Vietnam’s Tentative Approach to Regional Infrastructure Initiatives

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Comprehensive infrastructure development has been highlighted as one of the three strategic breakthroughs for Vietnam’s 2021-2030 Socio-Economic Development Plan. In this picture, workers clean the surface of Thang Long bridge during a major renovation in Hanoi on August 27, 2020. Nhac NGUYEN, AFP.

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EXECUTIVE SUMMARY

- Vietnam’s Socio-Economic Development Plan 2021-2030 highlights infrastructure development as one of the three strategic breakthroughs.

- However, financing for infrastructure development remains constrained. State resources fund approximately 90 per cent of the country’s infrastructure projects, and mobilising private capital has proven difficult.

- There are currently many foreign-financed connectivity initiatives in the region, such as China’s Belt and Road Initiative, Japan’s Expanded Partnership for Quality Infrastructure, and projects supported by America’s International Development Finance Corporation.

- While competition among these initiatives provides Vietnam and regional countries with more funding options, they also come with challenges. Vietnam therefore has approached them with some reservations.

- Moving forward, it is crucial for Vietnam to adopt stringent standards in approving new projects, improve the legal environment to attract private infrastructure investment, develop better national infrastructure master plans, diversify infrastructure investment sources, and refrain from taking sides in pursuing international infrastructure development cooperation.
HUGE DEMAND FOR INFRASTRUCTURE INVESTMENT

Infrastructure competitiveness plays a central role in attracting investment and promoting economic growth. However, Vietnam is lagging behind some regional countries in this regard. For example, the World Economic Forum’s 2019 Global Competitiveness Report ranked Vietnam 67th out of 141 economies for national competitiveness and 77th for infrastructure quality.¹ Only 20 per cent of the country’s national roads are paved,² much lower than neighbouring countries such as Malaysia (80.9%),³ India (63.24%),⁴ and Indonesia (89.7%).⁵ Vietnam’s Ministry of Planning and Investment estimates that the country will need approximately US$480 billion in infrastructure investment from 2017 to 2030,⁶ while the 2019 Global Infrastructure Investor Survey report ranked Vietnam, together with India, China, Brazil, and Indonesia, among the top five developing countries with the largest infrastructure markets in the next five years.⁷

Comprehensive infrastructure development has been highlighted as one of the three strategic breakthroughs for Vietnam’s 2021-2030 Socio-Economic Development Plan. The need to upgrade physical infrastructure and logistics services has become even more urgent due to increasing competition among regional countries to attract investors who wish to diversify their manufacturing base away from China. Post-pandemic economic recovery has also underscored the importance of infrastructure development as one of the most effective measures to stimulate economic growth. The Vietnamese government has targeted a growth rate of at least 6 per cent for 2021, with public spending on infrastructure development identified as one of the key measures to achieve this target.

CONSTRAINED BUDGETS

However, Vietnam is facing difficulties in mobilising infrastructure investment from the private sector, causing it to rely heavily on state resources, which currently fund about 90 per cent of its infrastructure projects.⁸ According to the World Bank’s Private Participation in Infrastructure (PPI) database, Vietnam has approved only 116 public-private partnership (PPP) projects totalling US$19.4 billion since 1990, accounting for less than 10 per cent of the country’s total infrastructure investment during the same period.⁹ Private infrastructure investment remains limited, at less than 1 per cent of Vietnam’s GDP in the past decade.¹⁰ By 2020, although several road-building PPP projects have been implemented, some of them were later renegotiated and eventually converted to public-invested ones due to project delays, incompetent investors, or financial irregularities. Recently, two North-South Expressway component projects have also been converted from PPP to public investment due to the lack of interest from private investors.¹¹

