

# **Study on Economic Development Policy in the Transition Toward a Market-oriented Economy in Viet Nam (Phase 2)**

**FINAL REPORT  
VOL. 4 State Enterprise Reform**

**February 1998**

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**Ministry of Planning and Investment  
The Socialist Republic of Viet Nam**

**Japan International  
Cooperation Agency**

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## Foreword

This study entitled "Economic Development Policy in the Transition toward a Market-oriented Economy in Viet Nam" was conducted within the framework of the technical cooperation program of the Government of Japan, in response to a request from the Government of the Socialist Republic of Viet Nam.

The study was carried out as joint research by professionals specializing in economic policy from both Japan and Viet Nam. The research groups headed by Prof. Shigeru Ishikawa, Professor Emeritus of Hitotsubashi University, for the Japanese side, and by Dr. Nguyen Quang Thai, Vice President, Development Strategy Institute, Ministry of Planning and Investment, for the Vietnamese side were set up in each country, assisted by consultant teams consisting of leading research institutes in both countries.

The research groups and consultant teams held a series of discussions, and conducted several field surveys. This report was prepared jointly by the Japanese and Vietnamese research groups based on a mutual understanding.

I hope that the useful suggestions presented in this report will contribute to the formulation of policies for economic transition and sustainable development of Viet Nam, and it would be my great pleasure if the report would be used practically by concerned organizations, officials and experts.

I wish to express my sincere appreciation to Professor Ishikawa, Dr. Thai and each research member for their close cooperation in the study, and to the officials concerned for their valuable opinions.

February 1998

A handwritten signature in black ink, appearing to read 'Kimio Fujita', with a stylized, flowing script.

Kimio Fujita  
President  
Japan International Cooperation Agency

## Preface

This Final Report of the project on the Study on Economic Development Policy in the Transition toward a Market-oriented Economy in Viet Nam (Phase 2) aims at collecting all the important reports on the research results and policy suggestions which have been produced on the subjects of the title during September 1996 and November 1997, and thereby concluding the Phase 2 study. Moreover, the Final Report of Phase 2 combines with the Final Report of Phase 1 which was published in August 1996 in five separate volumes, to conclude all the formal research activities of the whole study project. The project itself was decided on April 1995 on the basis of the consultations between the governments of Japan and Viet Nam during 1994 and 1995, and was implemented under the Social Development Studies Program of the Japan International Cooperation Agency (JICA). The project was formally inaugurated in August 1995.

Under the agreement, the project was to be conducted in two phases. The general purpose of Phase 1 was to study the "Five-year Plan for Social and Economic Development in Viet Nam" (1996 - 2000), which was then being drafted for consideration by the Eighth Congress of the Vietnamese Communist Party. The phase 1 was brought to a close by the submission to the government of Viet Nam of a "Summary Report" in June 1996 and a "Final Report"<sup>1</sup> in that August. The general purpose of Phase 2 that followed Phase 1 has been to research the implementation of the "Five-year Plan" and the new issues raised during the course of it.

The agreement also stipulated that this was to be a joint Japanese and Vietnamese project. To accomplish this, research groups consisting of scholars and high-ranking experts were organized and worked under the direction of relevant steering committees on both sides. The general leaders of the research group were Professor Shigeru Ishikawa of Japan and Dr. Nguyen Quang Thai of Viet Nam. The project consisted of Subgroups to research selected priority topics, to which both Japanese and Vietnamese researchers were assigned. Both Phase 1 and Phase 2 had four priority topics, though the topics themselves changed a bit between the phases:

Phase 1:

- Macro economic growth and its relationship with inflation and stability
- Capital mobilization policies in the fiscal and monetary sectors
- Industrial policy and industrialization

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1 Ministry of Planning and Investment, the Socialist Republic of Viet Nam = Japan International Cooperation Agency, "Summary Report — Study on Economic Development Policy in the Transition toward a Market-oriented Economy in Viet Nam Phase 1, Opinions on the Draft New Five-year Plan for Social and Economic Development in Viet Nam (1996-2000)," June 1996, Hanoi and Tokyo.

Agriculture and rural development

Phase 2:

Agriculture and rural development

Participation in AFTA, APEC, and the WTO, and industrial policy

Fiscal and monetary policy

State enterprise

As for the concrete procedures for implementing the joint research, the general leaders from both sides met together for consultations at the start of each phase and draw up minutes of those meetings,<sup>2</sup> thereby ensuring that the project does become a real "joint research."

To ensure that joint research was fruitful, opinions were exchanged, materials and literature provided for each other, joint field studies and interviews conducted, and research findings discussed closely at the overall project level, the subgroup level, and the individual researcher level. At the overall project level there were five workshops held during Phase I and three during Phase 2, in either Tokyo or Hanoi.<sup>3</sup>

The results of the joint research can be seen, first and foremost, from the research findings themselves. In many aspects, the Vietnamese economy suffers from a lack of basic data, statistics, and information, which combined with the complexities involved in the transition from a centrally planned economy to a market economy (this overlaps the problems found in the process of rehabilitation and reconstruction from an economy long on a wartime footing) to produce the many inadequacies that remain in our research. But these details aside, during Phase I we were able to elucidate four problems in the Vietnamese economy and advise that they be taken note of in the drafting of the Five-year Plan.

The four points we called attention to were: 1) restraining an excessively high growth rate; 2) improving domestic savings rates; 3) recognizing that the development of agriculture and rural economy (including rural industrialization) was a major prerequisite to industrialization; and 4) recognizing that it was desirable to take a dualistic economy approach to industrialization, having a modern industrial sector with modern industrial technology and equipment existing side by side with a small industry sector using traditional technologies and facilities.

The importance of these four points was in no way diminished during Phase 2. However, new conditions that emerged or became apparent in the Vietnamese economy in 1996 and

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2 August 30, 1995, "Minutes on Guiding Principles of Joint Studies"; August 9, 1996, "Minutes on the Conduct of Vietnamese-Japanese Joint Studies for Phase 2."

3 Phase 1: 1) Hanoi Preparatory Meeting (May 1995, Hanoi); 2) First Hanoi Workshop (August 28-29, 1995, Hanoi); 3) Consultations on the work plan for joint research (November 27-28, 1995, Tokyo); 4) First Tokyo Workshop (January 28-29, 1996, Tokyo); 5) Second Hanoi Workshop (March 1-2, 1996, Hanoi).

Phase 2: 1) First Tokyo Workshop (March 22-23, 1997, Tokyo); 2) Consultations on the progress of joint research and announcement of results (May 22-23, 1997, Tokyo); 3) First Hanoi Workshop (June 6-7, 1997, Hanoi).



after resulted in the addition of a new research priority, namely new issues of the Vietnamese economy emerged in its international economic dimension. The priority here was to consider how Viet Nam should draft and implement its trade and investment policies in the circumstance that Viet Nam have joined AFTA and applied for membership in the WTO and APEC. This, by way of conjunction, also raised new issues directly and indirectly in state enterprise reform, industrial policy, fiscal and monetary policy, and agriculture and rural policy.

The second result of the joint research can be found in the evolution of the mechanism for joint research itself. This mechanism was devised experientially as a means of furthering the cooperative relationship between developed and developing countries concerning industrialization for economic development. It was obviously anticipated that there would be many difficulties in the realization of this mechanism, but as a matter of fact, the results outweighed the difficulties. In a word, a relationship of mutual trust has begun to take root between Japan and Viet Nam at all levels of the joint research. In the process of researching topics together, we were able to understand the sincerity and good faith of our counterparts. Naturally, differences of approach sometimes remain regarding analysis and policy options, but both sides understand the arguments behind these differences and indeed the background that has produced them, and from that have developed trust and confidence in one another.

In proceeding with this study project, we have obtained profound support from a wide circle of the people. We would like to acknowledge this with warmest gratitude.

The Japanese side of the joint research project feel extremely fortunate to have been given many opportunities to meet with Secretary-General Do Muoi and other Vietnamese leaders and seek their opinions. These opportunities were instrumental in bringing depth and strength to our findings.

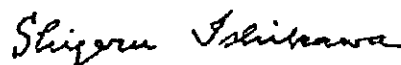
The Vietnamese side of the project expresses sincere thanks to JICA and its Vietnam Office for supporting its research activities particularly in Japan.

In addition to submitting this Final Report to the leaders of Viet Nam, we will be providing it to other interested parties in order to seek comments and opinions.

February 1998, Hanoi and Tokyo



Nguyen Quang Thai  
Vietnamese Cochair of  
the Research Group  
Doctor of Economics



Shigeru Ishikawa  
Japanese Cochair of  
the Research Group  
Doctor of Economics



# Introduction: State Enterprise Reform\*

Shigeru Ishikawa

Hitotsubashi University

The purpose of the State Enterprise Subcommittee is to provide policy options for the policy tasks in state enterprise reform assigned by the government of Viet Nam. To do this, we have taken the steps to study the performances achieved by Vietnamese state enterprises and their determining factors, and on the basis of these to identify the issues that policy options should address and resolve. To describe the study results in these steps is the main theme of this chapter.

The policy tasks assigned by the government of Viet Nam was to formulate measure for improvement and reform in all aspects of state enterprises, with implicit emphasis on the reform of the legal and institutional framework for state enterprises, a task that the government of Viet Nam must address urgently. The reform in state enterprise sector production, management, and finance will be also important, affecting the overall success of state enterprise reforms. But in light of the decisive importance of the state enterprise sector to the current economy of Viet Nam, it should not be overlooked that those areas other than the state enterprise sector of the national economy, in particular the systems and policies for macroeconomy, fiscal and monetary sector, industry and technology and the external economy will have a large impact on the success of the state enterprise reform. It will also be influenced by the initial conditions unique to Vietnamese economy.

