State-Owned Enterprise Reform in VIETNAM

Lessons from Asia

edited by

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Nick J. Freeman
Frank H. Huynh

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The **Institute of Southeast Asian Studies (ISEAS)** was established as an autonomous organization in 1968. It is a regional research centre for scholars and other specialists concerned with modern Southeast Asia, particularly the many-faceted problems of stability and security, economic development, and political and social change.

The Institute's research programmes are the Regional Economic Studies Programme (RES), Regional Strategic and Political Studies Programme (RSPS), Regional Social and Cultural Studies Programme (RSCS), and the Indochina Programme (ICP).

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The **Indochina Unit (IU)** of the Institute was formed in late 1991 to meet the increasing need for information and scholastic assessment on the fast-changing situation in Indochina in general and in Vietnam in particular. Research in the Unit is development-based, with a focus on contemporary issues of political economy. This is done by resident and visiting fellows of various nationalities. To understand the Vietnamese perspective better, the Unit also has a regular programme whereby scholars from Vietnam are invited to do research on issues of topical interest.

Preface

Vietnam became the newest member of the Association of Southeast Asian Nations (ASEAN) on 1 July 1995. Its membership marks the beginning of a new chapter in the rapidly developing Southeast Asian region. Barely three decades ago, in the 1960s, the region was classified as one of the most turbulent in the world, and ASEAN was established in 1967 in an attempt to help change that view. Today, Southeast Asia is regarded as one of the most economically dynamic regions in the world. Undoubtedly, the upheavals in the socialist bloc during the late 1980s, leading to the crumbling of many planned economies, have proven that the command system is not sustainable. These economies simply did not deliver the goods, material and immaterial, which had been anticipated. Consequently, there has been a recent trend of command economies changing towards market-oriented principles.

The performance of the market economies of the ASEAN member countries and Japan, amongst others, has undoubtedly impressed Vietnam, to the extent that it is now trying to learn from their experiences. An added motive is the relatively handicapped position of Vietnam's integration with the other ASEAN economies; a substantial number of its state-owned enterprises (SOEs) are just too inefficient to compete in the international market-place. However, should Vietnam have refrained from joining ASEAN, and side-stepped the economic transformation that is now taking place, the prospect of an ever-widening gap with the ASEAN economies and the risk of being left in the backwaters of development would have been real. Vietnam has little alternative but to change its economic system to a more market-driven one, and at the very centre of this change is the reform of its SOEs. But the successful transition from a command to a market-oriented economy is no easy task. The path is wrought with pitfalls and problems that can at times seem intractable. Whilst Vietnam has done much to reduce drastically the cumulative number of SOEs — undertaken by various means since 1986 — the arguably harder task of transforming their operating structures has still to be done.

In early 1994 the Institute of Southeast Asian Studies (ISEAS), an institution devoted to the generation, enhancement, and dissemination of research on the region and beyond, proposed a study on the reforms of SOEs in Vietnam, to help better facilitate the country's integration with the ASEAN economies. ISEAS holds the view that one of the critical bottle-necks in restructuring the Vietnamese economy — characterized by state allocation and production, through the pervasive public enterprise system — lies in subjecting SOEs to market forces, as well as a programme for their divestment (where appropriate), and a larger role for the private sector. Consequently, ISEAS submitted a project proposal on the study of reforms of SOEs in Vietnam, which was accepted for funding by the Sasakawa Peace Foundation (SPF). In this regard, we are thankful for the generosity of SPF and for its assistance in the co-ordination of the project.

Undertaking this project was an educational experience in itself. How things are done in a transitional economy is clearly distinguishable from that of a market economy. For instance, this project required the approval of senior government; a clear indication that debate on key issues must be measured. In this regard, we are thankful to our counterpart, the Committee for the Reform of SOEs, which assisted not only in the selection of Vietnamese researchers — who gave us frank and honest views of the state of SOEs in Vietnam and the difficulties faced in their transformation — but also expedited this approval process.

The study — which stems from a series of papers presented at a workshop gathering in September 1995 — is divided into three sections. The first section comprises four chapters by Vietnamese experts, which together give a domestic perspective of the SOE reform process undertaken in Vietnam. Given that the topic of each chapter overlaps those of the other chapters, it is unavoidable to find a degree of repetition on the issues covered and arguments presented. The repetitions observed should not, however, be regarded negatively, but rather viewed as an indication of the uniformity of these perspectives. The second section comprises another four chapters, dealing with the experiences of reforms in SOEs in Indonesia and Japan, and two specific issues: on the legal and administrative aspects of SOE reform; and the role of government and private sector mix. These four chapters provide possible lessons for Vietnamese economic practitioners, in their attempt to reform SOEs in Vietnam. It was envisaged that this exercise would highlight some important issues, which could easily be neglected, or at the least clarify some doubts practitioners may have, including the avoidance of pitfalls experienced by some countries and the adoption of more successful policies implemented in others. Finally, section three, which draws on the previous two sections — and on comments made during the workshop — provides some concrete recommendations for consideration by Vietnam's economic reform planners.