Be that as it may, according to the Asian Development Bank (ADB), Vietnam is the biggest infrastructure spender in Southeast Asia. Between 2010 and 2014, infrastructure spending from both the public and private sectors made up 5.7 per cent of the country’s GDP, compared to the 2-3 per cent of its neighbouring countries.¹² In Asia, Vietnam ranks second only to China (6.8 per cent). The large infrastructure spending puts Vietnam under significant fiscal pressure as its tax base weakens due to the Covid-19 pandemic.
In addition, as Vietnam officially graduated from the International Development Association (IDA) in 2017, it has lost access to IDA concessional financing. IDA loans and grants previously financed a majority of Vietnam’s infrastructure projects. The need to diversify financial resources for infrastructure development in Vietnam is therefore urgent, causing the country to welcome regional infrastructure initiatives.

PRUDENT APPROACH TO REGIONAL INITIATIVES

Many significant infrastructure development initiatives have been introduced in recent years. For example, China introduced the ambitious US$1 trillion Belt and Road Initiative (BRI) in 2013 to support “affordable infrastructure” in developing countries, primarily in transportation and power. Japan quickly responded with its “quality infrastructure” drive and ramped up lending under its 2015 Partnership for Quality Infrastructure (PQI) campaign. Accordingly, Japan pledged to increase its investment in Asian infrastructure to roughly US$116 billion for the period 2016-2020, a 30 per cent increase compared to the previous five years. In 2016, Japan announced the Expanded Partnership for Quality Infrastructure, the High-Quality Infrastructure Export Expansion Initiative, as well as reforms to improve its loan-granting process and to provide additional guarantees against risks, to encourage private sector investment. The annual budget for Japan’s infrastructure exports has since 2017 nearly doubled from ¥110 billion to ¥200 billion (approximately US$1.8 billion).

In order to operationalise the economic dimension of the Free and Open Indo-Pacific (FOIP) strategy, the US Congress passed the Better Utilization of Investment Leading to Development (BUILD) Act in October 2018. Under the Act, Washington established the US International Development Finance Corporation (DFC) and doubled its development finance capacity to US$60 billion worldwide.

Other notable initiatives include the EU Strategy for Connecting Europe and Asia (2018), Russia’s Trans-Eurasian Belt Development (2015), the India and Japan-led Asia-Africa Growth Corridor (2017), and South Korea’s New Southern Policy (2017). ASEAN, together with the ADB, also established the ASEAN Infrastructure Fund (AIF) to mobilise capital for infrastructure development in Southeast Asia.

Competition among these initiatives brings Vietnam and regional countries more funding
options for infrastructure projects. But although Vietnam has expressed its support for these initiatives, it approaches these initiatives with some reservations.

First, different regional infrastructure development initiatives have been launched for some time but all revealed significant limitations. Despite its impressive promises, the BRI faces two main challenges: (i) In many BRI projects, China’s ambition to build connectivity corridors might not always align with the interests of local communities living along these corridors. For instance, in Laos, criticisms have been levelled at the relocation of villages to make way for railroads and dams which are believed to benefit Beijing more than locals.\(^\text{16}\) (ii) The initiative has generated debt concerns. According to one study, among 68 countries that are hosting BRI-funded projects, 23 of them are at risk of high debt stress.\(^\text{17}\) Eight of them, namely Djibouti, Tajikistan, Laos, Maldives, Mongolia, Pakistan, and Montenegro, are marked as “highly vulnerable”.\(^\text{18}\)

The second-largest infrastructure initiative in the region is Japan’s Quality Infrastructure in Asia (PQI). The initiative promotes high-quality infrastructure partnerships and assistance in Asia through the collaboration between Japan International Cooperation Agency (JICA) and ADB to increase the supply of funding and promote relevant international standards. With the target of providing US$200 billion within the period 2015-2020, the scope of this initiative was extended from Asia “to the world,” and the range of projects went beyond infrastructure in a narrow sense to cover different projects, ranging from extracting natural resources to building hospitals.\(^\text{19}\) Nevertheless, the PQI also has certain limitations. As PQI cannot compete with China’s BRI in terms of scale, and Japan cannot pursue low-cost projects the way China does, the country has to opt for a high-quality approach. However, the standards for high-quality infrastructure are still not clear while it is still questionable if developing countries can afford the high cost of Japanese projects.