## 1. The "Gap Approach" and the "Market Economy Promotion Approach"

Given the complex interdependencies of these factors and also the dearth of statistics and other information about the economy and in particular its state enterprise sector, we believe that a very well-prepared framework will be required for this study to be a success. Moreover, as a conditionality for

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\* In conducting this policy-oriented studies on the Viet Nam State Enterprise Report, we benefit greatly from the collaboration of two organizations: one is the MPI's Central Institute For Economic Management (CIEM) as our counterpart organization in the Joint Viet Nam- Japan Study Project, and the other Japan's Overseas Economic Cooperation Fund (OECF) as an organization conducting an independent research project on Vietnamese State Enterprise Reform which was complementary to ours based on JICA. Particular mention should be made of Dr. Le Dang Doanh (President) and Dr. Tran Tien Cuong of CIEM, and of Mr. Kaoru Hayashi (Director) and Mr. Yoshio Wada of OECF's Research Institute of Development Aid. Moreover, Mr. Koki Hagiu and other members at Tohmatsu & Co. (a management consultant) helped us by conducting an in-depth management study of selected small member of State Enterprises in Viet Nam. Finally, in writing this report, I myself received very useful help from the Japanese side academic group members belonging to the State Enterprise Study Sub-group. For all of these, I express my sincere appreciation.

receiving structural adjustment lendings from the World Bank and IMF, and as a necessary condition to effectively fulfill the international commitments for trade liberalization, Viet Nam is required strongly by the international community to enact, amend and enforce its corporate law, state enterprise law, foreign investment law and other state-enterprise-related laws according to the international norms. It would therefore seem that complying with this, at least to a minimum tolerable limit, would be the obvious path for Viet Nam to take, as it has already resolved to seek rapid economic development through internationalization. The urgency of the state enterprise reform coming from these international obligations also requires that special considerations be given to designing the framework for this policy-oriented study. The resulting special considerations are shown below in four items.

① When trying to bring legal-institutional framework for state enterprise reform in line with international norm, the Anglo-Saxon model is usually used which presupposes a stringent application of the principles of "corporate governance," and hence the elimination as much as possible of "insider control." However, this model may not be suited to the countries in the initial stages of development like Viet Nam. This is because when it is attempted to be applied immediately, the Anglo-Saxon model may have a beneficial impact of bringing stimulus and tension to accelerate market economy oriented institutional reforms, but international experience shows that it may also produce a large gap (sometimes triggering social upheavals) between the "model" and the limit of the capability of the economy and society to absorb it. This limit of the absorptive capacity comes from the low degree of enterprise organization and the fact that the social and organizational awareness of the people concerned is not sufficiently modernized. What we can do to counteract this is to research the nature of the anticipated gap ahead of time and take measures to guard against the detrimental impacts while still enjoying the benefits. We will call this the "Gap Approach."

② If at the present stage there is no pressing need to reform the legal and institutional framework to international norms, then the most realistic and effective market-oriented (or state enterprise) legal and institutional framework that Viet Nam could adopt would be one which is most suited to the Vietnamese reality, namely the framework that: 1) is less sophisticated and suited by its nature to the current stage of development in Viet Nam and 2) will encourage the transition to the next stage of development when this stage of development has matured. This approach we will call the "Market Economy Promotion Approach." However, if Viet Nam is required to immediately reform its system to international norms, solutions suggested by the "Market Economy Promotion Approach" are highly unlikely to bring overall solutions, and we have to resort to the "Gap Approach."

Despite which approach we should follow, we will need to understand how fundamental market economic systems in fact work within the Vietnamese society and economy at present, and in particular how the institutions and organizations of state enterprises really work. And, for a country like Viet Nam in the initial stages of development, the starting point for these studies is to determine where the country (or its state enterprise sector) stands on a scale of economic development and, in particular, to locate their present stage in the light of certain predetermined model of development stages for the market economy (or in particular the state enterprises). It should be noted that the study of the economy along the line of such development stages is originated from the Market Economy Promotion Approach." Hence the "Gap Approach" is founded partly upon the Market Economy Promotion Approach. (As for the Market Economy Promotion Approach, refer to Shigeru Ishikawa, "On the Market Economy Promotion Approach – Theoretical Considerations and Application," *Kaihatsu Enjo Kenkyu*, (OECF-RIDA), 4-1, 1997—

in Japanese).

③ As one of the ways to deal with the extreme lack of information on what is taking place in Vietnamese state enterprises, this study has put great expectation on developing a framework of research on the basis of a comparative study of China and Viet Nam. Japan has already done a large amount of research on China and therefore has far more information about China's state enterprises and market economy than about Viet Nam's. What is more, there would appear to be some broad similarities between the model for state enterprise development used in the two countries, since both China and Viet Nam are socialist countries in the process of making the transition to market economies. A detailed consideration reveals that there are differences as well. There are differences in the economic structure originating from the historical and cultural characteristics. Even apart from these, China is more advanced in areas like industrialization, economic structure, formation of large and medium sized enterprises, savings and investment levels, participation in foreign trade and investment, and development of a financial intermediaries.

But here the similarities are more important and fundamental. The point is that due to these similarities, we can develop a common framework for state enterprise research on the basis of accumulated research on comparisons between China and Viet Nam (particularly on the process and other factors of capital accumulation), and this framework will be useful in identifying missing information about Viet Nam and analyzing economic issues.

④ Another method for dealing with the lack of information is to use two mutually complementary micro-level studies of Vietnamese state enterprises. The first is the joint research project by Japan's Overseas Economic Cooperation Fund (OECF) and Viet Nam's Central Institute of Economic Management, MPI (CIEM) that aimed to conduct comprehensive surveys and interviews of two hundred state industrial enterprises in seven provinces and cities covering six manufacturing sectors. The other is the joint project between the Japan International Cooperation Agency (JICA) and CIEM that used surveys and interviews to do in depth case studies of eleven state industrial enterprises and three state corporations nominated by CIEM. Both sets of studies attempted to elucidate the current state of, and changes over time in, the production, manufacturing, and financial performances and to determine factors therein at state industrial enterprises (The OECF-CIEM project concentrated on 1991-1995; the JICA-CIEM project on 1993-1995). Both projects were overseen by the Vietnamese government's Planning and Investment Ministry, and when Phase II of the Japan-Viet Nam Joint Research Project began, the government of Viet Nam (MPI Vo Hong Phuc, First vice minister) specifically requested the chief researcher on the Japanese side of this joint study project to integrate the results of these projects into the final report for this research.

## **II . Framework Prepared for Comprehensive Research**

We have prepared a framework for comprehensive, systematic research based on the ideas and considerations described above. This framework is summarized in Table 1 ("Research Items of the Study on the Performance of State Enterprises and their Determining Factors"). Below are the main points only.

① The three major components of this study—(A) enterprise performances, (B) determining factors in the performances, and (C) policy options—themselves provide a clear order to follow in doing research on the formulation of policies for state enterprise reform. Studies of enterprise performances (A) and the determining factors therein (B) will produce a multi-layer elucidation of

the issues facing state enterprises that need to be resolved. The policy options (C) will attempt to deal with and resolve these issues.

② Indicators of enterprise performances (A) are selected from both short and long term points of view. Short-term indicators, as their name implies, consider only short-term performances. Long-term indicators do not necessarily consider performances *per se*, but attempt to measure the enterprise's strength and competitiveness so as to understand its potential for development. The JICA-CIEM case studies of eleven enterprises included conceptual observations on a system of indicators with which to measure enterprise performances from different short and long-term perspectives. One innovation worthy of note was the attempt to create a multi-layer structure of long-term indicators in line with the concepts of Porter's "competitive advantage" theory. Regardless, most of these indicators lack the statistical data to be useful. Competitiveness in particular can only be measured in qualitative terms. The indicators listed in Table 1 therefore have a somewhat different perspective than the JICA-CIEM concepts.

③ We have divided the determining factors in enterprise performances (B) into four components, but they can in fact be narrowed down to just two basic components: "initial conditions" (the objective conditions placed on the economy at the present time, primarily as a result of past history) and "government economic policy." These are the two main variables we deal with in attempting to provide a comprehensive explanation of the enterprise performances (A) that are measured. The reason they are broken down into four components is that we wanted to distinguish "the stage of development of state enterprises and the factors related to it" (B2) and "managerial factors (determinable) within state enterprises" (B4), both of which will directly impinge on the explanation of corporate performances, from other "initial conditions." A similar point can be made for the internal structure of "government economic policy" (B3). We have therefore distinguished the items that go into "state enterprise reform" (B3-2) from other areas of economic policy. On the other hand, there should be an infinite number of factors in performances that do not directly impinge on state enterprises themselves. What we have included in this table is a comparatively limited number of factors, the importance of which has already been proven in the process of comparative research on China and Viet Nam.