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SECTION I

REFORM OF SOEs IN VIETNAM

1
Problems and Prospects of State Enterprise Reform, 1996-2000

Phan Van Tiem and Nguyen Van Thanh

I. Introduction

State-owned enterprises (SOEs) have been operating in Vietnam for a long time. SOEs, together with non-corporate economic institutions — such as the State Bank of Vietnam, the national reserves, and the country's infrastructural system — constitute the state-managed economic system in Vietnam. They comprise all the capital, assets, and natural resources of the country, owned by the nation. The Government of the Socialist Republic of Vietnam is the sole representative of that ownership.

The existing SOE system came into being with the founding of the Democratic Republic of Vietnam, in 1945. Since then, the country and its SOEs have passed through a series of wars and peace-time construction periods. Most notably, since 1975, the SOE system has consisted of enterprises from the north, enterprises taken over from the pre-1975 Saigon administration (in the south), and a number of nationalized private enterprises. Until now, SOEs have had a dominant share of the Vietnamese economy. According to the statistical review of 1 January 1990, Vietnam at that time had 12,297 SOEs in operation. However, as a result of economic reforms — including the crucial restructuring of SOEs — the number of SOEs was reduced to 6,264 by April 1994.

The reform and restructuring of these SOEs towards market forces, albeit with continued state control, has not only reduced the total number of enterprises, but also considerably strengthened every aspect of the SOEs' performance. At the same time it should be noted that the contribution of the state enterprise sector to Vietnam's gross domestic product (GDP) has increased at a faster rate than the growth of the national economy's GDP growth rate in the five consecutive years between 1990 and 1994. As a result, the share of total GDP contributed by SOEs has increased considerably. Recently, SOEs have been the main driving force for high economic growth. Vietnam's SOEs have been developed primarily in the industrial, construction, trade, and service sectors of the economy. This reflects the historical character of Vietnam's economic structure, and is also the result of structural reforms enacted in recent years.

Although it has experienced a period of reform and renovation, the SOE sector is not yet sufficiently developed to play its rightful role in Vietnam's mixed economy. The organizational structure and management mechanisms that currently exist in the SOEs remain inconsistent, and must be overcome. If the legal framework and macro-economic policies of the government are not completed and perfected, this inconsistency will become an obstacle in the development of the SOE sector. The development of both efficient SOEs and private enterprises is the driving force which would ensure the successful implementation of the sustainable economic growth strategy that Vietnam wishes to enact in the coming decades.

II. The Seven Major Issues

The first major issue that must be tackled is the identification of the role of the SOE sector in the mixed economy, and the position of the state sector system amongst all enterprises, of all sectors, operating in Vietnam. This is the first important problem; the correct treatment of this will establish the basic direction for the process of reform and renovation of the existing SOEs, and the implementation of the industrialization and modernization process of the country in the future. The consistent direction of the Vietnamese Government is that reform and renovation of the SOE sector, at both the macro and micro levels, must contain a policy assuring the dominant role of the state sector, and that SOEs will play the leading role in Vietnam's mixed economy. However, this policy should not harm or prevent the development of enterprises outside the state sector, and their acquiring investment capital from private, collective, domestic, and foreign sources, and playing a full and active role in Vietnam's development.

This leading role and position of the SOE sector reflects the past formation and development of the Vietnamese economy during the last fifty years. The practical experiences of economic development in many countries in East and Southeast Asia (including the ASEAN countries), especially over the last twenty or thirty years, depict the role of the state sector and SOEs in their economic development. During Vietnam's last ten years of renovation, the policy of a multi-sectored economy has paved the way for the strong development of mixed ownership enterprises, in which private capital (and especially foreign capital) has invested 70-75 per cent or more. But in fact, no private sector can substitute for the important role of SOEs, especially in the following areas:

1. supplying essential public utilities, especially in infrastructure and social services, national defence and security, for either no profit or low profit;
2. the development of upland mountainous and remote areas, where the

rate of return on capital is very low and large-scale investment is required, and investment recovery is highly risky, but yet these areas have an important role in the national development strategy; and

3. in those key sectors which act as the locomotive pulling the whole economy towards sustainable high growth, yet the private sector has not played a major part.

