign donors for these pathfinder projects.

3.5.2.4 Granting of ODA capital to VGF Fund

Under the Law on Public Debt Management, one purpose of Government loans (including ODA loans) is to make investment for socio-economic development, which is one of the expenditure duties of the central budget. ODA loans, as a capital source of the central budget shall be granted to specific projects in compliance with the laws and regulations on State budget management as well as the laws and regulations on public debts management. Taking into account the process of granting ODA capital, in general, for projects which are eligible to receive ODA capital, MOF is responsible for conducting allocation of ODA capital to specific projects in line with the project progress and the capital disbursement progress of the donors.

More specifically, similar to regular State budget allocation process, annually on the basis of the project timelines, the Project Owner shall formulate the plan on the use of ODA capital for the project and submit it to the Line Agency.[150] The Line Agency shall consolidate such plan with other investment plans into a common budget plan to be submitted to MOF and MPI so that the plan shall eventually be presented to the Prime Minister and National Assembly for approval.[151] In accordance with the regulation of State budget management, the National Assembly shall make decision on central budget allocation based on which the Prime Minister shall allocate the expenditure duties (using ODA capital) with the respective proportion of each expenditure duties to the Ministries, ministerial-equivalent agencies, Government agencies, etc. (including the Line Agency).

Depending on the disbursement method as agreed with the foreign donors on a case-by-case basis under ODA treaties, the process for management and disbursement of ODA loans to specific projects shall be different. However, generally, the account for receiving ODA capital from foreign donors can be opened by MOF or the Project Owner at the State Treasury or at other specific commercial bank qualified and listed by State Bank of Vietnam.[152] And MOF shall take main responsibility for receiving the dossiers requesting for disbursement of ODA loans.

In term of the VGF Fund, the ODA loans from the donors might take the forms of a mix of seed funding and contingent funding (e.g. standby facilities). As discussed above, the seed funding would be disbursed by the development partners upon the establishment of the VGF Fund, which would cover the expected operational costs of the VGF Fund and the expected disbursements of VGF for the initial pathfinder projects. For subsequent PPP projects, the disbursement of ODA capital will be contingent with the needs of specific project and requested annually by the VGF Fund (based on specific request of ASA to the VGF Fund). *It would need to be explored further with MOF and development partners on specific mechanism of such contingent funding mechanism.*

[150]Circular 218/2013/TT-BTC of the Ministry of Finance dated 31 December 2013 on financial management of the programs, projects using ODA capital and concessional loans from donors (Circular 218),Article 8.1.
[151]Circular 218, Article 8.1.
[152]Circular 218, Article 10.

3.5.2.5 Case study of PDF facility as an ODA project

The Study Team has reviewed the case of PDF Fund which is also a project using ODA capital. This is designed as a project for providing technical support for ASA in terms of preparation of PPP projects under Decree 15 under the ODA grants from ADB and AFD.

Below is the demonstration of PDF fund flow mechanism.[153]

[153]Source: http://www.adb.org/sites/default/files/linked-documents/44507-002-vie-oth.pdf

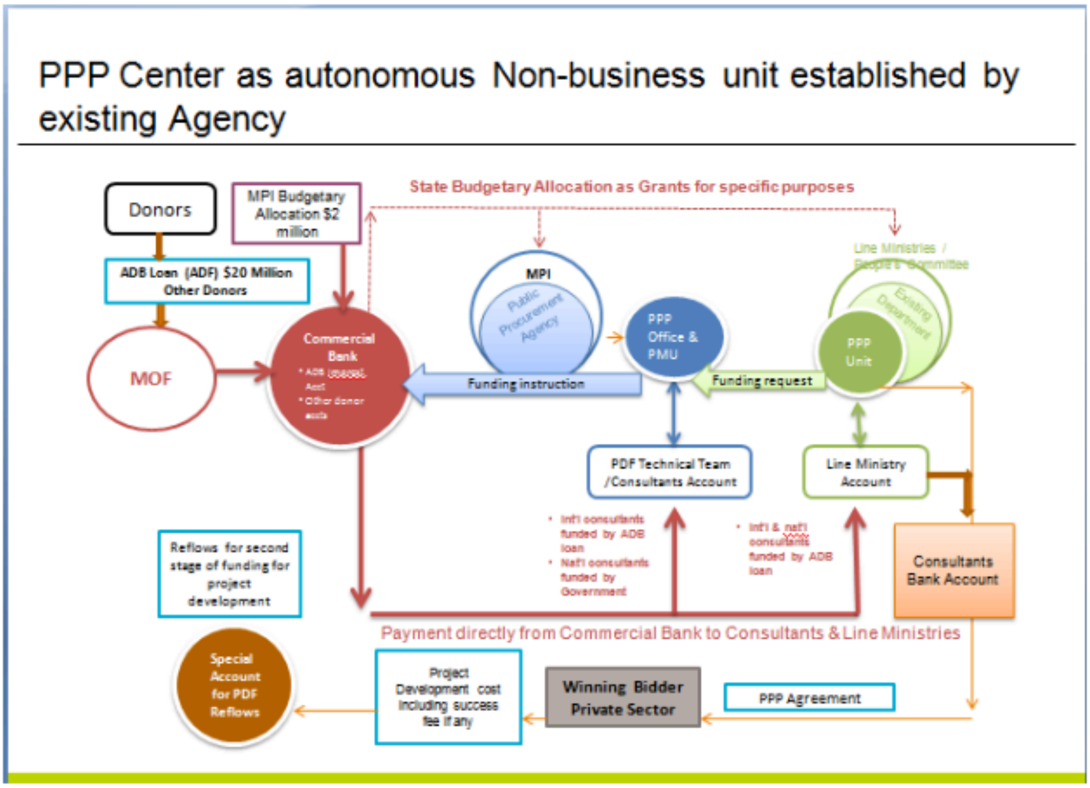

Figure 3.5.2.5a: PDF fund flow mechanism.

As presented in the diagram, PDF fund is not established as an institution of any kind. Instead, the project uses custodian structure with the only physical presence is an account in a commercial bank authorized by the MOF. Such account receives funding instruction from the PMU established under MPI for the disbursement into specific projects. At that time, the Government took a policy decision of not to establish an independent PDF Fund to avoid changing fundamentally the institutional structure within the Government and because the draft PPP Decree was in an early stage. Although the structure would still work for funding the preparation of PPP projects, it is anticipated that it would face certain difficulties in operation due to lack of an independent institution as a fund. Further, the PDF fund relies on government staffing, supported by technical advisors, where the government staff members have a number of daily tasks in addition to the PDF. This is not an optimal arrangement for the VGF Fund as fund staff should be exclusively tasked to operate the fund without competing work load. Thus a stand alone VGF Fund structure is preferable to the current structure of the PDF fund.

3.5.2.6 On lending of ODA capital to PPP project

Similar to the case of ODA capital allocation, on lending of ODA capital is also subject to the Prime Minister decision.

Only MOF and the financial institutions authorized by MOF shall have the right to conduct on lending of ODA loans. The VGF Fund, structured as a financial institution to implement ca credit program, could be such an institution authorized to conduct on lending of ODA loans. In accordance with the laws and regulations on public debt management, the specific authority to onlend ODA capital depends on the entity / agency receiving the capital. More specifically as follows:

- MOF shall directly conduct on lending to:
    - Financial/credit institution in order to implement credit programs without specific conditions;
    - People's Committees of provincial level;
    - Special projects, which the Prime Minister allows to be exempted from appraisal of on lending conditions and loan guarantees.[154]
- On the other hand, the financial/credit institutions authorized by the MOF have the authority to on lend to:
    - Enterprises in order to implement specific investment project, program;
    - In order to implement programs, projects with specific conditions on the subject, location, sector, on lending interest rates and other relevant conditions.[155]

In the other words, only MOF and the financial institutions authorized by MOF shall have the right to on-lend ODA loans. In practice, certain funds established as State financial institutions have been authorized by MOF as the on lending agency in order to receive and on lend ODA loans, for example the Vietnam Environment Protection Fund. In term of VGF Fund, if it were established as a State financial institution, it would be eligible to carry out on lending of ODA loans to PPP projects through authorization of MOF.

3.5.2.7 Earmarking ODA originated funding for specific projects or investor qualifications

As noted in Section 3.3.5 the Government may wish to maintain some flexibility in the VGF Scheme to handle unsolicited projects. Decree 15 permits VGF to be used for projects being subject to ODA sources and concessional loans of foreign donors. We interpret this to permit VGF for unsolicited or tied projects where the ODA loan so requires. Conceptually, if ODA funds are earmarked for specific uses or investor types then specific criteria would be designed and implemented by the VGF Fund to comply with such ODA mandate. This may be visualized as follows:

[154] Decree 78, Article 18.1.
[155] Decree 78, Article 18.2.