Second, most current initiatives have often been associated with great power strategic competition, particularly between the US and China. For example, the BRI is considered a vehicle for China to expand its political, economic and security interests abroad, with many of its infrastructure projects having the potential for civil-military dual use.\(^\text{20}\) On the other hand, US-led initiatives have been widely seen as a mechanism to offset Chinese influence.\(^\text{21}\) There is thus a concern in Vietnam that its choices may be wrongly understood as picking sides in the current “alignments of force”.\(^\text{22}\)

Third, Vietnam’s concerns about the BRI go beyond the common criticisms against this initiative such as debt burdens, lack of transparency or social and environmental problems.\(^\text{23}\) In particular, given China’s maritime ambitions and its increasing aggression in the South China Sea, projects along the Maritime Silk Road have raised concerns over China’s intentions in the South China Sea. Vietnam also has some economic concerns regarding the BRI, including:

(i) Unattractive commercial terms and conditions, especially the high interest rates of Chinese loans. According to a report by the Ministry of Planning and Investment, China’s ODA often carries an interest rate of 3 per cent per year, if Chinese contractors are used.\(^\text{24}\) This rate is higher than Japan’s (0.4 to 1.2 per cent, depending on the loan terms), Korea’s (0 to 2 per cent, depending on bidding conditions), and India’s (1.75 per cent). Loans provided by the China Export-Import Bank are also subject to a commitment fee of 0.5 per cent and a management fee of
0.5 per cent, while loan terms and grace periods are both shorter than those of other capital markets by five to 15 years.\(^{25}\)

(ii) Increased trade with China due to the implementation of China-funded infrastructure projects can exacerbate Vietnam’s trade deficit and economic dependency vis-à-vis China. In 2020, for example, Vietnam’s trade deficit with China amounted to US$32.5 billion. The large trade deficit with China has been increasingly seen by some Vietnamese policy makers as a security issue.

(iii) There have been many problems associated with China-funded infrastructure projects in Vietnam, including environmental pollution, project delays, cost overruns, low construction quality, outdated technologies, and the unauthorized use of Chinese labourers.\(^{26}\) The Cat Linh–Ha Dong urban railway project in Hanoi is a case in point. The project, which started in October 2011 and was initially expected to be completed in November 2013, has been delayed for more than seven years. Its cost also doubled from VND 8,770 billion (US$552.86 million) to VND 18,002 billion (US$868 million) by the end of 2020.\(^{27}\)

(iv) As Vietnam is speeding up reforms towards high-quality and sustainable growth, the non-transparent practices and relatively lax standards of the BRI\(^{28}\) are seen as an impediment to such reform efforts.

Fourth, the availability of better alternatives, particularly from Japan, has dimmed the attractiveness of the BRI.

**Figure 2.** Japan’s vs. China’s infrastructure projects in Southeast Asia, 2019

![Building Battles](image)


Japan is currently Asia’s biggest source of development finance, providing US$367 billion, compared to China’s US$255 billion.\(^{29}\) As of June 2019, Japan’s infrastructure investments in Vietnam (including pending projects) amounted to US$209 billion, accounting for more than half of Japan’s total in the region.\(^{30}\) In particular, between 2005 and 2016, Japan’s ODA to Vietnam surged by three times compared to the period 1993-2004, while its ODA to other Southeast Asian countries generally decreased. Notably, 46 per cent of Japan’s ODA to
Vietnam has been channelled into transport infrastructure projects. Some Vietnamese experts were of the view that the high quality of these projects, implemented by innovative companies with strong technical expertise and transparent business practices, adds to Vietnam’s overall reform efforts.