It is forecast that the state, including the SOE sector, will, in the coming decades, play an essential role in providing Vietnam with economic prosperity and high, sustainable growth, which cannot be substituted by other (that is non-state) economic sectors. But there are four problems which have also been forecast. First, although the growth of GDP in nominal value produced by SOEs is increasing, this growth rate is lower than that being recorded in the private sector and in enterprises of mixed capital ownership. Thus, the SOEs' share of total GDP is decreasing, and should this trend continue, the mixed ownership enterprises will come to dominate. Secondly, the state is currently relying on the state sector and SOEs to influence the economy and direct Vietnam's socio-economic development. In the future, however, the direct influence of SOEs will decrease. Thirdly, in the coming one or two decades, the number of SOEs wholly owned by the state will also decrease. Fourthly, an increasing number of SOEs will be transformed into joint-stock companies or limited liability companies, in which the state has an equity stake of between zero and 51 per cent, depending on the specific SOE's importance.

The second major issue is the need to overcome rapidly the problem of limited state capital for investment being spread across the entire state sector, which leads to piecemeal injections of small amounts of capital, and thereby low competitiveness. Thus, there is an urgent need to restructure Vietnam's SOEs, depending on their role and the positions of the specific SOEs in the future economic development of the country. This need was evident from the early years of *doi moi* (renovation), when the process of transition to a state-regulated market economy was agreed at the Sixth Congress of the Communist Party, held in December 1986. Delays in promulgating the master plan, strategies, and goals of state sector restructuring have been a major drawback in the country's renovation process. There is a lagged discrepancy between the role and status of Vietnam's SOEs. As a result, this delay has generated many of the difficulties and inconsistencies apparent in the renovation process, in both the near and long-term future.

Measures aimed at overcoming these inconsistencies have not proved very effective. As a result, the scarce funds of the state budget are being distributed too widely across the industrial and trading sectors. The 1990 general statistical review recorded that there were more than 12,500 SOEs. A process of merging the SOEs, carried out for the five years between 1990 and 1994, reduced the number of SOEs by almost half, yet the amount of capital was still too small. More than half of the SOEs have a capitalization of under one billion dong (approximately US$100,000). Indeed, in a number of economic and technological sectors, the average capitalization of the SOEs is less than 500 million dong (approximately US$50,000). Such a low capital base, even in relation to private enterprises operating in the same sectors and locations, is the biggest problem facing SOEs in the competitive market. Clearly, therefore, this poses major difficulties if the state sector is to play a leading role in the national economy. As the funds from the state budget remain scarce, the maintenance of a large number of SOEs, in all locations and all sectors, results in unacceptable levels of capital disbursement.

To solve the problem of insufficient capital for the state sector, the first urgent measure is to develop promptly a capital market, on the basis of affirming the economic legality of the SOEs, granting them all possible opportunities to participate in the domestic and foreign capital markets, both through the credit system and through issuing shares, bonds, and other commercial papers. One important measure is to diversify the ownership of the SOEs, transforming some into joint-stock enterprises or limited liability enterprises. But enacting this process has proved to be a very slow process. In the three years between 1992 and 1995, only five SOEs have been transformed through equitization (the sale of a limited number of shares). The delay in implementing the SOE equitization process — thereby diversifying the ownership of some parts of the state sector — has been an important obstacle in trying to overcome the piecemeal, highly dispersed nature of funding for the state sector. Equitization can be undertaken in those sectors and branches of the state sector which are not important to the national economy, do not necessarily need state capital, or require only an element of share ownership to be held by the state. This is the basic master plan, on which the law to restructure the state enterprises was promulgated. The need for a legal framework was an urgent demand, which could not be delayed further. According to the 1992 Constitution, for the smooth restructuring of the state sector, it is necessary to have a law governing the transfer of part of the state's ownership of SOEs into mixed ownership, or completely withdrawing the state's ownership from SOEs where state participation is not necessary. The state capital that is withdrawn from these non-essential SOEs, and thereby freed up, can be redirected immediately towards state investment in those SOEs which are crucial to the economy, but which are currently performing inefficiently due to a lack of capital or an insufficient capital base.

There is a need to liberalize the restrictive 'management control by line ministry' regime and other regulations which block the flow of state capital into SOEs, so as to give them more discretion in their own budgetary decision-making, as stated in the recently promulgated State Enterprise Law.