④ B2, "the state enterprises' development stage and the related factors," deserves special explanation because it is deeply related to our "Gap Approach" and "Market Economy Promotion Approach." As we have noted, this is a separate listing of part of factor B1, "initial conditions," and it exhibits characteristics that are not seen for other aspects of "initial conditions." The first is that there is shown a task of formulating development stage model for state enterprises that seems to fit commonly to the situations in Viet Nam and China. Establishing this model is itself an important subject of research, but in this report only the conclusion is indicated. (As for the derivation, refer to Shigeru Ishikawa, *op. cit.*) Namely, there are three stages involved: (1) the stages of state enterprises as "governmental undertakings" in a planned economy, in which the production and management of the state enterprises are conducted solely under the directive issued by the planners; (2) the stage of the state enterprises which basically belong to the category of "governmental undertaking," but are endowed with partial and yet increasing managerial autonomy; (3) the stage of "equitization" (i.e. incorporation and formation of joint-stock companies) under the condition of complete separation of ownership and management, and (4) the stage of "privatization." The second characteristic is that the present state enterprises in Viet Nam is considered in a mixture of stages 2 and 3, taking into account the legal contents of enterprise reform imposed from both inside and outside. It is therefore possible that in these two stages, "gaps" exist between the desired legal structure and reality. Stage (4) is presently only allowed for

the small and medium enterprises. The third characteristic is that while the past stages may seem to be things of the past, stage transitions are actually incomplete in the development of Vietnamese state enterprises (the same is true of China), and hence there are “residue” of past stages such as those listed in B2-2. These “residue” may serve as constraints on the present enterprise activities. Note that careful study will be required to determine how significant in reality the second and third possibilities are.

### **III. Enterprise Growth Performances and the Determining Factors Therein**

Our research into the issues facing Vietnamese state enterprises, which was conducted according to the study framework shown in Table 1, used the OECF-CIEM comprehensive survey of 200 state industrial enterprises and the JICA-CIEM case studies of eleven State Corporations as main data. Research results of three Sub-Groups other than this State Enterprise Sub-Group were also relied upon. There remain still many uncovered portions left in the “fact-finding” surveys and research and analysis of deeper factors is also incomplete. We must therefore emphasize that our research into this topic is yet at a tentative, intermediate stage.

#### **1. Short-and Longer-term Enterprise Performance**

First, short-term indicators of enterprise performances show improvements in various aspects for the 1991-1995 period, which was covered by our comprehensive survey. The absolute levels seen in 1995 in production and finance are fairly acceptable. However, much of this improvement owes to the fact that the “re-registration policy” of 1991 forced the weakest of Viet Nam’s estimated six thousand state enterprises to reorganize or close down, effectively cutting the number of state enterprises in half. The long-term indicators show that the percentage of arrears in state enterprise borrowings from state commercial banks has declined dramatically from 20.2% in 1991 to 3.5% at the end of 1996 (according to a source in the central bank), but again, the same factors due to the re-registration policy are at work. The question is whether the re-registration program was able to make fundamental improvements in the loss-making structures of state enterprises. The long-term indicators suggest that there has been almost no investment in productive capacity or new technology by state enterprises and that their products have only weak international competitiveness.

The case studies found many talented and dedicated enterprise leaders, but while they may be suited to running “factories” according to the predetermined output target, they have yet to grow into managers of “competitive modern corporations.” These observations point to several important structural factors regarding the most basic and urgent issue of how to grow state enterprises into strong, competitive companies by 2006, the year in which Viet Nam will be obligated, as part of its AFTA membership, to almost completely liberalize its trade.

#### **2. Determining Factors – Initial Conditions**

Of the initial conditions for economic development in Viet Nam, a special emphasis is needed on the fact that Viet Nam belongs to the latest-comer country group among today’s developing countries: the domestic savings are of a very low level and its industrialization is just at the burgeoning stage, with a very small number of large-scale factories equipped with modern, up-to-date industrial technologies and machinery.

Measured in terms of gross value of industrial production in official statistics (1993), the size of

industrial output of Viet Nam is only 0.64% of that of China. Allowing for the difference in the size of population (that of Viet Nam is 6.0% of that of China), the per capita industrial output of Viet Nam is only 10.6% of China. (Refer to the statistical data shown in Viet Nam's MPI and JICA, *Study on Economic Development Policy in the Transition toward a Market-oriented Economy in Viet Nam (Phase I), Final Report Vol.1 General Comments*, August 1996, p.37. (Table 8)) While the statistics on the size-structure of the industrial enterprises or establishments are not easily available to us, fragmented information indicates that in Viet Nam the number of state industrial enterprises employing 1000 persons or more was only 121 units (1990), while in China the number of the enterprises with the same size class (but covering non-state enterprises adopting the independent accounting system as well) was 9579 units (1989).

In Viet Nam, the private enterprise and collectively owned enterprises (which seem to cover the small and medium enterprises and rural industries as well) have not grown up on a sufficient magnitude. This is reflected in the statistics showing that the weight of non-state enterprise industrial output (gross), excluding that of household industries, in the total gross industrial output was only 5.6% in 1993 (the weight of household industries was 22.0%). In China the same weight was 38.4% in the same year (with that of household industries being 9.1%).

Side by side with such lagging industrialization, there are indicators of poor technological standard and insufficient maintenance and development of production facilities, which are discussed later. The indicators which tend to combine all these characteristics of Vietnamese initial conditions are found in the area of foreign trade in manufactured goods. First, the amount of exports of manufactured products was 830 million US\$, occupying only 21% of total amount of exports in 1995. Product category wise, they consisted mostly of labor-intensive light-industry products. The corresponding figures for China were 101.3 billion US\$ and 84% in the same year. They consisted of almost all categories of manufactured goods.

Next, tariff schedules of Viet Nam, too, provides us a useful information for reference. The current tariff rates range between 60% and 0%, with the average rate being 15-16% in 1993. The categories with 0% cover headings of production materials, machinery and equipment, etc. Tariff rates determination was said to be based on the following principles: (1) to mobilize an appropriate contribution to state budget and (2) to give guidance on domestic consumption. No reference was made to the principle of protection of infant industries. As was described in Part 1 of this report, all of those imports for Viet Nam included in the Inclusion List of AFTA-CEPT tariff reduction scheme are, as shown in Table 1 of Part 1, of the Tariff lines the import tariff rates of which are on average 0.88% already in 1996 and hence no change at all for the years up until 2003. The explanation is that these products are not yet produced in the country, nor recognized as the object of infant industry protection.

Other items of initial conditions which have a special importance (such as the existence of surplus labor and underdevelopment of market economy environments) will be taken up later in connection with analysis of determining factors.

### 3. Stages of Development of State Enterprises

Next we will consider the state enterprises. It is necessary, first of all, to prepare a model of the stages of development of state enterprises, and to specify the current stage of Viet Nam in light of such a model. Results of these studies are covered briefly in advance in the section on the framework of investigation. What is required here is to elucidate how to identify the "gap" between the legal institutional system reform aimed at in the current stage and reality.

The legal-institutional development of state-owned enterprises in Viet Nam already shifted in the early 1980s, as discussed above, from the stage of planned economy type state enterprises (the stage



where they were "governmental undertakings" as part of the administrative structure, or what is called in China "the stage of factory system") to the stage where state enterprise management autonomy is respected and strengthened in order to improve the efficiency of enterprise activities (legally speaking, these enterprises are still within the category of "governmental undertakings"). The "strengthening of autonomy" stage began with the Cabinet Decision No. 217 of 1987. The State Enterprise Law of 1995 referred to the separation between ownership and management for the first time, giving ascendancy to ownership. However, the stage was still removed from "corporate governance" which characterizes the stock company system. Viet Nam's decision to move on to that stage was in the form of "equitization" taken in 1996.

So far only twelve out of the approximately 6,000 state enterprises that exist now have been equitized. The number of enterprises which on the basis of government decision of May 1996, will be equitized are still not many: 150 to be equitized by the end of 1997 and another 200 by the end of 1998. It can safely be said that the goal of most of the state enterprises is yet stricter enforcement of the State Enterprise Law. Therefore, when we say that the development stage of state enterprises in Viet Nam is now covering both stages of strengthening of autonomy and equitization, it means that two different groups of enterprises are in different stages, respectively. (Incidentally, the second round of the Re-registration System, which began in early 1994 following the termination of the first round initiated in 1991, is aimed at resolving more decisively the small scale and technological backwardness of existing state enterprises and drawing a more distinct line between ownership and management. The results are the establishment of 18 so-called General Corporations to be placed under direct jurisdiction of the prime minister and more than 80 General Corporations (of somewhat smaller in size) under the jurisdiction of divisions or local governments. However, our investigation of facts about this matter is still incomplete. Its political significance is also being frequently debated both at home and abroad. This summary report does not discuss "General Corporations" any more.)

#### 4. Analysis of the "Gaps"

##### (1) Gaps at the Autonomy Strengthening Stage

It seems that what determined the state enterprise behaviors at the present stage is the mutual relationships among the following three entities.

① Enterprises -- while all of its production and management activities had originally to be conducted in accordance with government executive directives, at this stage, however, part of such directives have been delegated to enterprises as its autonomous management right. The scope of delegation is gradually expanding.

② Government -- The government, as the entity having executive authority, is playing the role of regulating enterprises activities.

③ The government, as the holder of ownership of enterprise assets, oversees and intervenes in enterprises management itself.

The desirable state of the autonomy strengthening stage is that the authority of each of ①, ②, and ③ is clearly defined in the legal system, and restricts and helps promote one another to improve management efficiency. (These mutual relationships include effective handling of the incentives issue characterized as "principal-agent relationship.") A real issue is that it is necessary to improve the manpower capability and organizational efficiency of each of the three entities so that they can exercise their authorities in an appropriate manner.