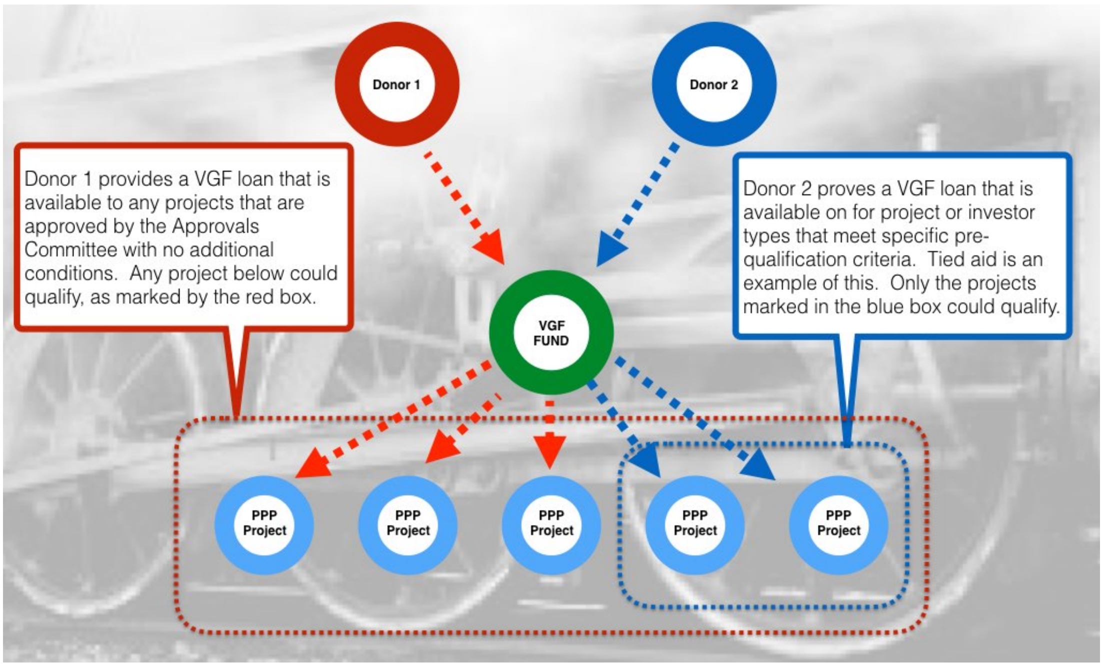

Figure 3.5.2.7a: ODA originated funding for specific projects or investor qualifications.

In the above figure, the VGF Fund receives money from more than one ODA source. While one source may be open to any project that is approved by the Approvals Committee of the VGF Fund, the VGF Fund would need to apply specific criteria required by the ODA source to select specific projects or specific investor types. This pathway may be attractive to test some or all of the functions of the VGF Fund on existing projects under development, using tied grant aid. For example, as a precursor to the fully functional VGF Fund, a donor sourced VGF ODA loan could be designed to test core VGF procedures (e.g. project appraisal and approval steps, tendering procedures, etc.) on selected project or with selected investor types (in the case of tied aide). Such a loan could be used to establish in whole or in part the basic institutional structure of the VGF Fund in order to fast track it. For purposes of this proposal, the issue is noted but requires further investigation.

3.5.3 Annual allocations

It is not anticipated that the Government would fund (from either State capital or ODA sources) all of the startup and future needs of the VGF Fund by way of seed funding at the startup of the VGF Fund. Full funding at startup would be an inefficient use of capital where inactive, uncommitted funds would either accrue interest (in case of ODA sourcing) or create inefficient opportunity costs (e.g. where the Government cannot otherwise use the State capital committed to the VGF Fund). Therefore, the more efficient approach to ensure the long term financing of the VGF Fund would be through annual budget allocations sized to meet the ongoing and committed grants and operations of the VGF Fund. As noted above the annual allocations may originate from central State budget through annual budget allocation of MOF and annual budget allocations of various ASAs.

3.5.3.1 How to estimate and include the State capital for VGF in the annual budget estimates (under the Law on State Budget 2015)

The Law on State Budget 2015 does not contemplate a separate mechanism applied to PPP projects, but sets out general provisions on the estimation and allocation of investment capital for development, which covers State investment in infrastructure projects (implicitly including PPP projects). The State capital for VGF, as a part of the expenditure for investment in development, will be estimated and included in the annual local budgets and the central budget under the normal procedure for formulation of annual state budget estimates and its allocation. The estimates of expenditure investment in development shall be formulated on the basis of (i) approved plans, programs, and projects; and (ii) five-year financial plans, medium-term (five-year) public investment plans and capacity of balancing resources in the budget year.

Applicable to PPP projects, State budget estimation and allocation shall be made annually on the basis of specific projects. Particularly, the ASA must plan and estimate the amount of VGF needed for each project and consolidate it into the ASA's estimate of expenditures for investment in development. As discussed in Section 3.3 above, in the current process, the ASA shall submit its budget estimate and allocation plan to the Government before the National Assembly approves it. After such approval, the estimated budget will then be allocated to the ASA. However, the disbursement the State Treasury will only take place when a particular project actually needs a specific amount at different milestones. In other words, the ASAs do not physically keep the money but only get a 'commitment' of the Government to pay a specific amount of State budget capital into a project during that year.

With the VGF Fund structure, each ASA must still estimate the annual budget to be allocated to specific projects within the ASA's responsibilities. Of note, the budget estimate and allocation process discussed herein applies only to the VGF needed from central State budget. The VGF Fund does not apply to the State investment capital into projects sourced from local budget (including provincial-level budget, district-level budget and commune-level budget). After the budget allocation to the ASA, such budget would be immediately disbursed from the State Treasury to the VGF Fund and the VGF Fund would account it as State capital amounts contributed by each ASA. The VGF Fund will be the agency, which disburses the specific amount of VGF needed to projects during the year.

A remaining question is whether the VGF Fund can legally receive the aggregated amount of VGF needed for the entire year on behalf of the ASAs instead of receiving the amount needed for each project following the project's milestone. This issue needs to be further considered and discussed with MOF.

As an alternative, the VGF Fund, acting as a centralized fund, would be based on the request of each ASA, estimate the annual budget allocation needed for the entire year and receive directly the allocation and disbursement of the amounts without having to go through ASA's estimate and allocation process. A precedent of this approach is the case of VEPF where the fund estimates its own budget allocation for the State capital needed to support wind power projects and receives budget allocation directly to the fund.

This deserves further consideration to determine whether such mechanism will also work for the VGF Fund.

In addition, it should be noted that under the current process of State budget law, the State Treasury is the agency controlling the payment of State investment capital from the State budget. There are only two exceptions where the State Treasury does not disburse the State investment capital to projects, namely:

- In some special projects as decided by the Prime Minister, certain specific agencies are assigned to control the payment of investment capital from the State budget; and
- In projects funded with ODA, commercial banks will play the role of the service bank and control the payment process.[156]

It appears that the disbursement from the VGF Fund directly to a project will require a Prime Minister decision. This disbursement process of State investment capital is contemplated in Circular 86 issued under the Law on State Budget 2002. It is expected that a new circular replacing Circular 86 will be promulgated when the Law on State Budget 2015 comes into force in January 2017. Such new circular may need to take into account a new process of disbursement from a fund if this VGF Fund scheme is accepted and implemented by the Government.

3.5.4 Decentralization (local government use of the VGF Fund)

The study team finds that a decentralized approach to PPP development does not prevent local government from using the VGF Fund or allocating its budget to management by the VGF Fund. It should be noted that the VGF Fund would be available to provincial government projects as well as central ministry projects, similar in concept to how provincial governments can apply to use the PDF fund during project development. It is beyond the scope of this proposal to analyze the various budgeting rules of local governments. This issue should be discussed with stakeholders to identify a pathway for allowing local government to seek VGF fund support and allocate some of its own budget to funding the VGF approached for its projects.

3.6 Mandatory procedures and criteria

To ensure efficiency, transparency, market confidence and maximum benefit to the Government's management of State debt, the VGF Fund must have clearly defined procedures and criteria that are applied consistently to all projects. Mandatory procedures and criteria will need to be developed for each stage of the VGF assessment process including:

- Submission of requests for VGF: Each ASA will follow clearly defined steps to make a request to the VGF Fund to appraise the project, following procedures and criteria that address, amongst others:

    - project qualification criteria,
    - timing of when the project is ready for an assessment of its VGF needs,
    - form and contents of the request,
    - handling of non-compliant requests,

[156] Circular 86/2011/TT-BTC dated 17 June 2011 stipulating on management and payment of investment capital of state budget (**Circular 86**).

  - steps for responding to feedback from the VGF Fund, and
  - procedures for preparing VGF disbursement plans and their related annual allocation plans to fund such disbursements.

