

GREEN economy Vietnam

BACKGROUND

The distribution of water resources in Vietnam is highly variable both geographically and seasonally. This variability, coupled with the fact that almost 60% of the country's water resources are generated outside of its borders, creates an unstable resource base and associated management challenges. Water shortages during the dry season and poor water quality are acute issues, exacerbated by below-cost pricing and excessive subsidies. For government, the reform of water pricing and related fiscal policies, coupled with improvements to governance, regulation, and the use of development finance provide a means to scale-up financial resources, to internalize environmental externalities, and to shift patterns of behaviour to increase the efficiency and effectiveness of water resource use. In turn, these efforts can contribute to increased productivity, reduced poverty, and improved social equity while managing water sustainably for all.

PRICING AND FISCAL POLICY

- ▶ Vietnam currently prices its water supply and wastewater services following an increasing-block-rate design. This means the price per unit of water supplied is larger for households who consume more each month. The average price levels charged do not generate enough revenue to sustain the physical infrastructure or to provide the financial capacity to expand the system. Wastewater services, where available, are priced in a similar manner.
- ▶ For industrial wastewater discharge, a fee was introduced to firms that are responsible for treating their own wastewater in specified industries in 2017. This fee consists of a fixed annual payment component and a variable component sensitive to the quality of effluents.
- ▶ In Vietnam, irrigation is the largest consumptive use of water. In 2008, the government established a policy reform that waived or removed the collection of most irrigation service fees that were previously paid by irrigators to irrigation and drainage management companies and to water-user organizations. After this policy reform, there was increase in rice production and farmers' incomes, but these changes were not specifically attributable to the price waiver per se.
- ▶ There have been explicit or implicit subsidies (e.g. tax expenditures) from public funds provided in some jurisdictions as instruments to address the affordability of water supply and wastewater treatment by poor households in recent years.
- ▶ Water supply prices, wastewater fees, and charges in Vietnam are officially approved and regulated by some 63 sub-national jurisdictions, subject to some oversight from national government authorities. Vietnam does not have an independent regulator for the water supply and sanitation service sector, even though it has created a number of joint-stock service monopolies that are now operating with a profit motive.

REFORM OPTIONS FOR PRICING AND FISCAL POLICY

There are a number of reforms relating to Vietnam's water supply and wastewater services that could improve the effectiveness of current practices, especially as related to the ability to attract and deploy capital investment. The main reform options to consider fall into four areas: pricing, fiscal policies, investment financing, and regulation.

- ▶ Key reform options for pricing policy of water supply and sanitation services include raising average prices in a manner that preserves affordability for lower-income households by changing the rate structure. The current increasing-block-rate design can be modified to ensure more households face the opportunity cost of the resources they use. Alternatively, it is recommended to move to two-part pricing with a uniform volumetric charge based on the seasonal,

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social marginal cost of supply. To address affordability while extending the coverage of services, a rebate or subsidy could be built into the monthly water bill or could be delivered through some other public assistance program targeted at poor households. In this way, a stable revenue base will be generated sufficient to sustain the physical infrastructure, to meet performance standards and to provide financial capacity to expand the system.

- ▶ Similar reform options can be applied for wastewater treatment and for irrigation water services subject to adjustments. Efficient irrigation use and wastewater treatment can be promoted by exposing irrigators and firms that discharge wastewater to the seasonally and regionally-specific social marginal cost. Wastewater and irrigation use should be measured, but if metering is not possible and cost-effective, pricing can be based upon other proxies related to crops, seasons, irrigation methods, or location in order also to change user's behaviour.
- ▶ Available tax instruments should be used purposefully and consistently. Since existing subsidies or tax expenditures may have specific effects on utilities and a specific social cost, policymakers should make an effort to prioritize and implement instruments that minimize these costs. The approach to rationalization of diverse subsidy approaches is similar to that of taxation. Each way of delivering a subsidy benefit can be associated with an extra social cost per unit of subsidy paid.
- ▶ Financial assistance to ensure affordability for low-income households could be decoupled from the water prices themselves to achieve better targeting of those supports. The government has committed to holding an equity position in most water and sanitation utilities, necessitating continuing expenditure and revenue flows to and from the public treasury. There could be an opportunity for greater scrutiny of the effectiveness and need for public expenditures for water supply and sanitation if the financial supports offered to utilities and consumers were subject to the annual budgeting process. At present, many of these supports are built into diverse pricing, subsidy and tax policies without full transparency to policy makers and taxpayers.
- ▶ There are already investment financing reforms underway focusing on equitization or the partial privatization and conversion of state-owned enterprises into new joint stock companies. To reform the use of equity financing, options include improving processes and effectiveness of equitization and public-private partnerships, requiring open and transparent selection processes, and subjecting all utilities to independent regulatory oversight. A preferred option for debt finance reform might be to create or develop a facility for blended finance, supporting and leveraging the use of concessional and commercial loans from both domestic and foreign lenders.
- ▶ Such a reform option, synergistic with pricing reform, could increase loan amounts and effectiveness by reducing transaction costs and risks, and increase risk-adjusted returns to prospective lenders. Without providing a clear and supportive regulatory framework to ensure effective performance, increasing the levels of financial investment might fail to realize potential productivity gains.
- ▶ Key options for regulation include the creation of an independent regulator, establishment of performance standards that are tied to consumers' willingness and ability to pay, and provision of oversight with respect to financial and operational commitments. Where price-setting processes currently engage the Provincial People's Committees and the utility operators, there is an option to introduce an independent regulator into the process, with capacity and authority to approve and monitor new performance contracts.

WAY FORWARD

The way forward consists of a series of choices among these options, including implementation of a program of legislative and regulatory reforms. Ideally, the best choices would be informed by the views and insights of all of these potential participants. These are impactful choices that Vietnam will soon need to make in its pursuit of socially inclusive and sustainable development. The reform also offers a promising opportunity to pursue green growth through sustainable investments in the water supply and sanitation sectors, and a pathway toward achievement of the Sustainable Development Goals.