The state where the gap exists is one of the states that are at the opposite pole from the above desirable state. There, the actions of the three entities clash with one another, making it impossible for

the activities of all state enterprises to demonstrate their potential. In the back of this state is the fact that the manpower and organizational capabilities of the entities and the consciousness structure of concerned people are still backward, and that this makes it impossible to maintain the desirable state. The study of Viet Nam gives us a glimpse of such a gap.

The strengthening of autonomous right started in 1987 with the Cabinet Decision No. 217. In its initial period, (a) most state enterprises thought that they had been given unconditional authority for the use and disposition of their capital and assets and for conducting production and business management activities, and hence refused to accept the government's administrative intervention or supervision. (This was partly because the government did not take the necessary regulatory measures regarding the exercise of those authorities when it granted the autonomous right.) (b) State enterprises were not concerned about the maintenance or increase of the value of the capital invested by the government. Periodical re-valuation of assets was stipulated because inflation was escalating in those days, but was never fully implemented. (When the assets of state enterprises were re-valued in 1990, their total value was 4-6 times that of the book value.) (c) Concurrently with the strengthening of the autonomous right, subsidies and interest-free fixed capital investment through public finance were abolished and shifted to bank loans. However, the provisions covering debt repayment obligations (including foreign loans and inter-company commercial debts) were not clear, and were not being complied with. (d) Under these conditions, it was not possible to avert the incessant "lacking out" of state-owned assets at state enterprises.

To deal with these problems, various laws and policies were established, such as the Accounting Law, Statistics Law (1988), Measures for the Strengthening of Financial Management of State Enterprises (1990), Maintenance and Increase of the Values of Capital and Assets by State Enterprises (1991), and Accounting Audit System (1988, 1994), but it is not known how effective these measures have been.

## (2) Gap in the Equitization Stage

The entities that are concerned with the determination of (state) enterprises' decision making at this stage are ① the enterprises as entities having all the management right, in a consolidated and integrated sense (and not as entities having ad hoc autonomous management right); ② the state as the owner of the national assets held by enterprises — especially the state as the owner of enterprises when it is in a position to secure a majority vote at the annual stockholders meeting, and ③ the state as the entity to enforce administrative regulation on enterprise activities. A desirable state of the mutual relationships among the three parties is that the authority of each of ①②, and ③ is clearly defined and helps promote the development of the enterprises. No corporation law — a basic law to provide such definitions — that has these provisions including those on state enterprises has been instituted in Viet Nam yet. However, this report assumes that such a law has been instituted, and that it contains provisions, as the minimum necessary clauses, on a relationship whereby the owner commands and governs the management when the enterprise's corporate strategy is formulated (the so-called corporate governance). In order for such a desirable relationship to be sustained, it is necessary, as in (1), for each entity to have adequate manpower and organizational capabilities. It is also necessary for the consciousness structures of the concerned people to be sufficiently receptive to such a relationship.

Further, when the international environment surrounding Viet Nam at present is considered, equitization is nothing but an important step for the introduction of international standards to the Vietnamese legal system regarding enterprises. (The aim is to prepare a legal environment that will help promote direct investment by foreign enterprises, and organize important conditions that will allow foreign enterprises and state enterprises to compete on an equal footing in the country.) When

that is taken into account, we know that the objective of equitization cannot be attained unless it is done concurrently with the introduction of industrial technologies, production facilities, and enterprise organizations similarly based on international standards. It is known, however, that if the market is incomplete, the market mechanism cannot be relied upon to allow resources such as capital, technology, and management know-how to develop spontaneously. Especially if the market is underdeveloped, appropriate policy intervention by the government becomes an additional necessary condition.

A gap develops when various conditions emerge that prevent the realization of such a desirable state. Based on the study of Viet Nam, those conditions are as follows.

① One of the difficult questions involved in the equitization of a state enterprise is to which government agency the ownership of the state-owned assets should be reverted. In the period of planned economy, state enterprises were stipulated to be "owned by all people." In reality, however, they were virtually owned by the line ministries ("sectoral ownership system"), and the ministries led the activities of the enterprises in accordance with their objectives (which were virtually the same as "the objective to maximize the total value of production") In order for this to be stopped and for the enterprises to work to maximize the return (on equity) as their objective and try to optimize the allocation of resources as a consequence, the owner of the enterprise's assets must be an organ that is neutral to the sector's interest. Such an organ must have the ability to monitor the management's activities so that they will work to maximize the return and retain and increase the equity value, and to force them to do so.

When separation of ownership of an enterprise from its management was required by the State Enterprise Law, the solution was to revert the most part of ownership of state-owned assets to the State Enterprise Assets General Control Bureau of the Treasury Ministry and to leave the right of personnel management with the line ministry. The question is whether the General Control Bureau has the ability to monitor the actions of the management. (In late-emerging capitalist countries like Japan, the monitoring of management has been often left in the hands of the "main bank.") Sometimes the line ministry's holding the right of personnel management makes it likely for it to intervene in detailed management affairs.

② If the ascendancy of the owner is established, it will serve as an effective "check" in the event the effort to establish autonomy goes too far and gives rise to insider control and as a result, when the net output of the enterprise is distributed to its various elements, the share of labor tends to increase at the expense of the share of the capital. Also, equitization gives state enterprises a new source of funds. However, the emergence of a securities market and its development will be required for that to happen. If it is attempted to promote corporate governance when such a need for equitization does not exist (in Viet Nam, the increase of autonomous right did not lead to a strengthening of management right, then to a strengthening of the insider control; rather, the increase of autonomous right was accompanied by the laissez faire or non-interference of the enterprises. What is actually needed is the strengthening of prudential regulation, rather than the strengthening of ownership), or when there is such a need but conditions for equitization do not exist yet, then the net result may not only be a failure to foster corporate governance but also impair the growth of the business.

As a measure to facilitate equitization, a Bankruptcy Law has been instituted as a legal means to screen out enterprises that have been defeated in market competition, while at the same time minimizing the social loss. What happened in China as a result of enforcing such a law is an event that can happen in Viet Nam, also. This is based on the results of a survey made by the China Industry and Commerce Bank in 50 cities across the country covering 5,128 bankrupt enterprises to which it had made loans. ("Report of a Survey Concerning the Issue of Enterprise Bankruptcy,"

*lingji yanjiu* (Economic Research), 1997, No. 4.) The law provides for a procedure whereby the assets of an enterprise filing a petition for bankruptcy are used to preserve the interest of the creditors, pay dissolution allowances to the employees losing their jobs, and then to let the enterprise cease to exist, the enterprise which has already become the source of a waste of resources for the society. In actuality, however, the cases for filing for bankruptcy are disposed of by the enterprise by means of writing off its cumulative debt at the expense of the creditors (banks, in fact) under the guidance of the line ministry and even with the support of the judicial authorities. Bankruptcy is just an excuse, and the enterprise that has petitioned for bankruptcy simply changes its name and continues to exist in fact. The remaining assets do not transfer to the creditors but are turned over to the nonperforming enterprise.

③ The study on the manpower and organizational capabilities of enterprises and the government (as the owner of state enterprises and as the authorities for the administration of enterprises) as gap-causing factors is still insufficient. With respect to the current state of the technology of enterprises and the improvement of their production facilities and management capabilities based on international standards, also, only fragmental information is available, and it is not possible at this stage to make an overall assessment. As far as these are concerned, however, the basic situation is the low level of development usually seen in early stages of industrialization, as discussed earlier in the section on "Initial Conditions." Two things must be pointed out in this connection.

One is that the device of "management responsibility contracting system" for enhancing the management capability which has implemented since 1978 at many state industrial enterprises in China, is not practiced in Viet Nam. (This Chinese contract system was suspended once, from 1983 to 1986, when the profit surrender system was changed to a taxation system, resumed in 1987, and then abolished in 1994 when the uniform 33% income tax system was introduced. In fact, however, it is still seen at quite a few enterprises.) The system is one whereby the competent ministry gives a contract to the head of an enterprise to earn a certain amount of profit in return for a promise of a certain incentive. The incentives include the right for the enterprise to use for itself the portion of the profit over and above the promised amount, and an increase in the "total amount of wages" (payroll). There were pros and cons about this system, but there is no denying that it has helped to increase profits and also to improve the enterprise organization and business operations of the enterprise. It is fair to say that the system is an useful method to foster enterprises which have not separated ownership from management, when there is no full-fledged market mechanism yet.

The other thing is related to innovation of industrial technology which is yet to be seen in Viet Nam. Here, too, China's experience offers a high reference value. China's industrial technology improved through the four intermittent "waves" of introduction of latest industrial technologies during the periods from the 1950s to early 1960s, at the end of the 1960s, at the end of the 1970s, and from the 1980s to the 1990s. As for the method of technology introduction, during the periods of the first three waves the technologies were introduced by importing complete plants (on the "turn-key" basis). However, it became increasingly difficult to digest and develop the imported technologies locally as they became more sophisticated. Therefore, in the latest stage (wave), China chose direct investment by multinational enterprises. However, they are still continuing their efforts to develop those technologies locally.

## 5. "Residue" of Former Development Stage

The six types of "residue" of Item B22 shown in Table 1 were selected as examples of study items were selected on the basis of China's experience. The importance of each of them cannot be accurately identified; however, it is certain that these exist in Viet Nam, also. The "residue" works to expand the gap discussed in the previous section (though this was not discussed in that section). However, the "residue" is also an independent element that works directly to delay the improvement of business performance.