- Appraisal of requests for VGF: The VGF Fund will follow clearly defined procedures for conducting its appraisals of requests for VGF and making recommendations to ASAs and the Appraisal Committee, including amongst others:

  - procedures for receiving and appraising requests for VGF,
  - appraisal methodologies,
  - accounting procedures for monies managed by the VGF Fund,
  - reporting requirements to the Government for monies managed by the VGF Fund and projections on future commitments, and
  - procedures for providing feedback (recommendations and opinions) to ASA and making recommendations to the Appraisal Committee to approve grants of VGF.

- Approval of VGF grants: The Appraisal Committee will follow clearly defined procedures for appraising and approving recommendations from the VGF Fund for grants of VGF, including amongst others:

  - procedures for receiving and appraising recommendations,
  - rules to avoid conflict of interest and to ensure transparency in the approval process,
  - criteria for determining compliance of the VGF Fund with the mandatory requirements,
  - criteria for which the Appraisal Committee may reject a recommendation by the VGF Fund, and
  - procedures for issuing approvals.

- Disbursement of VGF grants: The VGF Fund will follow clearly defined procedures for disbursing and accounting for VGF grants, including amongst others:

  - procedures for assessing the disbursement plan submitted by ASAs,
  - procedures for confirming disbursement plans set forth in finalized project contracts, and
  - procedures for issuing disbursements of VGF grants.

- Monitoring usage of VGF grants: The ASAs and the VGF Fund will follow clearly defined procedures for monitoring the usage of VGF grants, including amongst others:

  - procedures to confirm the disbursement and use of VGF grants in accordance with the grant approval and terms of project contracts;
  - methodology to account for aggregated disbursements of VGF monies;
  - methodology for assessing medium to long term impact of the VGF Scheme on the State budget.

3.7 Overview of the appraisal and approval of VGF grants

This section of the proposal introduces some of the key principles and steps recommended to ensure the VGF Fund has a robust assessment and approval mechanism.

3.7.1 Principles driving scheme

As may be seen in the International VGF Study, a clear appraisal (VGF assessment) process and designated approval authority is critical to ensuring that grants of VGF are made with integrity and efficiency. The principles that should drive the appraisal and approval of VGF by the VGF Fund include:

- Appraisal or assessment of VGF needs should be based on the findings of a feasibility study report completed in accordance with Decree 15.
- The body assessing a VGF request should be independent of ASAs to prevent moral hazard and to encourage ASAs to prepare higher quality feasibility studies (because they will be peer reviewed).
- VGF needs assessment by the VGF Fund should conducted consistently and applying uniform technical criteria by a skilled technical team.
- The technical assessment body should make a recommendation to an approving body that makes its decision on the basis of clearly defined approval criteria.
- The approval body needs insulation from political pressure.

3.7.2 Appraisal and Approval Bodies

It is proposed that two bodies be established to provide all technical appraisal and official approval of requests for VGF. Those bodies are:

- **Technical Appraisal Team**: A team of skilled PPP and VGF assessment technicians within the VGF Fund. The core functions of this "Technical Appraisal Team" would include:
    - Review all submissions of requests for VGF from ASAs and screen against qualification criteria.
    - Review the project proposal and/or feasibility study submitted with a VGF request for compliance with law and technical accuracy of the proposed quantum and type of VGF.
        - Note: The Technical Appraisal Team would be an assessment team that provides robust peer review of a feasibility study but would not be replicate or reconstruct an ASA's feasibility study.
    - Provide constructive commentary and recommendations for an ASA to improve its assessment of VGF where the Technical Appraisal Team finds issues with the findings of the project proposal or feasibility study submitted by an ASA.
    - Make a recommendation to the Approvals Committee for the grant of VGF.

- **Approvals Committee**: A committee of three members whose core function is to endorse a recommendation for a grant of VGF by the Technical Appraisal Team. The

Approvals Committee represents the Government and its approval of a request for VGF may be relied on by an ASA and the PPP investor as good proof of the Government's commitment to provide VGF support to a project. The structure and institutional arrangement of this committee needs further discussion but the proposed principles for consideration include:

- The committee can be placed within the VGF Fund as an investment committee or be structured as an inter-ministerial committee.
- If structured as an inter-ministerial committee, the proposed composition includes:
    - A high level (e.g. Vice Minister level) representative of the Ministry of Finance
    - A high level (e.g. Vice Minister level) representative of the Ministry of Planning and Investment
    - A high level (e.g. Vice Minister level) representative of the ASA making the VGF Request. This third position would be on an ad hoc basis when the relevant project is under consideration.
- The committee's role is to assess the propriety (e.g. compliance with procedures and criteria) of a recommendation by the Technical Appraisal Team. The committee should not become involved in the actual technical appraisal.
- The committee could be the focal point for issuing Government policy preferences on the types of projects to be prioritized for VGF. For example, the committee could issue one and two year priority statements that the Technical Appraisal Team would then incorporate into the criteria for assessing VGF requests.

A proposed institutional structure for the Technical Appraisal Team and Approvals Committee may be visualized as follows:

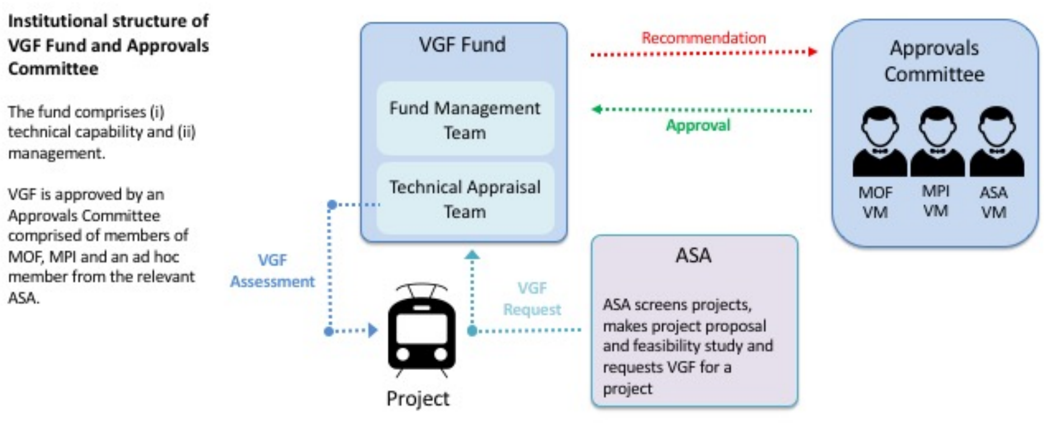

Figure 3.7.2 Example of external approving body.

3.7.3 Appraisal and Approvals Process

3.7.3.1 Principles

A number of options exist for structuring the appraisal and approval procedures to be used under the VGF Scheme. The important principles for structuring an appraisal and approvals process include:

- The procedures must be clear, transparent and fair.
- Both the Technical Appraisal Team and the Approvals Committee should be guided by mandatory criteria, free from influence of the ASA or other political pressures.
- It is possible to introduce varying sets of criteria depending on the project type, source of VGF funding (e.g. ODA requirements), etc. but criteria should be in place.
- The process should be initiated by the ASA seeking to develop a project and based on a compliant project proposal and/or feasibility study.
- A well developed feasibility study provides the best measure of a project's VGF needs.
- The process should be timely and fit as closely as possible to the natural PPP project development cycle under Decree 15.

3.7.3.2 Example of a stepwise appraisal and approvals process

Based on PPP project development introduced by Decree 15, this section identifies an option for consideration of the key procedures for how the Government may assess and approve VGF grants using the Technical Assessment Team of the VGF Fund in coordination with an Appraisal Committee. The main options considered by the study team include:

- A single step assessment scheme wherein VGF is determined on the basis of a completed feasibility study.
- A two step assessment scheme wherein VGF is determined on the basis of first an approval in principle based on a completed project proposal, followed later by a final assessment and approval based on a completed feasibility study.

Further discussion is needed with stakeholders to determine which of the above approaches will be most suitable in the Vietnam context (and compliant with law). Each approach may have its merits and demerits, as follows:

Table 3.7.3.2a: Pros and cons of a one and two step assessment schemes.

	Pros	Cons
One step assessment scheme	• One less step, reducing administrative burden	• No significant time savings over 2-step process because the project must still conduct both a project proposal and feasibility study[157] • Less opportunity to refine the feasibility study to respond to an assessment by the VGF Fund after a project proposal
Two step assessment scheme	• Allows ASA or investor to respond to initial appraisal by the VGF Fund and structure feasibility study with the benefit of an approval in principle • If the VGF Fund has a clear review period (e.g. 30 days) there is minimal delay to the project development when compared to a one step process • Allows ASA to begin planning its budget allocation earlier, on the basis of an approval in principle • Allows ASA to either terminate a project denied by the VGF Fund or restructure the funding sources	• One additional step, possibly increasing administrative burden

It is acknowledged that the approval of both VGF and the feasibility study under the Public Investment Law will be a main driver of the procedures and that a difference process may need to apply to projects of national importance versus types A, B and C investment projects.