The third major issue is the generally very low level of efficiency of capital performance throughout the state sector. This places a large restriction on the capacity for reinvestment in SOEs, and limits the ability to develop the state sector rapidly, in order that it maintains a dominant role in certain important sectors of the economy, particularly where there is increasing competition from private enterprises (including joint ventures with foreign companies). The direct causes of this low level of efficiency are:

1. as discussed above, the very widely dispersed and piecemeal manner in which state budget capital is allocated to SOEs;
2. the obsolete technology — sometimes two to three generations behind other countries in the region — operating in many SOEs; and
3. a management mechanism that does not create direct incentives for managers and employees working in SOEs.

Attention must be paid to two problems. First, SOEs have not been classified into the two different forms: those in business for profit, and those in business for public benefit. Secondly, whilst there are many SOEs conducting business for public benefit, the government does not have in place the appropriate supporting measures for them, and those SOEs operating for profit enjoy the same support (subsidies) as the public utilities SOEs do. The forms of existing state subsidy include: no payment for land rental (including land in central cities which is of high rental value); low interest credit support through the state-run commercial banks; and an assessment of the fixed capital at well below the market value. These subsidies help make SOEs appear profitable, and the tax payment by SOEs to state revenues is also affected. Taking into account this subsidy element, the net profit (after tax) for all SOEs in 1993-94 was on average 5 per cent of total business capital, which is one index that indicates the very low level of capital efficiency in the state sector.

If the number of SOEs with 100 per cent state capital is reduced, in the agriculture, forestry, fishing, commerce and services, light industry, and food processing sectors, then considerable capital will be freed up for the state to invest in the formation of modern SOEs, with sufficient investment to compete adequately in the market. The result of this contraction will be an improvement in the quality and dominant position of the remaining SOEs in Vietnam. The current low efficiency of SOEs is a consequence of the delay in restructuring the state sector, yet restructuring SOEs is crucial to the improvement of their efficiency. This restructuring is also the way to promote SOEs to play the leading role in the state sector, which has been determined by the Vietnamese Government as an essential part of its fundamental economic policies.

The fourth major issue is the need to determine exactly the main elements of restructuring SOEs, and to define the planning and policies that will point the state sector in the right direction for the ultimate goal of state enterprise reform. The main elements of the restructuring of SOEs can be profiled briefly, as follows:

1. The concentration of all existing resources (particularly the capital owned by the state) in the state sector, development investment from the state budget, and credit (both inside and outside the country) for a number of SOEs in key sectors and branches of the economy, in order to assure essential infrastructural development and public services.

2. That government resources are invested with the priority given to technological change and modernization of those SOEs wholly owned by the state.
3. On the basis of the master plan, withdraw state equity from those existing SOEs which do not require state support and investment.
4. Through management reform inside SOEs, incentives should be introduced to bring economic interest to each manager and worker within the state enterprise sector. In particular, members of the board of directors of SOEs should be granted responsibility and full powers to manage the SOEs, through a management contract with representatives of the state.
5. A division between the two forms of SOE must be made; between business-for-profit SOEs and business for public benefit SOEs, so that an appropriate management regime exists for each form of state enterprise. Also, some of the existing SOEs should be transferred to the business-for-profit category.
6. Renovating macro-economic policy by ensuring that the government institutions performing the role of administrative control (such as the ministries) over enterprises do not intervene directly in the business activities of SOEs, but rather influence their activities broadly through policies and laws. State administrations which directly control SOEs should be abolished.
7. An improvement in the two existing laws pertaining to SOEs and those enterprises not wholly owned by the state, forming a Corporate Law that is applicable to all enterprises in all economic sectors, under the rule of law in Vietnam.
8. The overall goal is to make SOEs perform as efficiently as those in the non-state sector. SOEs that are wholly owned by the state will be restricted to those performing a key role in the national economy (and improving the economic structure of the country), and those providing public utilities. The main feature of these two types of SOEs is that they operate in those sectors of the economy where business-for-profit companies are reluctant to enter. SOEs are also required in areas concerning the national interest (such as defence and security), where investment must come from the state budget.

The fifth major issue is addressing the concept of owner and manager of SOEs, which are currently not very well defined by the authorities, at all levels. Thus, there is no clear distinction between the investor function of the state and state economic management. Since there is a large number of SOEs, which account for a large part of the economy, government institutions and local authorities tend to intervene too much in the management of SOEs. For SOEs themselves, they have been granted a confusing status: the right to use capital to invest, yet insufficient legal power to do so. Thus, on the one hand SOEs have power beyond the regulated scope of the legal framework and government supervision, yet on the other hand they are subject to too