Although related to the systems at the stage of planned economy, among the six items, the four items of "Line-ministry's ownership system," "unitism (*dan wei*)," "forced donation" and "Inseparable condition of business and society" are basically arisen from customary economy and customary politics elements at the stages that precede planned economy (the discussion on these is omitted in the model of development stages in this report). Next, the "soft budget constraint" is a remnant of subsidies, basic investment and bank credit provided to enterprises under generous conditions through government finance during the period of planned economy. In that period, the inter-sectoral allocation of capital goods based on a physics mobilization plan became the main motive force for capital accumulation. Because of that, state enterprises made it their most important task to maximize the total value of their production and comply with the instructions on the distribution of the products. Fiscal and financial policies supported this flow of capital accumulation money-wise. "Soft budget constraint" became an element to prevent the growth of enterprises only after the time for market transition came and the main motive force of capital accumulation shifted to decisions in the fiscal and financial fields.

Likewise, it was after the market economy-oriented reform was made that monopoly, privileges, and corruption began to work conspicuously as elements impairing the growth of enterprises. (The planned economy authorities had predilections for the characters of "indivisibility of investments," "economies of scale," and "increasing returns" which are in the background of the monopoly and privileges; however, they did not try to set monopolistic prices on the basis of these technical characteristics to maximize the enterprise own profits. Also, in the planned economy, non-monetary incentives were more effective, and the kind of corruptive practice to pursue personal profits or shares of non-productive rents did not catch on.)

It is difficult to quantitatively determine the negative impact of "residue" on enterprises' performance. With respect to "inseparation of business and society," however, it is becoming a general practice among enterprises that they retain all of the excess workers produced structurally in economy within their organizations as "employed jobless people" ("superfluous manpower"), or assume the entire amounts of the unemployment insurance and old-age pension premiums. The amounts of money borne by enterprises when they do this, and the extent of the impact of these on the enterprises' financial losses should be calculable. However, actual numbers are obtained only in the case of China for 1994.

In China (1994), the size of excess manpower retained by enterprises, for which society should normally assume responsibility, was no less than 1/3 of the current employees of state-run industrial enterprises, and the number of people for whom the enterprises were paying for their retirement pensions also was 1/3 of the current employees. The sum of only these two burdens borne by enterprises reached 120,000-150,000 million yuan. This amount is large enough to be compared with the country's annual financial loss of that year, 48,300 million yuan, or the amount of profits plus tax income, 287,600 million yuan. In other words, the social burden of "excess labor," which we have examined as one of the initial conditions, is transferred, through the medium of this "residue," to the business in the form of expanded net loss after going through the "non-operating expenditure"

category.

## 6. General Roles of Economic Policy

The remaining major factors that determine the performance of state enterprises are the government's economic policies in general (B3-1, Table 1). Let us consider "macroeconomic policy," "fiscal-financial policy," "trade policy," "foreign capital introduction policy," and "industrial-technological policy," which are believed to be closely connected with enterprise performance.

Importance of macroeconomic policy is stressed in recent policy discussions among international financial institutions. It is that macroeconomic stability is a precondition for the success of all sorts of market economy-oriented reforms. However, the success of the stabilization policy followed in Viet Nam since 1989 is not because the government used effectively the orthodox instruments of macroeconomic policy, it is believed to be the result of the strict reduction of subsidies and tightening of bank credit, which were done at the expense of state enterprises, on the one hand, and the increase of profit contributions and tax burdens, on the other. Such an observation runs counter to the trend of "soft budget constraint" which was previously discussed as one of the "residues." In fact, on this matter we are troubled by the many conflicting pieces of information and observations on their bases. The truth of the matter seems to be that the trend of "soft budget constraint" was predominant in large enterprises, while for the smaller enterprises, serious cash shortages occurred because the competent government agencies stopped supporting smaller enterprises since the fiscal-financial crisis occurred at the end of the 1980s when the former Soviet Union discontinued its aid to Viet Nam.

The background of the strict control of macroeconomy in Viet Nam includes the basically low savings rates of the people, instability of international current account, and the large amounts of the dollar and gold distributing and hoarding in the country, in addition to the temporary crises such as the one in the late 1980s.

The significance of fiscal-financial policy lies in the fact that those policies prevent or even impair the efforts to improve the poor financial health of (mainly) large enterprises, as far as their direct impact is concerned. The poor financial health of enterprises resulted from the lax way the government had been spending public funds, as reflected in the "soft budget constraint" earlier discussed, on the one hand, and the lack of financial discipline in enterprises because they continued to rely on financial help from the competent government agencies which they used to enjoy during the period of planned economy, on the other. An additional cause is that enterprises do not pay bonuses when they earn profits, and are not punished when they perform poorly. A vicious circle is to be seen where recurring losses appear as a result of the poor financial health, and when deficits accumulate and result in huge amounts of outstanding liabilities, the amount of interest payable grows enormously, and that makes the financial health even worse. This cumulative debt obligation was reduced to a significant extent since the Re-registration System was put into practice in 1991 and the inferior enterprises were weeded out, but apparently it is going to increase again because the financial health still remains weak.

To improve the poor financial health it is necessary, for example, to freeze the existing accumulated debts and, if possible, expend public funds to dispose of them; if an enterprise makes a fresh start, to have a state-run commercial bank to monitor its business management through the medium of bank loans; and revise the Commercial Bank Law to that end, and at the same time strengthen personnel training at banks. However, none of these measures have been taken.

The foreign trade policy, foreign investment introduction policy and industrial-technological policy have bearings on the growth of enterprises in a different way than in usual cases. It has become necessary to implement these policies to provide emergency support to the many state enterprises in Viet Nam to help them overcome the crisis of survival now facing them because of the "year-2006"

issue.

The “issue of year 2006” relates to an international obligation which Viet Nam has assumed as a result of its participation in the ASEAN Free Trade Area (AFTA). In Viet Nam essentially all manufacturing industries which must take off have to get started industrialization by the year 2006 at the latest under such severe trade liberalization conditions as “no non-tariff barriers” and “5% or less import duties for all product items,” without having enough time to go through the processes of “import-substituting industrialization” or “export promoting industrialization,” as earlier-coming developing countries (such as Korea and Thailand,) have done in the past. Both WTO and APEC, which Viet Nam has applied to affiliate with, also are trying to have Viet Nam liberalize its trade, though under less stringent conditions.

Trade liberalization has the aspect of introducing international competition to promote marketization of economic systems, and also provide a precious opportunity to expand access to world markets. However, the problem with it for a late-starting developing nation is that it may have to pay an extremely high price for those benefits.

A detailed study of the “year-2006 issue” in that sense and the issues of trade, investment, and industrial policies that arise from it, and research of policy options are the topics covered in Part 1 and, partly, Chapter 3 of Part 2. To summarize the issue identified in those studies, the issue of trade policy is the question of how Viet Nam can skillfully utilize the opportunity of a very short duration allowed for import substitution and export promotion, and thereby develop a foreign trade system centered on export of industrial products that are based on Vietnamese comparative advantage. The study period will extend to 2006 for the medium term, and to around 2020 for the long term. The issue regarding industrial-technological policy is to write a feasible medium-to-long range scenario for the development of an industrial structure to provide that policy with land-marks. For foreign investment inducement policy, it is necessary to identify roles to be placed to introduce foreign technologies which are indispensable for the development of such trade and industrial policies, and formulate medium- and long-range programs for that purpose.

This kind of approach to policy issues is based on the objective of sound development of Viet Nam's industry and foreign trade. It is not very difficult to shift the aim and take that approach on the basis of sound development of Viet Nam's state enterprises (or of the multi-sector economy built around those enterprises, as the New Five-year Plan says). The issue as regards Vietnamese enterprises in dealing with the “year-2006 issue” resulting from such a shift can be described as follows: “To assist major enterprises in selected industries to grow, progressively, to become enterprises, by 2006, that have a proper legal form and management substance as modern incorporated enterprises (limited liability stock companies, limited companies) and also have adequate strength and competitiveness in all aspects of production capacity, technology, business management, and finance. Such an objective must be attained in a way that fulfills necessary conditions for a successful start of industrialization and modernization by 2006 and for the country's participation in AFTA's trade liberalization plan.”

## **IV. Policy Issues and Policy Options**

Although the above research on the actual results of state enterprises' activities and the determining factors is based on a comprehensive framework and careful methodological preparations, its discovery of principal determining factors is empirical and intuitive, and the study did not precisely verify the cause-and-effect relationships between the determining factors and results. In many cases, the study of the cause-and-effect relationships are possible only qualitatively. What is more, the studies of the mutual relationships between many determining factors are even more immature.

The research is thus interim in nature; however, it is currently possible to identify several policy issues that are urgent and important for the reform of Viet Nam's state enterprises and show the direction of policy options for each of them. In the following subsections, the research discussed in the preceding section is summarized in the form of listing the major policy issues, with additional comments made on policy options for each such issue.

① Because of the need to internationalize the Vietnamese economy or the promises made for that reason, the legal reordering of Vietnamese state-owned enterprises is a high-priority issue, and thus must be done without fail and as quickly as possible.

Legal reordering means the introduction of the principle of separating ownership of the enterprise from its management, or corporate governance, and fair treatment of foreign investing enterprises in laws related to foreign investment, and granting of incentives to attract those enterprises to Viet Nam. In the case of enterprises that are in the "autonomy strengthening stage" of corporate development, stricter enforcement of the "State Enterprises Law" (1995) is required internationally. Its content includes the following three points:

(1) The organization and management of state enterprises should strictly adhere to the principle of corporate governance, and in this connection, the categorization of state-owned enterprises into the "profit-oriented type" and the "public utility-oriented type" should be expedited.