For sake of brevity and to illustrate the basic assessment and approval process to be used by the VGF Fund, this section presents the key steps of a single assessment scheme, wherein the VGF Fund assesses the VGF needs of a project based on the draft Feasibility Study submitted to it by an ASA for a project and provides an initial approval in principle, with recommendations, that then shape the finalization of the financing structure set forth in the feasibility study to be approved by the relevant approval authority. Using the approved feasibility study, the VGF Fund again reviews the request for VGF and finalized feasibility study and then makes its recommendation to the Approvals Committee. Note: although this is called a single assessment scheme the VGF Fund could review a feasibility study twice as follows:

[157] Note: Group C projects require a project proposal but not a feasibility study.

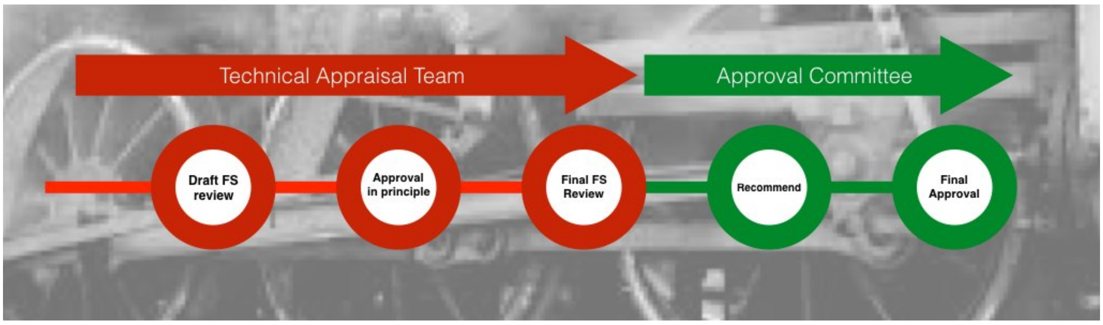

Figure 3.7.3.2a: Single assessment scheme.

As can be seen above, the feasibility study would undergo two reviews by the Technical Assessment Team prior to its finalization and the recommendation for VGF to be sent to the Approval Committee. This scheme needs further discussion with stakeholders.

As noted above, the detailed steps of the appraisal and approval scheme need further tailoring to the requirements of the Public Investment Law and other regulations but conceptually they should be tailored to follow these basic steps if possible:

Step 1: Completion of Project Proposal or Feasibility Study Report

The ASA may apply for approval of VGF for a project developed in accordance with Decree 15 on the basis of a completed feasibility study for Groups A&B project or project proposal for Group C projects.

From the feasibility study report (or project proposal) the ASA should make its determination of:

- the proposed financing structure for the project including concessional loans or other incentives
- the proposed contract structure and key commercial terms of the project
- the proposed quantum, form and disbursement plan of the VGF.

Step 2: Request for initial approval of VGF

If VGF appears to be necessary for the financial viability of the project, the ASA may seek a preliminary assessment of whether the project meets the basic criteria for VGF by submitting a request for preliminary assessment from the Technical Appraisal Team of the VGF Fund.

Example of materials to be submitted:

- Pro forma request for preliminary assessment identifying:
  - Description of the project
  - Determination of need for the project
  - Statement of project's qualification for VGF against the qualification criteria

    - Proposed quantum, form of payment and disbursement plan of the VGF based on the finalized feasibility study report (for Groups A&B projects) or project proposal (Group C) projects.
- Copy of the draft feasibility study report or project proposal, as the case may be.
- A budgeting plan for how the ASA will make annual budget appropriations to the VGF Fund to cover the quantum of VGF needed for the project.
    - Note: we are proposing that the ASA be responsible to contribute from its annual budget the majority share or full quantum of the VGF monies to then be managed and disbursed by the fund. The fund would aggregate the monies of various ASAs and ensure the timely and easy disbursement of approved VGF payments. By aggregation the fund is able to determine the full extent of State support used for VGF and also reduces the risk of an ASA failing to make the proper annual budget allocation for the relevant VGF payments. If an ASA fails to make its allocation to the VGF Fund, the fund would have sufficient reserves to cover the VGF until the allocation is achieved. In the worst case the fund may turn to donors to draw down on an ODA standby loan while Government addresses the underlying State budgeting issues.

Step 3: Initial approval of VGF request

Upon receiving a request for determination of VGF, the VGF Fund would conduct a full assessment of the VGF structure of the proposed project examining:

- The level of priority ranking to apply to the project type
- Compliance of the project with the criteria set forth in the mandatory requirements
- Compliance of the feasibility study report with the mandatory requirements
- Ability of the fund to provide the VGF in the quantum, form and timing requested by the ASA

The VGF Fund will apply mandatory criteria in making this assessment.

Step 4: Approval of Feasibility Study Report and VGF Disbursement Plan

Upon receipt of the approval in principle the ASA will undertake the finalization and approval of the feasibility study report in accordance with Decree 15 and reflecting from the approval in principle:

- the quantum and form of VGF approved for the project
- the disbursement plan for the VGF
- any conditions for disbursement set forth in the Initial VGF Approval

If the feasibility study report is approved with terms or conditions for VGF differing from the terms set out in the approval in principle, the ASA will submit to the VGF Fund a request for secondary review of the terms for VGF. The Fund will reappraise the request for VGF using the assessment procedures and will issue a revised VGF opinion (e.g. recommendation to the Approval Committee) if needed.

Step 5: Final VGF Approval

On receipt from an ASA the request for a final VGF approval, the VGF Fund shall assess the request and dossier submitted by the ASA to ensure it complies with the above procedures and criteria. If the request, and in particular the VGF disbursement plan, complies with mandatory requirements, the VGF Fund will issue to the Approval Committee a recommendation to approve the VGF request. The Approval Committee will then assess the recommendation against its approval criteria and issue a final approval of the grant of VGF.

Step 6: Bidding and Contract Award

Pursuant to Decree 15, after the feasibility study report has been approved, the project may be tendered to investors in accordance with the Bidding Law and Decree 30. Investors shall be selected through fair and transparent bidding in accordance with the laws or through terms required by any ODA funding agreement applicable to the project. It is proposed that the bidding documents set forth the terms and conditions of the VGF as approved by the Approval Committee. Within their financial proposals, the bidders shall compete on the basis of the lowest VGF required to implement the project.

After the investor has been selected, the ASA and investor shall negotiate the project contract and agree on a VGF disbursement schedule that complies with the terms and conditions set forth in the approved VGF.

Option: Following initialize the project contract, the ASA shall apply to the VGF Fund for final confirmation of the VGF disbursement schedule (that has been set out in the project contract). The application for final confirmation will include:

- a copy of the approval of VGF
- a copy of the negotiated and initialized project contract which includes the VGF disbursement plan
- a certification by the ASA that the VGF disbursement plan has been approved by it and complies with the terms of the approval of VGF
- the finalized budgeting plan for how the ASA will appropriate the required budget to the VGF Fund to cover the quantum of VGF needed for the project

Step 7: Disbursement

At the milestones set forth in the approved VGF disbursement plan, the investor may apply to the VGF Fund for disbursement of VGF monies. The VGF Fund will then assess that the conditions for disbursement have been met and will then disburse the funds. Each time the investor makes a request for disbursement, the ASA will issue a confirmation that contractual terms have been met.

Step 8: Monitoring

The ASA will monitor the progress of projects and submit to the VGF Fund periodic progress reports identifying:

- compliance of the investor with the terms of the project contract
- status and any issues with the implementation of the project

The VGF Fund will add to such report its assessment of the VGF monies paid in respect of the project and the impact of the individual project to the aggregated use of State budget for VGF across all PPP projects supported by the VGF Fund.

Step 9: Annual Budgetary Allocations

Each year, the ASA shall disburse the pre-agreed budget allocation to the Fund for each project of the ASA that is receiving VGF and make a budget allocation plan for the following year and mid-term budget plan in accordance with State budget laws.