Figure 3. Japan’s ODA to Southeast Asia (gross disbursement base, billion US$)


These alternatives to the BRI, however, also present Vietnam with other challenges. Japanese funding comes with increased loan costs, strict approval conditions, and higher spending for Japanese consultants. Projects under the Special Terms for Economic Partnership (STEP), for example, must engage a Japanese company as its general contractor, and source at least 30 per cent of its materials and equipment from Japan.

Japanese ODA projects have also reported cost overruns and slow disbursement. Moreover, high-quality initiatives by Japan, the US, and others mainly draw on the private sector. Vietnam, however, is struggling to create attractive conditions for private infrastructure investment. Although it has made some progress in streamlining regulations on the PPP framework to ensure investor rights, policies on risk-sharing mechanisms, exchange rates and revenue guarantees, which are top concerns among foreign investors, are still lacking.

RECOMMENDATIONS FOR VIETNAM

Vietnam’s participation in international mechanisms and initiatives is guided by its national interests. In addition to economic interests, national security, social stability, reform and innovation are also Vietnam’s priorities. With the labour- and resource-based growth model initiated in the 1980s having reached its limit, Vietnam currently aims to bring about a Doi Moi 2.0 that will lead to an innovation-based growth model. Vietnam thus prioritises sustainably planned FDI projects, especially those with high potential for hi-tech transfers and spill-over effects. It is therefore crucial for Vietnam to adopt more stringent standards in evaluating and approving new projects.
At the same time, Vietnam needs to improve its legal environment to facilitate high-quality partnerships. Vietnam’s new Law on Public-Private Partnerships, which came into effect on 1 January 2021, demonstrates the government’s commitment to attract high-quality PPP projects. However, there is still room for further improvement, such as by introducing regulations with credible penalties to deter offenders. The government should also formulate enforceable anti-corruption laws and implement prudent macroeconomic policies that promote financial prudence and discipline.

Vietnam also needs to develop medium- and long-term national infrastructure master plans that thoroughly assess its needs, priorities and projects in order to make optimal use of its limited fiscal resources. It should also diversify its infrastructure investment sources by encouraging financing from private and foreign investors, as well as by tapping personal savings. It is estimated that the Vietnamese people possess some 500 metric tons of gold as personal savings, which would provide a massive boost to the economy if brought into circulation.36

As far as international funding initiatives are concerned, given the intensifying great power competition, Vietnam should refrain from taking sides. Instead, it should maintain a neutral stance and uphold its principles in a consistent manner. It should support open, transparent, inclusive and non-discriminatory cooperation mechanisms and proactively work with regional countries to shape the rules for regional infrastructure initiatives.

Finally, some Vietnamese experts have pointed out several potential benefits that the BRI can bring Vietnam, such as strengthening connectivity and facilitating Vietnam’s access to the Chinese market, or helping Vietnam make the most of its long coastline by connecting Southeast Asian ports to enhance intra-ASEAN trade.37 Joining the BRI also gives Vietnam opportunities to actively take part in the shaping of rules governing international cooperation. However, when taking part in the BRI, Vietnam should adopt proper management mechanisms to avoid potential problems, such as the transfer of outdated technology, project delays and cost overruns.

9 Ibid.
16 John Reed and Kathrill Hille, “Laos’s Belt and Road project sparks questions over China ambitions”, Financial Times, 30 October 2019, https://www.ft.com/content/a8d0bdae-e5bc-11e9-9743-db5a370481bc
26 Nguyen Thi Thuy Ha, “Tac dong tu nguon von cua Trung Quoc qua sang kien Vanh dai va Con duong den cae nuoc dang phat trien,” Ly luan chinh tri, 25 October 2019,


42 Japan increased its loan interest rates from 1.2 to 1.5 per cent per year for regular loans and from 0.3 to nearly 1 per cent per year for preferential loans, effective 1 October 2017.


46 See, for example, Le Hai Binh, Tap hop luc luong trong the ky XXI, p. 299.