(2) Laws should be revised promptly to allow enterprises in the private sector to compete with state enterprises on equal terms.

(3) Privatization of state enterprises through equitization, and then public offering of their stocks, must be promoted (by a temporary statutory measure).

② If it is likely that a gap will develop between the modern corporation system introduced and reality because the system is advanced, but if the extent of that gap is not significantly large, then the action to promote system modernization which the gap may bring about must be fully utilized. However, if the gap is large enough to impair the growth of the enterprise, a measure must be taken to offset such action.

Examples of systems to be fully utilized include the laws that make accounting, auditing, and disclosure of corporate information obligatory. In cases where the gap exerts negative effects, consideration should be given, in most of the state enterprises, to measures to effectively strengthen the management (autonomous) right. It is especially important to study quickly the introduction of performance contracts between the government and state enterprises, referring to the "management responsibility contract system" which played the central role as a measure to strengthen management's autonomous right in China since the 1980s. (World Bank, *Bureaucrats in Business: The Economics and Politics of Government Ownership*, 1995. An evaluation of the subcontracting system in China appears on Page 131.)

③ Lack of manpower and organizational capabilities is among the elements to cause a gap that brings about negative effects. An organized approach will be required to alleviate these effects.

Personnel training for employees should be conducted in an organized fashion as soon as possible at each of the top, middle and lower levels of management, as well as for rank and file employees and thereby have them become familiar with jobs and labor practices in an environment of market competition and acquire the necessary knowledge and skills. It takes more than enthusiasm and sincere attitude toward work to create a competitive enterprise. Efforts to improve those manpower capabilities must be made concurrently with work to devise employment and wage systems that will motivate each individual and let them emulate with one another. In the management organization reform, it will be desirable to newly establish or expand departments



that handle such functions as marketing, product planning, R&D, and strategic accounting which were not considered important to enterprises operating in a planned economy.

The development of manpower and organizational capabilities is at the same time an issue of systematic networking and reform of curriculums to go with it in school education, especially at universities, professional schools, and technical schools.

④ When a developing country is going through the process of industrialization, the introduction of industrial technologies at advanced levels, which is especially important in solving the problem of gaps at the equitization stage, must be done at the government's initiative.

We did not take up research on this issue in Viet Nam as a topic. However, it is a fact that many countries in East Asia have done it as a government project. Viet Nam must try to learn from it.

⑤ The issue of "residue" from previous stages that is generated in an incomplete stage-to-stage transition in the development of a market economy is a serious impeding element for the development of a state enterprise whose character can be clarified only by our "approach residue" of promoting the development of a market economy."

The ultimate means to remove much of the refuse is the Vietnamese government's political decision. If it takes time for that to be reached, some means has to be devised which works, if only in an indirect way, to cancel out that effect.

⑥ The phenomenon that financial deficits of state enterprises increase and their bad debts to banks accumulate is connected in a complex way with the "residue" element and gap element which are closely related to the severity of initial conditions. However, can we say that once such elements have been brought under control, there are no elements ascribable only to the financial acts of enterprises or to actions that the fiscal and financial authorities take in connection with those acts of enterprises?

The conclusion of our investigation is that such elements do exist, and it is proposed, on the basis of that finding, that the financial discipline at state enterprises be strengthened (by means, for example, of introducing incentive and punishment systems against the backdrop of reformed wage, employment and personnel systems), and that banks' financing agency function be strengthened, so that the management and financial performance of enterprises can be improved. The fiscal and financial subcommittee even considered proposing contracting of the work of monitoring the management of state enterprises to foreign banks.

⑦ The international pledge concerning trade liberalization in fact is causing another "gap issue" to emerge. Here, the central issue is how best to utilize elements brought about by trade liberalization that are helpful to the reform of state enterprises, and at the same time overcome the "crisis of survival" for state enterprises resulting from those elements by means of trade policy, industrial policy, and foreign investment introduction policy. Policy options were considered in Part I.

To offer a final comment, the development of state enterprises is a part of the development of the kind of multi-sector economy sought in the new "Five-year Plan." "Multi-sector" means the five sectors consisting of "state economy," "group economy," "state capitalism" (a form of cooperation among various types of joint ventures and "state economy," domestic private capitalists or foreign capitalists), "individual and small proprietors economy," and "private capital economy." We were not able this time to make a full-scale research on the development of a "multi-sector economy" in Viet Nam; however, we believe that time has come to make studies on the subject in earnest, now that internationalization is in progress.

Table 1 Research Items of the Study on the Performance of State Enterprises and Their Determining Factors

<b>A. Enterprise Performances</b>	
1. Performance indicators of the short period	<ul style="list-style-type: none"> <li>a. Production, Productivity and their growth (Growth Capacity)</li> <li>b. Sales, exports and their growth (Growth Capacity)</li> <li>c. Operation Profit ratio, Management profit ratio (Profitability)</li> </ul>
2. Performance indicators from a long-term perspective (Enterprises' physical strength and competitiveness)	<ul style="list-style-type: none"> <li>a. Liabilities (or Capital) / Total Assets Ratio; arrears and bad debt (financial health)</li> <li>b. Management capability, Enterprise organization / Operational machines/ labor relations</li> <li>c. Condition of production facilities / technological capacity</li> <li>d. Competitiveness of products inside and outside of Viet Nam (price, quality, etc.)</li> </ul>
<b>B. Major determinants of performance</b>	
1. Initial conditions	
1-1 General initial conditions	<ul style="list-style-type: none"> <li>a. Per capita income, saving rate</li> <li>b. Factor Endowments</li> <li>c. Degree of industrialization and agricultural development</li> <li>d. Degree of market development</li> </ul> <p>Degree of retrograde in planning and dirigisme Financial and monetary system Labor market (including managers' market) Product market (whether there is all-round product markets and the extant of their functioning)</p>
1-2 Initial conditions of enterprises / state enterprises	<ul style="list-style-type: none"> <li>a. State enterprises (except B2 and B4)</li> <li>b. Foreign enterprises</li> <li>c. Private enterprises</li> <li>d. Family enterprises</li> </ul>
2. The state enterprises' development stage and the related factors	
2-1 Stage-wise development and its characteristics	<ul style="list-style-type: none"> <li>a. A common model of development stages</li> <li>b. Legal and institutional characteristics of each development stage</li> <li>c. Specification of the current development stage</li> </ul>
2-2 Those unfavorable factors which are produced from the factors of the past development stages and which are in operation presently: <i>residue</i>	<ul style="list-style-type: none"> <li>a. "Line-ministry's ownership system"</li> <li>b. "Tan wei" (a village community like social unit)</li> <li>c. "Tan Pai" (Forced donation)</li> <li>d. Inseparable condition of enterprises and society</li> <li>e. "Soft budget constraints"</li> <li>f. Monopoly, privileges, moral hazards, rent - seeking and corruption</li> </ul>

2-3 The gap between the institutional model  
and the reality in the current  
development stage

3. Government economic policy

3-1 General policies

- a. Macroeconomic policy
- b. Technological innovation policy
- c. Industrial policy
- d. Labor incentive policy
- e. Financial / monetary system policy
- f. Price / marketing policy
- g. Enterprise reform (including competition promotion / monopoly prohibition policy)
- h. External economic policy (issues such as the invitation of foreign capital / participation to AFTA and WTO)

3-2 State enterprise reform

3-2-1 Incentives

-Internal

-Initiatives from government

-External pressures

3-2-2 Legal and institutional reform

3-2-3 Accumulation of capital, production  
technology and human capital

3-2-4 Differential enterprise promotion

policy with priorities put on specific  
enterprises and enterprise groups

3-2-5 Others

- a. Initiatives arising from managerial side
- b. Initiatives arising from enterprise owners (the subject of monitoring)
- c. Initiatives arising from creditor banks

As policy-making bodies and bilateral donors

Demands from international institutions and bilateral donors

4. Managerial factors within state enterprises

- a. Manager's talent / ability and skill
- b. Management organization
- c. Management control
- d. Management resources

C. Policy options

Note: Items here must be indicated correspondingly with each item of performances under A and of the major determinants under B.



# **The SOEs Reform Policies in Viet Nam and Their Implementation Performance**

—JICA-CIEM Project: “ Study of SOEs Reform in Viet Nam” —

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## **1 . Introduction**

The SOEs reforms in Viet Nam have been initiated since 1986 and are regarded as one of the key issues of the economic reforms. The SOEs reforms have experienced a number of periods marked by diversified measures and reform orientations. At the present, the SOEs are proven to play an important role in the country's economy. However, further reform of the SOEs, toward enhancing their efficiency and applying appropriate measures for implementing policy, is found to be of central interest in Viet Nam.

This research is undertaken in partial fulfillment of the study program (sub-topic 2 of the topic No. 4) designated for SOEs reform in Viet Nam. The research aims at providing a better understanding and detailed analysis of the main contents of the SOEs reform policies and their related measures undertaken during the process of economic renovation, with particular focus made on enhancing the autonomy of SOEs, the rearrangement and reorganization of SOEs and national corporations, financial aspects, and the equitization of SOEs. At the same time, it is intended to determine the results achieved, as well as unfulfilled issues and new problems arising from the process of application and implementation of these policies and measures.