Conceptually, the various activities of the ASA, VGF Fund and the Approval Committee can be visualized as intersecting lines of activities as follows:

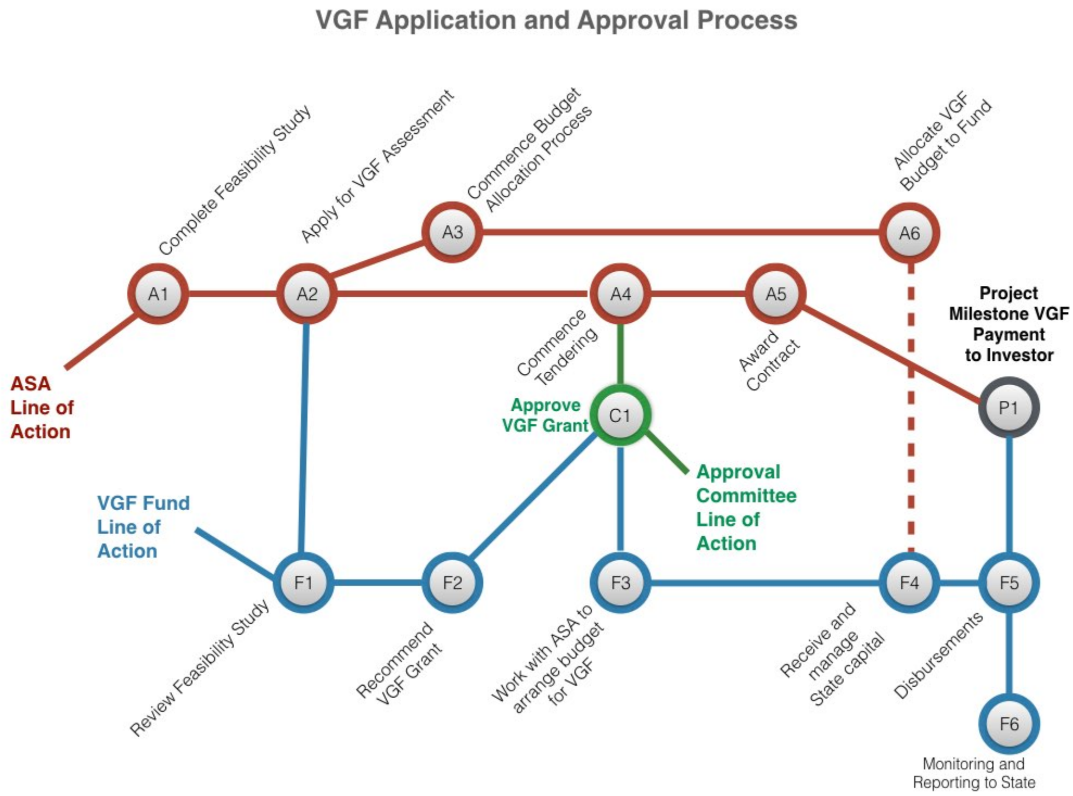

Figure 3.7.3.2b Lines of activities.

3.7.3.3 Notes on conditions for disbursement

Disbursement must also be managed by clear conditions and procedures. Generally, the VGF Fund will disburse VGF payments to the investor in accordance with the disbursement plan set out in the finalized project contract. It is recommended that the the following conditions apply:

- the Investor has fully paid its equity contribution into the Project Enterprise
- VGF payments are made in proportion to the drawdown of other funding sources (e.g. loans)
- the contract milestones are met.

3.7.4 Long term monitoring of State debt

A core function of the VGF Fund is to provide long term monitoring of VGF usage across all projects supported by VGF. Mandatory procedures would be applied by specialists in State debt assessment and management. Annual reports and projections would be presented to Government.

3.8 Remaining Issues

The study team recognizes that the VGF Fund proposed in this document will require deep consideration of the Government and input from various stakeholders. This proposal is intended to structure a concept around which stakeholders can have meaningful discussion to arrive at a VGF Scheme that is suitable for the needs of Vietnam.

It is anticipated that the subject matter of this proposal will be discussed frankly in a workshop of stakeholders. The study team identifies the following issues that remain open for discussion:

1. How the current public investment planning could be adjusted post hoc to address the reality of how VGF is determined much later than the date of the approval in principle? This naturally raises the question of whether an approved VGF grant could only be amended by waiting until the next round of determining the medium term public investment plan.

2. Can the VGF Fund receive directly from the State Treasury the aggregated amount of State budget allocation to each ASA after the budget allocation to ASAs was made?

3. Alternatively, can the fund request for the State budget allocation on behalf of ASA (based on the ASA's specific request to the Fund) and make it as the fund's own budget allocation? [This essentially treats VGF at central level a separate spending item which does not require each ASA to carry out State budget estimate process by itself. The fund will carry out the process centrally instead. The budget allocation to the fund will also be independent of MOF's budget].

4. The specific mechanism of contingent funding of ODA loans from development partners would need to be further explored with MOF and development partners.

4. Response to Government Feedback on the VGF Fund Proposal

This Chapter 4 sets out the response to Government feedback on the VGF Fund Proposal, contemplated under task 6.3.3 of the TOR for the Study.

4.1 Introduction

This Chapter sets out the issues to feedback received from the VGF Working Group[158] in the working sessions held during March 2016 and the Study Team's response to such feedback. For the most part, this Chapter is organized in tabular format, as was presented to the Government on 18 May 2016. The intent of the response document contained in this Chapter was to initiate deeper analysis with the VGF Working Group to arrive at a clearer mutual understanding of any real barriers to the creation of the VGF management scheme proposed by the Study Team. The Study Team proposed the VGF Fund, as set out in detail in Chapter 3 of this Study.

4.2 VGF Working Group

The VGF Working Group comprises members from MPI and MOF who have engaged with the Study Team to examine options for structuring a VGF management scheme for Vietnam.

Members of the VGF Working Group included:

Table 4.2.1a: Table of Members and Departments.

MPI Members		MOF Members	
Name	Title/Department	Name	Title/Department
Mr. Nguyen Dang Truong	Department of Public Procurement	Mr. Le Tuan Anh	Department of Investment
Mr. Hoang Manh Phuong	Department of Legal Affairs	Ms. Nguyen Thi Minh Phuong	Department of Investment
Mr. Tran Viet Dung	Department of Public Procurement	Ms. Nguyen Lan Anh	Department of Debt Management and External Finance
Mr. Cao Thanh Phu	Department of Economic Relations	Ms. Nguyen Bao Ha	Department of Debt Management and External Finance
Ms. Nguyen Hong Van	Department of Legal Affairs		
Mr. Ly Hoang Nhat Anh	Department of National Economic Issues		
Ms. Tran Hoang Lan	Department of Local and Territorial Economy		
Ms. Nguyen Thi Phuong Que	Department of Public Procurement		

Within this group, MOF spearheaded the drafting of a VGF circular to which the Study Team provided commentary around 25 December 2015. The commentary may be found in Annex 4.1.

[158]Note: The VGF Working Group was comprised of members from the relevant department of MPI and MOF to examine the VGF scheme proposed under this Study. See Table 4.2.1a.

4.3 Third Working Session (18 May 2016)

On 18 May 2016, the VGF Working Group met with JICA and the Study Team for the third working meeting in respect of the proposed VGF Fund. The working session examined some of the issues raised Study Team's response (as set out in Section 4.4 below), particularly the establishment of a financial institution for managing VGF. It was recognized in the meeting that the proposed VGF Fund need not be a fund structure but instead may be another vehicle such as a financial institution. The main result of the third working meeting was a suggestion of the MPI Working Group to look in the immediate future at an ODA programmatic loan to support a pilot group of PPP projects. The VGF Working Group seems to take the view that establishing a new vehicle for managing VGF will be too challenging for the Government to achieve in the near term. Instead they intend to make a proposal of the Prime Minister to issue a circular on the usage of ODA for VGF for a program of pilot programs. JICA is asked to support this programmatic loan.

It should be noted, however, that establishing an ODA programmatic loan to support VGF will likely entail some of the same issues and barriers that have been raised in regards to the VGF Fund structure and that are known to cause difficulties for the Project Development Facility. For example, it is foreseeable that an account held by MPI for disbursal of ODA backed VGF to projects will give rise to the same problems that the current Project Development Facility account faces, namely an interpretation that such funding should be under the approved budget of the ASA rather than MPI. This issue will require additional legal analysis that is outside the scope of this Study to resolve, as it is caused by how Government is interpreting the Law on Public Investment against an existing loan treaty.

4.4 Issues and Responses in Respect of a VGF Fund

The remainder of this Chapter responds to the issues raised by the VGF Working Group in respect of the proposed VGF Fund.

Table 4.4a: Issues raised by MOF and MPI during meetings of 18 March and 22 March 2016.

