

FINANCIAL ANALYSIS

1. The financial condition of the five provincial peoples' committees of Binh Phuoc, Dak Lak, Dak Nong, Gia Lai, and Kon Tum was assessed for the project. The assessment aimed to determine each province's financial capability to (i) contribute the required counterpart funds, (ii) repay debt service arising from the project, and (iii) maintain the infrastructure sustainably after construction completion. The financial assessment reviewed each province's past financial condition and forecast their financial condition in the next 10 years.

2. **State budget system.** Vietnam's budget system consists of a central budget and local budgets, which consist of the budgets of local authorities, including people's councils and committees. Local budgets include provincial budgets (consisting of provincial and district budgets); district budgets (consisting of district and commune budgets); and commune budgets. Since the budgets of lower administrative levels are components of higher-level budgets, local budgets do not show deficits as they are balanced at a higher administrative level.¹

3. The five participating provinces are among the 50 provinces that are beneficiaries of the national equalization budget system; their budgets show no deficits as they are balanced by the central budget. Only 13 provinces and cities (Ba Ria-Vung Tau, Bac Ninh, Binh Duong, Da Nang, Ha Noi, Ha Tinh, Hai Phong, Khanh Hoa, Ho Chi Minh City, Quang Ninh, Quang Ngai, and Vinh Phuc) contribute to the central budget.²

4. **Costs and financing.** The project is estimated to cost \$122.1 million overall. The Government of Viet Nam has requested a loan in the amount of \$106.5 million equivalent from the Asian Development Fund resources of the Asian Development Bank (ADB) to help finance the project. The five participating provinces will provide the total counterpart funds (\$15.6 million equivalent). The government has asked ADB to finance part of the taxes and duties amounting to \$9.5 million. The eligibility of taxes and duties for ADB financing was determined through a due diligence assessment, which followed the Viet Nam country partnership strategy recommendation to finance taxes and duties that apply to ADB-financed expenditure.³ Based on the results of the assessment, ADB concluded that all eligibility criteria are met.

5. The government will make the loan proceeds available to the provincial people's committees on a subloan⁴ basis under the same terms and conditions as the original ADB loan. The ADB loan will have a 25-year term, including a 5-year grace period, a 2% annual interest rate during the grace period and thereafter, and other terms and conditions set forth in the draft loan and project agreements. The ADB loan financing charges during implementation will be capitalized as part of the loan. The financing plan is in Table 1.

¹ T. B. Yuan. 2014. Fiscal Decentralization in Vietnam: Outcomes and the Way Forward. Presentation at the Asian Regional Seminar on Public Financial Management in Phnom Penh. National Institute for Finance, Ministry of Finance, Viet Nam. 25–26 November.

² N. Van Hong. 2015. Eighty Percent of Provinces Cannot Balance Their Budgets. *Saigon Economic Online, The Saigon Times*. 20 March (www.thesaigontimes.vn)

³ The following principles apply to ADB financing of taxes and duties: (i) the amount must be within the reasonable threshold identified during the country partnership strategy preparation process, (ii) the amount must not represent an excessive share of the technical assistance project's investment plan, (iii) the taxes and duties must apply only to ADB-financed expenditures, and (iv) the financing of the taxes and duties must be material and relevant to the project's success.

⁴ Kon Tum and Dak Nong will sign subloan agreements equivalent to 20% of the proceeds they receive, while Binh Phuoc, Dak Lak, and Gia Lai will sign subloan agreements equivalent to 30% of the proceeds they receive. The balance of the proceeds they receive is considered a grant.

Table 1: Financing Plan

Source	Amount (\$ million)	Share of Total (%)
Asian Development Bank	106.5	87.2
Provincial Peoples' Committee		
Kon Tum	3.1	2.6
Gia Lai	2.1	1.7
Dak Lak	4.5	3.7
Dak Nong	3.6	2.9
Binh Phuoc	2.3	1.9
Subtotal	15.6	12.8
Total	122.1	100.0

Source: Consultant's estimates.

6. **Past financial performance.** The financial performance of the five participating provinces during 2011–2015 is summarized in Table 2.

Table 2: Summary of Past Financial Performance

Item	Average Share 2011–2015 (%)				
	Kon Tum	Gia Lai	Dak Lak	Dak Nong	Binh Phuoc
Domestic Revenue as % of:					
Total State Budget Revenue	23	32	29	20	39
Recurrent Expenditure	46	58	38	41	77
Development Investment as % of:					
Total State Budget Expenditure	22	11	7	23	17
Recurrent Expenditure as % of:					
Total State Budget Expenditure	56	60	81	57	53
Support from Government for Deficit as % of:					
Total State Budget Revenue	39	49	55	59	50

Source: Consultant's calculation from the provinces' financial data.