The study is placed within the scope of the following issues:

- 1) Strengthening autonomy of the SOEs, and step-by-step eliminating the direct supervision by the state over the SOEs' business operations.
- 2) Rearrangement and reorganization of the SOEs.
- 3) Organization and management mechanism of the general corporations.
- 4) Financial management of the SOEs.
- 5) Equitization of the SOEs.
- 6) Stages of SOEs reform in Viet Nam

## **II . Strengthening the Autonomy of the SOEs, and Step-by-step Eliminating the Direct Supervision by the State over the SOEs Business Operations**

### **1. Enhancing SOEs Autonomy**

Since 1986, Viet Nam has embarked on a comprehensive economic reform aimed at building a multi-sectoral commodity economy operating under the market mechanism and state management with socialist orientation, in which SOEs reform is identified as one of the key aspects. Decision No.217/HDBT, dated 14 November 1987, was the first legislation issued by the Government to enforce policies on moving the SOEs to a regime of business self-accounting and autonomy. This Decision has been marked as a turning point with revolutionary breakthrough features in an attempt to abolish the central planning and subsidizing mechanism, as well as to reaffirm initial success in management improvement as a result of the implementation of Government decisions promulgated before 1987. After the promulgation of Decision No. 217/HDBT, several other policy measures have been undertaken by the Vietnamese Government to further improve the management mechanism targeting enhancement of the SOEs autonomy. They are:

#### **(1) With Respect to Planning**

The new mechanism provides that the SOEs now are fully autonomous in preparing their long-term, mid-term, and short-term production and business plans; determining under their own consideration input and output schedules, based on the demand and supply principle; self-financing; self-development; and fulfilling financial obligations to the state budget. The system of directed plan targets previously applied to the SOEs dwindled to 1-3, and today the State has abandoned the system of directed targets and only maintained some to a balance rate necessary for the circulation of some particularly important goods to the national economy (such as petroleum, gasoline, fertilizer, electricity, . . .), and of some other goods produced under debt agreements and in response to national reserve requirements.

Together with the abolition of the two-tier price policy, the change to a single-price policy leading to floating prices of almost all goods and materials, and abandonment of the price subsidies, the planned allocation of production inputs and materials has been changed by the State to a market allocation system. The distribution of products under centralized planning predetermined by the State recipients has been replaced with the mechanism under which the enterprises themselves determine how much of the inputs and at what price they need. After the abolition of the system of directed plan targets, most of the products are priced by the enterprises themselves based on a balance between production costs and supply-demand relations within the markets. The State's role is at present limited to fixing ceiling prices for a some essential goods, such as paddy and rice prices, charges from posts and telecommunications, transportation of rice and fertilizer from the North to the South, electricity, petroleum, gasoline, cement and paper. Some other products or services are still provided with price subsidies from the State to implement social policies.

Since 1988, on one hand, the allocation of capital to SOEs from the state budget has been under a gradual cut to shift to credit loans. On the other hand, the state's direct collection of corporate revenues from SOEs has been replaced with tax payments as applied to other economic sectors. In April 1989, the Council of Ministers decided to implement a system of lending interest rates uniquely applicable to all economic sectors which may be adjusted to the fluctuation of the market prices. By June 1992, the State Bank of Viet Nam also made dramatic adjustments of the interest policy to secure a positive

interest rate (i.e. banking credit interest rates are in no case lower than savings interest rates), leveling the interest rates which were previously applied to different economic sectors and types of enterprises on a discriminatory basis. This serves as a fundamental improvement toward the orientation of liberalization of interest rates and capital prices and establishing a much expected equality between SOEs and other enterprises.

In this period, economic relations have been formed and maintained to ensure the autonomous rights of the enterprises in their business and production activities, and to protect of their legitimate rights and obligations and fulfillment of the obligations by the parties concerned in economic relations. In September 1989 and October 1990, the State issued the Ordinance on Economic Contracts and Ordinance on Economic Arbitration, respectively, to ensure appropriate implementation of economic contracts, as well as order and discipline in the enforcement of economic laws and regulations.

## **(2) With Respect to Hiring by Piece Work and Leasing Systems**

At this time, despite a lack of overall generalization and comprehensive assessment of the issue, and a shortage of preliminary information collected from Ministries, branches and localities concerned, the practice and results of introduction of both piece work and leasing in a number of specific sectors may be outlined as follows:

### **1) In agriculture**

Up to now, approximately 70% of the total SOEs operating in our agricultural sector have made a package assignment of husbandry, growing and harvesting crops and breeding products to their individual households. The assigned households are committed to be self-responsible for capital mobilization or borrowing from either enterprises or banks to invest in their own production activities. After each production cycle, each of these households or individuals are required to make payments to the enterprises in the form of tax on the use of agricultural land, social security contributions, depreciation, administrative costs and principal and interest thereof under loan agreements (if any). In addition, agricultural enterprises also hold bidding for plantation cultivation and aqua-cultural breeding. Successful bidders must be the most experienced and financially capable people, who are awarded management of a considerably large area of gardens and water surface for aqua-cultural breeding, as well as laborers working in this area. Enterprises are, in their turn, liable to assist (e.g., by providing credit) the contractor with mobilizing a sufficient amount of capital, supervising and making prompt and appropriate adjustment of any unreasonability in the relationship between the contractor and his/her employees.

### **2) In motor- and water -way transport**

Since 1988, various forms of piece work have been introduced to a number of transport enterprises, which have dramatically expanded to almost all motor transport enterprises by 1994. Diversified forms of piece-work currently applied in transport include those made on the basis of fuel consumption, individual shipment, combination between piecework and bidding, business and production results, and repair and replacements of spare parts. It is worthy to note that piece work applied in transportation is normally assigned with each driver being requested to make a deposit as collateral for his motor vehicle, and to pay from his own pocket for any subsequent repair of the vehicle. By 1995, the total deposits made by drivers to the motor transport SOEs owned by the central Government have amounted to VND 23,654 mill.

Meanwhile, leasing is found to be mainly introduced in water-way transport in the form of wet-lease (i.e. leasing of both means of transport and technicians to operated them). According to a recent report

released by the Ministry of Transport and Communication, incomes from such a form of leasing accounted for roughly 5% of the total turnover of the entire industry.

### **3) In trade**

In accordance with the report submitted by the Ministry of Trade, most SOEs engaging in commercial activities are applying piecework based mechanisms of various forms with reference to turnover, operating costs, profits, wages, etc., or a combination between bidding and piece work. Together with the introduction of such a scheme, leasing of assets and other business facilities such as shops, warehouses, and number of processing establishments are also exploited. Recently, the hiring of management companies has become popular in the areas of hotels, tourism and service businesses.

The introduction of piecework and leasing mechanisms over the past period has made certain positive effects in assisting SOEs to overcome numerous hardships in the transitional period, and at the same time, helped to maintain the State's ownership over the assets. Many enterprises applying piece work-based mechanisms have managed to maintain a relatively high growth rate and to improve their service quality. As a result, employees have enjoyed better and more stable earnings compared with those in the past. However, results from the piece work survey revealed that a considerably large number of enterprises in this sector "totally entrust" or "lease out for tax collection" their assets, i.e., the management abandons its supervisory responsibility or loosens its administrative function over operations which have been causing serious losses to State property and capital. The fact reveals that there is an urgent need to carry out a study, review practices, and draw from that necessary lessons and the basis of what to issue specific regulations governing piece work and leasing activities, as well as to determine the rights and obligations of each party in such transactions in conformity with specific types of mechanisms to ensure state control over the objectives of the enterprises, management efficiency, improvement of business and production results, that would allow an increase of employees' incomes, and the preservation and development of the state's capital in SOEs.

### **(3) With Respect to the Recruitment of Laborers and Personnel**

After the issue of Decision No. 217-HDBT, an important step taken in this area was the abolition of the unreasonable, direct, intervention by higher authorities over enterprises either in terms of labor planning, number of employees, or locality for recruitment. The lifetime recruitment of laborers to the permanent State staff has been replaced with labor contracts. Directors, as the representatives of enterprises, are authorized to take appropriate forms, methods, and measures to organize and manage their employees, including selection and recruitment, appointment, skill training and retraining, agreeing on payment and bonuses, or enforcing discipline (not excluding dismissal and termination of the contracts), according to the Labor Code. The enterprise's obligations and responsibilities to its employees are based on the provisions stipulated in the labor contracts and the labor collective agreement. This helps to create favorable conditions for the SOEs in establishing their relations with the laborers in response to various requirements of the market mechanism and their actual demands and capabilities. At the same time, this has brought about positive effects to labor management, tightened working discipline, and increased the labor productivity in the SOEs.

### **(4) With Respect to Wages**

At the initial stage, the State has taken control only over minimum wages and does not limit maximum incomes. The employees are paid based on their productivity, business results, and efficiency of the enterprise. After some period of policy implementation, the practices have indicated that there are considerably large discrepancies in the income distribution between enterprises of the



same commodity sector, between branches and regions, and particularly between monopolistic enterprises and ones who function in competitive conditions. Therefore, since March 1997, the State has specified the ceiling wage level that gives the basis for the enterprises to calculate their unit wage costs and restricts average wages in monopolistic enterprises. For them, the State has also determined the wage unit cost. The SOEs may take initiatives in selecting appropriate forms of payment, specific wage amounts, and bonuses to their employees. The State has been making gradual cuts and abandoning most subsidies to laborers, such as price, housing, travel, subsidies, medical insurance, retirement benefits, training costs, etc., which are presently provided by enterprises to the extent their capabilities and budgets allow.