No.	Issues	Comments from MOF/MPI	Solutions of MPI/MOF	Frontier's comments
1.	Establishment of VGF Fund as an independent fund or extra-budgetary fund (Independent Fund) Note: From Government's perspective, extra-budgetary fund means the fund which is established by a Government agency and has its charter capital contributed by such agency. However, as the fund is an independent legal entity, it will operate on its own and does not receive any further subsidy from the Government for its operation and future funding to projects. To this end, the fund needs to generate revenues on its own to be self-sustainable	In theory, the establishment of VGF is appropriate approach. However, with the current context of Vietnam, this approach is difficult to achieve because of the following reasons: (i) The recent instruction from the Government does not encourage the establishment of new agency/department. The Government also restricts the establishment of extra-budgetary funds (a.k.a. independent funds) because of inefficiency of existing funds (ii) It is very difficult to recruit new personnel for management of the VGF Fund. (The Government has restrictions on State agencies to recruit new civil servants)	(i) It may be better if VGF is managed and operated by current administrative authorities (e.g. MOF and/or MPI). Therefore, the Study Team should review the current agencies/units under MPI and/or MOF in order to consider the possibility of upgrading an existing agency so that this agency can cover the management of VGF. In addition, the Study Team should consider the possibility of using the existing human resource of MPI and/or MPI to manage the VGF fund instead of establishing a whole new personnel structure (ii) VGF Fund may be operating under a custodian structure, i.e. using an "account" opened at a bank to receive money from donors. The account will be managed by a PMU **If the account approach is taken, the questions here are:** • Which of MOF or MPI will be the host of the account? • Will MOF and MPI face difficulties in coordinating the operation of the account? For	We consider that the establishment of VGF Fund is doable because of the following reasons: (i) As reminded by Mr. Truong, during the meeting between MPI and ADB, the Minister of MPI, Mr. Bui Quang Vinh explicitly agreed with the idea of establishment of a fund to support PPP projects (ii) From our research, we have not identified specific conflicting legal provisions (under the Law on State Budget or any other relevant laws) preventing the establishment of a fund outside from the State Budget. If there are such provisions, or if Government interprets the law differently than us, such provisions should be identified for further consideration (iii) According to the Law on State Budget, as long as an Independent Fund meets all compulsory conditions provided in Article 8.11, such fund may receive the financial support from the State Budget in the form of charter capital. We understand from discussions with MOF, it is not too difficult for a fund to meet all requirements under Article 8.11

No.	Issues	Comments from MOF/MPI	Solutions of MPI/MOF	Frontier's comments
			example, as current arrangement of PDF • Will the account be able to receive funding source from State budget? Or will it be established to only receive the funding from donors?	(iv) Human resources: We have considered the request to upgrade existing agencies of MPI and/or MOF to manage a VGF account. This appears to lead to a similar outcome as the current Project Development Facility where small ambiguities in procedural regulations is causing difficulties and delay in actual implementation. Civil servants are not protect from decisions or approvals they make. The VGF will involve larger sums with more technical analysis needed to support the approval process. The two Ministries do not appear to have the resources or skillsets to manage large scale VGF. Nor do the Ministries enjoy the flexibility or protection from prosecution for decisions—as in the case of India. We have prepared a *public finance scorecard* based on the UK's approach and the Ministries score a the "pre-nascent and nascent" level when compared to the capacity and performance level expected in the UK. The VGF Fund offers a solution to aggregating strong human resources outside of restrictions on agency hiring **Article 8.11 of the Law on State Budget**: *"The state budget shall not support funds for operations of extra-budgetary State financial funds. The provision of State budget funds to contribute charter capital of a extra-budgetary State financial fund in accordance with the applicable laws must suit the*

No.	Issues	Comments from MOF/MPI	Solutions of MPI/MOF	Frontier's comments
				capacity of the State budget and shall only be effected only when the following conditions are fully satisfied: the fund is established and operates in accordance with applicable laws; the fund has independent financial capacity; and revenue sources and spending tasks of the fund are different from those of the State budget." This provision does not specifically restrict the establishment of extra-budgetary funds, but describes conditions that it must comply with, particularly, the condition on the spending tasks of the fund. Accordingly, the fund should only be established if the spending tasks of the fund are different from those of State budget. There would be various options to address the issue if the VGF fund were to established, for example, assigning the function of provide second-tiers loan or on-lending to the fund. Additionally, the provision seems to apply specifically to the establishment of State fund. If a vehicle is established under a different form to manage VGF, e.g. a financial institution, the above provision might not apply **Further research on extra-budgetary fund**: According to the Instruction No. 22/CT-TTg dated 27 August 2015, it is likely that the Government does not encourage and/or support the establishment of a new fund. However, the current laws do not

No.	Issues	Comments from MOF/MPI	Solutions of MPI/MOF	Frontier's comments
				provide any express provision prohibiting competent authorities from setting up funds
2.	Overlapping functions of MOF/MPI related to public investment planning and budget planning [Note: this was not specifically stated during the working meetings but at various times members of the Ministries have mentioned this issue]	Public investment planning (five year and annually) is managed by MPI while estimate and allocation of state budget are managed by MOF (annually). The proposed operation of the funds seem mixing the two functions. According to MPI, the fund under MOF does the job of PPP project investment planning, which should be the function of MPI		The fund acts as an independent fund, meaning it does not operate as an agency under either MOF or MPI. The fund's technical team will do an independent assessment of whether the project can receive the VGF grants before proposing it to the Approval committee (including MOF and MPI leadership). Such committee will be the decision maker rather than the Fund Alternative, after the Fund's technical appraisal of a VGF request, the normal process of collecting opinions from MOF and MPI will take place instead of referring to the approval committee. However, experience shows that process can take significant time, and the study team questions whether either Ministry has enough (or will have enough) human resource capacity and the ability to take a risk to approve large scale VGF grants

No.	Issues	Comments from MOF/MPI	Solutions of MPI/MOF	Frontier's comments
3.	Responsibilities of the Technical Team	According to the proposed mechanism, the technical team has many functions, for example, the Technical Team may involve the review of project proposal and FS. This is unnecessary because at the stage of preparation of project proposal and FS, it is likely that the ASA will hire advisors to prepare project proposal and FS	The technical team should focus on making recommendations to the Approval Committee for grant of VGF	The proposed Technical Team does not appraise in depth. It mainly reviews the project proposal and FS to determine whether the projects meet criteria for granting VGF However, we have recommended that it offer the ability to provide an unbiased opinion to ASAs in examining an ASA's project proposal or feasibility study. Importantly, the Technical Team gathers useful data from across all project proposals on the costs, projected IRRs, level of VGF requested, etc. to give the government a database across all sectors from which to learn what is "normal" in Vietnam PPPs
4.	Functions of VGF Fund	(i) Normally, the main function of a fund is to provide loans rather than provide grants. (ii) The on-lending function of the VGF Fund may not be practical	none	Because there is a lack of a legal guidance for the establishment and operation of an independent fund, there is no legal basis to conclude what should be the main and sub functions of the Fund Examining other independent funds in Vietnam, it appears that some Independent Funds can provide grants. The National Foundation for Science and Technology and the VEPF are good examples

No.	Issues	Comments from MOF/MPI	Solutions of MPI/MOF	Frontier's comments
5.	Difficulties in signing ODA Loan Agreement	An ODA loan needs to be attached with specific projects (investment projects or technical support projects). However, in case of VGF Fund, there is no specific project, therefore, the question is how to sign ODA loan agreement without specific project	none	JICA proposed the idea of signing a ODA loan agreement for a stand-by loan. The disbursement of the stand-by loan when requested by the VGF Fund would be a condition of such ODA agreement We again ask the MOF and MPI to consider deeply that the VGF Fund itself should be considered an ODA project which is the subject of an ODA agreement. The analysis should be that the ODA monies are destined for the operations and activities of the Fund. This is a subtle nuance from saying the monies are destined to sub-projects. What needs further consideration is how currently the provincial infrastructure development funds seem able to receive both government and ODA funding for various sub-projects although those projects may be determined after the loan agreement We understand that MOF or MPI has raised this same issue with ADB in its proposal for a Fund of Funds to support SME venture capital matching. However, the Ministries have not identified the precise legal barrier to ODA support of a Fund that then disburses to future projects If a specific project needs to be identified as the target of the ODA support to the Fund, then consider identifying the project to be "VGF Activity". Again this is a subtle nuance. That is, the Fund is deemed a PPP all on its own and the ODA support is for the

No.	Issues	Comments from MOF/MPI	Solutions of MPI/MOF	Frontier's comments
				VGF Activities of the Fund. For example, if ODA is granted for a specific infrastructure project, it is granted to the project and not on the basis of the underlying project contracts. We are suggesting the VGF disbursals are equivalent to sub-contracts that are not to be considered when funding the project (i.e. the Fund)
6.	Gaps between the public investment procedures and PPP cycle	The comment of the Study Team that "*the pubic investment procedures do not match with the PPP cycle"* is quite rigid because it is possible to amend the approved medium-term investment plan	none	Law on Public Investment lists some circumstances where the medium-term investment plan may be adjusted (Article 75), for example in case objectives of national socio-economic development strategies and plans are adjusted, or in case of having unexpected changes in the state budget balance or in the capacity of mobilizing funding sources, or in case adjustments cause no change in the total funds approved in the medium-term investment plan That means this adjustment procedure is only on exceptional basis and not applicable for all PPP projects The MOF and MPI should demonstrate how the actual amendment of a medium-term investment plan can be done. Those internal steps are not apparent from the law
7.	Some additional issues should be discussed in the VGF Report	VGF proposal has not mentioned the following circumstances yet:	none	(i) For the management of different ODA loans (that have different conditions),