7. Of the five provinces, Binh Phuoc had the highest domestic (locally-sourced) revenue share (39%) of total state budget revenue. Dak Lak spent the least on development investment (7%) and had the highest share (81%) of recurrent expenditure to total state budget expenditure. Dak Nong had the highest dependency share (59%) from the government for deficit.

8. **Projected financial performance.** A projection of the financial condition of the five provinces for 2017–2026 has been prepared. Revenue and expenditures have been conservatively projected to grow annually over this period at the local inflation rate of 5% or, if higher, to follow past growth trends. It is assumed that the dong will depreciate 5% each year. The projections include the provincial project investment, ADB loan proceeds utilized, the counterpart contribution, debt service repayment on subloans, and adequate O&M for the sustainable operation of the project infrastructure.

9. The results of the financial projections show that the provinces can afford the project, as they can provide the counterpart contribution and adequate O&M for sustainable operation and repay the debt service on the subloan. The annual counterpart contribution is less than 1% of total state budget expenditures, and the combined annual O&M plus debt service is less than 1% of total state budget expenditures. The projected financial performance of the five provinces during 2017–2026 is summarized in Table 3.

Table 3: Summary of Projected Financial Performance

Item	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
a. Kon Tum										
Counterpart Contribution										
Amount (D million)	2,197	3,844	22,603	23,733	32,039					
% of State Budget Expenditures	0.03%	0.05%	0.25%	0.24%	0.29%					
Project O&M										
Amount (D million)						38,712	40,647	42,680	44,814	47,055
% of Overall O&M						0.54%	0.49%	0.45%	0.41%	0.38%
% of State Budget Expenditures						0.33%	0.31%	0.29%	0.27%	0.26%
Subloan Debt Service										
Amount (D million)						9,531	9,865	10,208	10,561	10,923
% of State Budget Expenditures						0.08%	0.07%	0.07%	0.06%	0.06%
b. Gia Lai										
Counterpart Contribution										
Amount (D million)	1,967	2,065	15,179	15,938	21,517					
% of State Budget Expenditures	0.02%	0.02%	0.13%	0.13%	0.15%					
Project O&M										
Amount (D million)						33,398	35,068	36,822	38,663	40,596
% of Overall O&M						0.29%	0.27%	0.26%	0.24%	0.22%
% of State Budget Expenditures						0.22%	0.21%	0.20%	0.19%	0.18%
Subloan Debt Service										
Amount (D million)						12,709	13,154	13,612	14,082	14,566
% of State Budget Expenditures						0.08%	0.08%	0.07%	0.07%	0.06%
c. Dak Lak										
Counterpart Contribution										
Amount (D million)	3,168	8,871	32,599	34,229	42,359					
% of State Budget Expenditures	0.03%	0.08%	0.27%	0.27%	0.32%					
Project O&M										
Amount (D million)						38,580	40,509	42,534	44,661	46,894
% of Overall O&M						0.32%	0.32%	0.32%	0.32%	0.32%
% of State Budget Expenditures						0.28%	0.28%	0.28%	0.28%	0.28%
Subloan Debt Service										
Amount (D million)						13,373	13,841	14,323	14,818	15,326
% of State Budget Expenditures						0.10%	0.10%	0.10%	0.09%	0.09%
d. Dak Nong										
Counterpart Contribution										
Amount (D million)	2,529	5,311	26,951	27,323	34,836					
% of State Budget Expenditures	0.06%	0.10%	0.43%	0.38%	0.42%					
Project O&M										
Amount (D million)						38,189	40,098	42,103	44,209	46,419
% of Overall O&M						0.46%	0.41%	0.36%	0.32%	0.29%

Item	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
% of State Budget Expenditures						0.41%	0.37%	0.33%	0.30%	0.27%
Subloan Debt Service										
Amount (D million)						9,187	9,508	9,839	10,179	10,528
% of State Budget Expenditures						0.10%	0.09%	0.08%	0.07%	0.06%
e. Binh Phuoc Counterpart Contribution										
Amount (D million)	2,117	2,223	16,336	17,153	23,156					
% of State Budget Expenditures	0.04%	0.03%	0.21%	0.19%	0.22%					
Project O&M										
Amount (D million)						33,573	35,251	37,014	38,865	40,808
% of Overall O&M						0.28%	0.25%	0.22%	0.20%	0.18%
% of State Budget Expenditures						0.28%	0.25%	0.22%	0.20%	0.18%
Subloan Debt Service										
Amount (D million)						8,455	8,751	9,055	9,368	9,690
% of State Budget Expenditures						0.07%	0.06%	0.05%	0.05%	0.04%

D = dong, O&M = operation and maintenance.

Source: Consultant's estimates.