No.	Issues	Comments from MOF/MPI	Solutions of MPI/MOF	Frontier's comments
		(i) Different donors have different policies, conditions and/or requirements. How VGF Fund can manage and use separately such different ODA loans from others? (ii) How VGF Fund can deal with circumstances where the VGF amount will be paid from both central state budget and local state budget. For example, in one project, total VGF needed accounts for 30% of the total project costs. Government and local people committee agree that the central state budget will be responsible for 20% and the local state budget will be responsible for 10%		when preparing the VGF proposal, we conducted an interview with Ho Chi Minh City Financial Investment Company (HFIC) and we also raised the same with HFIC. According to HFIC's responses, it has many experience and does not face difficulties in management ODA loans that having different conditions as well as in disbursement such ODA loans (ii) We don't think this is a special circumstance. VGF is a central fund, therefore, it shall be responsible for the part which is the obligation of the central budget, i.e. 20%. The local budget shall contribute the remaining part and the estimation and disbursement of such part will not follow the VGF scheme discussed in our proposal
8.	Compliance with the current laws	VGF needs to be built in accordance with current provisions of the Law on State Budget and Law on Public Investment	none	MOF and MPI should clarify further the specific concerns about compliance with current laws. So far no specific *violation* of law has been identified It is clear, though, that a VGF Fund may require some clarification of the Law on Public Investment. If we assume that political will can be generated for Vietnam to develop the region's best model for a professional VGF Fund to compete with the India and the Philippines, then the discussion with the Ministries should focus on the pathway that would be needed to implement the necessary changes to achieve the VGF Fund

No.	Issues	Comments from MOF/MPI	Solutions of MPI/MOF	Frontier's comments
9.	Questions raised by Frontier in Proposal which is not resolved	• How the current public investment planning could be adjusted post hoc to address the reality of how VGF is determined much later than the date of the approval in principle?		MPI to clarify and confirm the issue
		• Can the fund receive directly from the State Treasury the aggregated amount of State budget allocation to each ASA after the budget allocation to ASAs was made? • Alternatively, can the fund request for the State budget allocation on behalf of ASA (based on the ASA's specific request to the Fund) and make it as the fund's own budget allocation? [This essentially treats VGF at central level a separate spending item which does not require each ASA to carry out State budget estimate process by itself. The fund will carry out the process centrally instead. The budget allocation to the fund will also be independent of MOF's budget]		To be discussed further with MOF as it seems to be exceptional cases that an independent fund receives budget allocation from State in addition to charter capital However, as a precedent, in the regulations on operation of Environmental Protection Fund, the fund can receive the budget allocation and grand subsidies to wind power projects under feed-in tariff regime

ANNEX 4.1: Commentary on MOF Circular on VGF

This Annex 4.1 sets out the comments provided to MPI on 24 December 2015.

PRELIMINARY COMMENTS ON DRAFT VGF CIRCULAR DATED 8 DECEMBER 2015

1. General observations

Frontier team has reviewed the latest draft of the Circular dated 8 December 2015 of the Ministry of Finance on financial management of PPP projects (Circular). Our preliminary comments below are made based on the assumptions that the draft circular would fit in the current system of annual budget allocation under the current State budget law without any significant change of current institutional structure, particularly the establishment of an independent fund for VGF. In the next stage, we intend to provide recommendations for amending the VGF circular *after finalizing our proposal on recommended structure for VGF* which is to be discussed with the Government in January and February 2016.

(a) **Limited scope of the Circular**

The Circular only provides guidance on certain specific issues related to implementation of PPP Projects, but does not serve as a comprehensive guidance on financial aspects of PPP projects and State investment capital (VGF). Specifically, the Circular governs the following issues:

(i) The management, utilization of the cost for investment preparation and project implementation of the ASAs;
(ii) Financial plan of PPP project;
(iii) Payment of State investment capital for participation in PPP projects;
(iv) Finalization of completed PPP project; and
(v) The cost for investor selection.

We note that the preparation of detailed guidance on the above issues was specifically assigned to the MOF in Decree 15. The above scope lacks of key elements for preparation of financial aspects of a PPP project, such as guidance on how to budget and prepare funding sources for VGF, and the method for determining the VGF needs of a project. The circular only provides procedures for payment of VGF but is silent on how to prepare funding for VGF within State budget. Based on our analysis of the current Law on State budget and Law on Public Investment, the procedures set forth under these laws on preparation of budget for investment were not designed to handle specific issues related to PPP. The general process under these laws needs more detailed mechanism for budgeting VGF. For example, there is no separate budgeting allocation for VGF within the budget of a local government.

In our opinion, the scope of the Circular should be expanded to cover the preparation of funding source for VGF and guidance on mechanism to determine VGF. Otherwise, if the scope remains, we recommend that the MOF consider issuing a separate circular guiding on those other issues. Such new circular would need to be made based on the final approach of the Government / MOF on structure of VGF funding, using the current annual budget allocation or a stand-alone fund.

Of great importance, the current draft Circular does not contemplate a mechanism where VGF can be managed by a professionally managed fund that is separate from Ministries and Provinces. It appears in the Circular that VGF must be managed by an appointed agency within the State Treasury, subject to unclear approval processes. (See Art. 3). We believe that this and related articles need revisiting following Government consideration of a proposed VGF management structure, which is the main task within the JICA study.

(b) **Lack of detailed guidance on specific process**

Our overall observation of the Circular is that it lacks of detailed guidance to implement specific process. Although touched on specific issues, the Circular refers to various existing regulations applicable to other cases of public investment projects. Particularly, Article 7.2(b), Article 23, Article 24.2 and Article 2.6 refer to the processes of cost determination and project finalization applicable to public investment projects. These references make it difficult to implement the Circular and do not address particular issues related to PPP projects. Given the special nature of PPP projects and to avoid in compatibility of the processes applicable to other investment forms, further details should be provided in this circular.

Regarding financial plan (financial model) chapter, the Circular should provide more detailed guidance on calculation of financial indications in financial model and how to evaluate those indications because the preparation of financial model for PPP is new to Vietnam. Such calculation method should be based on international norms for public private partnerships and not traditional public procurement methodologies.

2. Comments on specific provisions of the draft Circular

We set out below specific comments on the current wording of the Circular.

Table Annex 4.1a: Comments on specific provisions of the draft Circular.

No	Issue	Article	Quotation	Frontier's comments
1.	Account for VGF management	3.3	Account opening must be conducted in compliance with the provisions of the MOF on the regime for opening and using account at the State Treasury.	These rules need to be examined for relevance to the timing of VGF disbursement. Of concern will be the level of approvals needed and whether it will allow smooth and timely disbursement of VGF. Once VGF payment is approved pursuant to the contract there should be no further approval process required by other agencies for the disbursement of the VGF monies.
2.	Sources of the costs and expense matters	6.1	Sources of the costs: a) State budget as being balanced in the annual regular expenditure plans of the Ministries, branches and PC of provincial-level for the activities provided in Point d, dd, e, g, h of Clause 1 Article 5 of Decree No. 15/2015/ND-CP; b) State budget source in the 5-year medium term and annual public investment plans of the Ministries, branches and PC of provincial-level; c) Revenues from the sale of request for proposals for selection of the Investor; d) Reimbursement made by the Investor being selected for project implementation; dd) Source from the cost for project management of Project Management Units as provided in Decision No. 1486/QD-BXD dated 12 December 2014 of the Ministry of Construction announcing the cost for Project Management Unit of the Authorized State Agency implementing PPP project; e) Other lawful capital sources (if any)	It would be more useful to readers of the Circular if clause 6.1(a) were expanded to set out the relevant provisions that are being cross-referred to in Decree 15. Compared to the list provided in Article 5.2 of Decree 15, the list does not mention the *Project Development Facility* as a source for project preparation cost. PDF should be on the list. We assume that "other lawful sources" also includes ODA payments but it would be helpful to clarify.

No	Issue	Article	Quotation	Frontier's comments
3.	Expenses	6.2	n/a	If the Government chooses a separate fund to manage VGF, then the operations of that fund will need to be an expense under this article
4.	Formulation, approval and assign the [expense] estimates	7.1(a)	Basis for formulation of the [expense] estimates: a) The projects list approved by the competent authority or the Investor's project proposal being approved by the competent authority to be added in the PPP projects list in accordance with the provisions of Decree No. 15/2015/ND-CP	The expense estimates, including expense for preparation of project proposal, are based on project list. However, a project can only be included in the project list if the project proposal is approved. This provision needs further clarification on how the ASA may prepare estimates for the cost of preparation of project proposal
5.		7.1(b)	Plans for implementation of PPP projects being approved by the competent authority	The plans for implementing PPP projects are not mentioned in Decree 15. This needs further details on the contents of this plan and who will approve the plan
6.		7.2(a) and 7.2(c)	Principles for formulation of the [expense] estimates: a) The applicable laws and regulations on formulation of construction expense estimates shall be applicable to the expense matters provided in Point a, c Clause 2 Article 3 c) The applicable laws and regulations on formulation of estimates of the regular expense from the State budget shall be applicable to the expense matters provided in Point d, dd, e, g, h Clause 2 of Article 3	The correct reference is Clause 2 Article 6 of this document (not Clause 2 Article 3). As a general principle, this article is very important to identifying what expenses are being calculated. It would be better to write out fully the permitted expenses rather than rely so heavily on cross-referencing (which is not user-friendly)
7.		7.2(b)	The regulations of the Ministry of Finance on management, use of cost in the process of selecting contractor for the project using State budget capital and Government bonds shall be applicable to expense for Investor selection	This needs further details on the management of cost as referred to the regulations applicable to selection of contractor

No	Issue	Article	Quotation	Frontier's comments
8.	Principles for formulation of financial plan	10.1	The total costs and lawful revenues in the process of project implementation and operation must be fully reflected in the financial plan of the project in Vietnam Dong	These costs and revenues will not be known until first the FS stage and then finalized by the investor after award of the project. Please note that the investor's final calculation may differ from the reference financial model created by the ASA prior to tender. The timing of when the estimates need to formulated is not clear. There is also the issue of what happens if there is a discrepancy between the estimates and the final costs
9.	Principles for formulation of the financial plan	10.2	The financial indicators of the project shall be calculated on the basis of the discounted cash flow after tax in accordance with the weighted average discount rate.	The financial plan may be prepared by the investor (in case of unsolicited projects) or by the consultant. Therefore, the method required to prepare the financial plan/ financial indicators needs to be clearly determined and explained. This provision needs clarification on the method for calculation of the discount rate
10.	Contents of the financial plan	11.2(a)	Structure of the investment capital source: a) Equity; […]	In addition to equity, the capital sourced from the investor may include shareholder subordinated loans
11.	Mobilizing capital	11.3(c)	Mobilized capital source (commercial loans, concessional credit capital, foreign loans, other sources)	The actual terms of loans taken out by the investor may not be known until the financing documents are signed following the award and negotiation of the project contract. This clause appears to require those details before they can reasonably become certain

No	Issue	Article	Quotation	Frontier's comments
12.	Contents of the financial plan	11.6(a)	The indicators for evaluating the feasibility of the financial plan: a) The competent authority decides to select the investment project on the basis of the following indicators: […]	This provision needs further details on method for calculation of these indicators and how to evaluate and weigh these indicators
13.	Total investment capital	12.1	1. Regarding the projects involving construction activities: total investment capital means the total amount of construction investment to be calculated in accordance with the laws and regulations on construction investment and the initial working capital to exploit, operate the project in compliance with the standards, technical requirements being approved by the competent authority	The circular should provide guidance on how to calculate the 'initial working capital' for project operation as a basis to determine total investment capital. This is an important point as the total investment capital is a basis for project classification (Group A, B or C) under Public Investment Law and Construction Law
14.	Interest calculation	15.2	The term in which interest is calculated is from the date when the initial loan is disbursed; the term in which loan interest is calculated does not exceed the project implementation term as provided in the Project contract.	We are checking with lenders whether this clause matches actual practice
15.	Interest of the loans mobilized as investment capital	15.3(b)	In specific cases the interest of loans shall be calculated as follows: […] b) In case the Investor is appointed: the interest of the loans shall be identified via negotiation and arrangement between the ASA and the Investor. The interest of the loans to be taken as reference during the process of negotiation, arrangement shall not exceed over 1.3 time of the average interest of the 10-year Government Bond within 6 months prior to the date when the Project Contract is negotiated	This threshold needs consideration and consultation with the market and lenders

No	Issue	Article	Quotation	Frontier's comments
16.	Profits of the investor	16	Regarding the case in which the Investor is appointed: [the profits of the Investor] is estimated on the basis of the project's FS Report while ensuring the effectiveness of the project and the results of the negotiation between the ASA and the Investor	As a general comment, this clause appears contrary to normal commercial practices for PPPs. During the FS, the Government determines *for its internal reference* a projected IRR for investors which allows the Government to benchmark the financial proposals during bidding. The Government does not set the profit of the investors but rather structures the overall VGF and commercial terms of the project taking into account the reference IRR. The investors then bid against the assumptions made by Government. It is the investor's right to try to maximize its profit within the parameters for the project
17.	Profits of the investor	16.2	The ASA shall be responsible for taking as reference the average profit of the enterprises operating and doing business in the respective sector, the project of similar projects compared to the market of the project sector and the profit of other sector to be the basis for negotiating with the Investor	This provision is not practical because there is limited official data base on profit of preceding projects. It is not clear on how many enterprises or projects would be taken into consideration. What happen if it is a project in a new sector?
18.	State investment capital	17.1	State investment capital for participation in project implementation include State budget capital, Government bonds, local Government bonds, ODA capital and concessional loans of foreign donors and must be consolidated in the public investment plan approved by the competent authority	Government bonds, local Government bonds, ODA capital and concessional loans of foreign donors are not included in the annual State budget estimates. Therefore, MOF should consider providing a particular mechanism applicable to the cases where state investment capital are extra-budgetary sources
19.		17.3	The State investment capital for participation in project implementation must be provided specifically in the Project contract in terms of the contents of support, the capital source, payment timeline. State investment capital shall only be paid after the final acceptance of the completed construction work. The paid capital shall be calculated in line	This provision may not be practical in the case where State's participation in project implementation is used for organizing compensation, site clearance and resettlement

No	Issue	Article	Quotation	Frontier's comments
			with the proportions of investment capital sources provided in the Project contract compared to the value of the completed construction work being accepted	Is there a reason to not permit VGF disbursements tied to the milestone payments under the contract? This may make financing more cost effective because it relieves the investor the need to take out bridge financing to cover milestone payments—which would be the case if VGF is only disbursed after commissioning of the project
20.		18.1(b)	The contract between the Investor, Project Enterprise and the contractor or supplier and other documents attached with the contract such as: contract annexes, separate conditions, general conditions relating to payment; work assignment documents or internal contracts in case the investor self-implement [the project]	Query whether it is necessary for the EPC contract to be included. We are checking this against international norms
21.	Payment dossier	18.2	Payment dossier a) In case the Project Enterprise together with the Investor form one party of the Project Contract in accordance with provision of Clause a Article 31 of Decree No. 15/2015/ND-CP or in case the Investor directly implements BT projects or Group C projects in accordance with Clause 2 Article 42 of Decree No. 15/2015/ND-CP. […] After the final acceptance of the completed work following the payment phase and payment conditions provided in the contract, the Investor shall prepare dossier requesting for payment to submit to the agency assigned to manage the State investment capital for participation in PPP project implementation. [This dossier shall] include: […]	The correct reference is Poin a Clause 3 Article 31 of the Decree 15 (not Clause a Article 31) In order to be consistent with two circumstances listed in Point a Clause 2 Article 18, the yellow highlighted part should be revised to "the investor or project enterprise"

No	Issue	Article	Quotation	Frontier's comments
22.	Terms of payment of state investment capital	18.3	The annual capital plan arranged for the State investment capital for participation in the project only pays for the completed workload which received the final acceptance up to 31 December of the planned year; the term for payment of the completed workload up to the end of 31 January of the following year	Is there a mechanism to deal with delay in a project such that payment is not made within the year it is anticipated? The second half of this clause is not clear as to intent
23.	Finalization of the State investment capital	23 and 24.3	Article 23. Principles for finalization Regarding the PPP projects having construction component, after the completed project obtains final acceptance and is in operation, the investment capital for construction of the facilities must be finalized in accordance with the provision of the Circular of the Ministry of Finance on finalization of the completed project subject to State capital source and the provisions of this Circular. Article 24. Formulation and approval of the finalization 3. Competent authority for approving the finalization: Minister, Head of the ministerial equivalent agency, Chairman of the PC of provincial level, Chairman of the PC of district level in case the PC of district level is authorized by the PC of provincial level to implement project contract	It is provided that finalization of the State investment capital of completed project shall be in compliance with the provision of this draft Circular and the Circular of the MOF on finalization of the completed project subject to State capital sources. We understand that the draft Circular refers to Circular No. 19/2011/TT-BTC However, certain contents of this draft Circular and Circular 19 are inconsistent, for example: Article 24 of this draft Circular on competent authority for approving the finalization is inconsistent with Article 13 of Circular 19 This provision needs further consideration
24.	Formulation and approval of the investment capital finalization	24.4	Agency [responsible for] appraising the investment capital finalization: […] Regarding the projects managed by the PC of provincial level: the Department of Finance shall carry out the appraisal.	This provision needs further clarification on the authorities appraising the contract signed by the PC of district level but also under the management of the PC of provincial level. Would it need additional appraisal of the Department of Finance of the PC at provincial level?

No	Issue	Article	Quotation	Frontier's comments
			Regarding the projects whose contracts are signed and implemented by the PC of district level: Office of Finance and Planning of district level shall carry out the appraisal	

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[159] **Note:** Presidential Regulation No. 38 of 2015 on the Cooperation Between the Government and Business Entities in the Provision of Infrastructure.

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