#### **(5) With Respect to Imports and Exports**

Enterprises are encouraged to promote their export production and processing activities, provided that several conditions are satisfied before the enterprises may engage in direct import and export activities. The conditions include: sufficient quantity and stable supply of export products, and number of qualified staff having sufficient experience in import and export transactions. Export processing enterprises are allowed direct access to the international markets; to borrow, buy, or sell foreign currencies in commercial banks; to call for shareholding capitals, to obtain foreign loans for their production of export goods according to principle of self-responsibility, self-financing and fulfillment of financial obligations to the state budget. The State has reduced the scope of export activities in quotas and assigned the licensing per shipment to local authorities and branches concerned. Measures undertaken in combination with the abolition of foreign currency concentration, liberalization of exchange rates, and adjustment of the exchange rates between VND and USD, have paved the way and offered the SOEs a golden opportunity to increase their imports and exports, and enhance the competitive edges of Vietnamese goods and products in international markets. However, the conditions required for getting export and import licenses can be considered as barriers to small and medium enterprises entering the export and import market and as restrictions on the competition among domestic enterprises.

#### **(6) With Respect to Economic Cooperation and Establishment of Joint Ventures**

Expanded rights have been granted to SOEs for making capital contributions with, or mobilizing capital from, other domestic economic sectors and foreign companies to improve business and production performance. Joint venture enterprises can be set up on the basis of voluntary capital contributions between economic units and operate on the principle of autonomy in accordance with the laws of Viet Nam. The SOEs are also entitled to call for additional capital from the private sector with a fixed duration of repayment that may be agreed upon in the contract by the capital contributors and the directors of the enterprises. The SOEs for their part, are obliged to repay both the principal and interests of the contributed capital amount under the terms and conditions of the signed contracts.

The enterprises have the right to take initiatives to enter into economic cooperative relationships with business and production establishments or with scientific and research institutions. These economic relations may take various forms depending on the actual production and business needs of the participants. For example, association of manufacturers and distributors, product grouping, group of satellites, industrial or regional council of manufacturers, union of exporters, . . . The members of such economic groupings must be legal entities, and it is provided that their juridical person status and autonomous rights will not be affected, and their obligations to the State or other contractual liabilities will not be exempted or reduced.

## 2. Gradually Eliminating the Direct State Supervision over SOEs Operations through the Ministries Concerned, and Decentralization of Execution of State Ownership of SOEs

The strengthening of the autonomous rights of SOEs will necessarily reduce administrative intervention by the relevant state bodies into the SOEs' operations. Decree No.196/HDBT (dated 11 December 1989) and Decree No.15/CP (dated 2 March 1993) have re-determined the functions, powers and responsibilities of the ministries in their performance of state management over economic activities. According to the provisions of these Decrees, the managerial functions of the ministries are reduced to only 4 areas, namely: making decisions on establishment, separation, merger and dissolution of the SOEs; assignment of the rights to use capital and assets to SOEs; appointment of directors and vice-directors of the enterprises; and supervision of the business and production activities of the enterprises.

The Law on SOEs (1995) has been regarded as very important evidence of the efforts made towards enhancing the SOEs' autonomy in doing business, as well as increasing control necessary to ensure the rights of the State as an owner of the enterprises.

The Law on SOEs has not only reconfirmed the autonomous rights designated to SOEs in the current legislation, but has also created additional incentives to the enterprises; specifically, profit-oriented enterprises today have rights in the use of and management over capital, land, natural, and other resources designated to them by the State; also, they have rights of transfer, rent, collateral, or mortgage of the assets under their management (except those which require special permits from relevant competent government agencies). According to Article 6, 7, 8 of the Law on SOEs, the SOEs have rights in making decisions about determining the size and profile of their business; on entering joint ventures and other forms of economic cooperation and/or contributing their share to other business establishments in accordance with law provisions; they are fully autonomous in determining management structure, business organization, technological innovation and improvement; and in capital mobilization, provided that this does not cause any change in ownership; SOEs are entitled to issue security bonds. Meanwhile, in order to reduce supply or contribution by individuals, organizations, or agencies, of capital and other assets which would negatively affect performance of the SOEs, the SOEs are entitled to make a claim to and/or reject requirements by any individual, agency or organization to supply goods and services beyond their duties.

Non-profit SOEs can enjoy more limited rights and responsibilities compared with profit-oriented ones. Particularly, non-profit SOEs have rights to transferring, renting, giving collateral or mortgage of the assets assigned to them by the State; furthermore they are entitled to invest, call for an additional investment, participate in joint ventures, and economic cooperation contracts, if this is authorized by the relevant competent agencies; also, the enterprises are obliged to use efficiently the capital and assets assigned to them by the State in order to supply goods and services to the recipients with the price charge, or fee determined by the State.

In order to enhance the SOEs' autonomy, gradually eliminate the State's direct intervention in the enterprises' business operations, and maintain an efficient control of the State as an owner over their functions, the Law on SOEs has clearly specified various functions of the Government, ministries, and provincial People's Committees as the representatives of the owner and as state governance bodies in respect to SOEs. The owner's rights are either directly exercised by the central Government or delegated to the ministries, provincial People's Committees, or the enterprises' Board of Directors. The rights of the State as an owner include decisions on a variety of important issues such as: determination of an enterprise's category (profit-oriented or non-profit); development strategy and long-term development plan; changes in objectives or legal status of the SOEs, such as establishment, merger, separation, reorganization, dissolution or change of ownership; appointment, dismissal, reward or

punishment of the SOEs' personnel, in particular of the management staff; decisions on financing, assigning the State's capital, investing, entering into economic cooperation contracts, expanding/limiting capital contribution amounts, major assets transferring if this affects the enterprises' production process; approval of plans for capital mobilization or capital contribution; joint-venture major management standards and norms; after-tax income distribution and investment plan; control and supervision activities to be undertaken in order to attain determined objectives and to fulfill obligations assigned to SOEs by the State.

Since 1995, the Ministry of Finance has been authorized to be responsible for management of the state-owned capital and assets in SOEs, in order to attain the goal of decentralization. The financial departments in line ministries nowadays execute state governance functions instead. The system of the state bodies being responsible for management of state-owned capital and assets in central and local enterprises has been set up to maintain and strengthen a uniform control over the properties. Establishment of national corporations independent from the Ministries or branches aims at a gradual elimination of direct state direct intervention into the SOEs' operational activities, which previously had been widely practiced via line ministries and other administrative bodies.

The abolition of the direct state supervision by the relevant ministries is not only a must, but also request of the times. It is important to note, however, that this aims only to eliminate unreasonable administrative intervention by the State into the SOEs' operations, to enhance the autonomous rights of the enterprises, and at the same time strengthen the protection of State rights as owner of wholly SOEs or state-owned shares in joint-venture enterprises.

### **3. Problems and Shortcomings Arising in SOEs Reform Aiming at Enhancement of the Enterprises' Autonomy and Eliminating Direct State Supervision of their Operations**

On one hand, enhanced autonomy of SOEs may lead to an increase of the enterprises' initiatives and stimuli to labors, but on the other hand, this may cause a decline in State control over the enterprises' activities, especially in control over production, management, and other operational costs, which in turn may lead to a misuse of the rights by the enterprises in order to unreasonably increase their production costs, causing a loss to the State. Furthermore, a shift from the former centralized financial regime, where enterprises' balance sheets were approved directly by the State, to implementation of new a accounting and auditing system has not yet helped to end the problem, because of low capacity and inefficiency within the accounting and auditing bodies themselves. A lack of sufficient theoretical background for the concept of maintenance and development of State-owned capital and assets also adds to the issue: duties and responsibilities of enterprises (themselves and their directors) have been not clearly specified. Moreover, involvement of too many government bodies (such as financial department, tax agency, police, inspection and control agencies, . . .) into supervision of the enterprises' financial activities actually leads to significant restriction of the enterprises' autonomy.

Although, theoretically, the SOEs today are given larger autonomy in various areas such as employment contracts, labor recruitment, wages and bonuses, in fact the enterprises are still facing a number of constraints and pressures: unemployment, the problem of laid-off workers, and other social welfare distribution issues, which has made it difficult for them to fire inefficient employees or to pay higher wages to the enterprises' workers and staff. Also, the autonomy given allows the different pay-off rates implemented in the SOEs of different ministries or branches having either a monopoly or comparative advantages. An efficient solution to the inequality problem caused by this has not yet been found by the State.

The enhanced autonomy presently obtained by SOEs has been not accompanied by State obligations in respect to SOEs that would ensure fair and equal "rules of the game" for the SOEs, functioning,

especially in obtaining necessary capital resources. Presently, SOEs in Viet Nam generally have a big shortage of capital investment, and what is more important, the ratio of capital allocated by the State is different from one enterprise to another, which finally leads to dissimilar performance among the SOEs. In the SOEs' performance assessment, however, this practice has often been neglected. As a consequence, this causes negative effects on the SOEs, with disadvantages in obtaining State support.

In realization of the policy on gradual elimination of direct supervision by the State over the SOEs' business operation, several general corporations have been established under Decision 91-TTg, which is supposed to be free administratively from direct supervision of the respective line ministries or provincial People's Committees, and directly accountable to the Central Government. Operationally, however, these corporations still have a great need for guidance, support, and consultancy from line and functional ministries. Therefore, they usually keep in direct contact with the ministries and government agencies; this, in turn, leads to creation of some new "focus points" and a complicated administrative relationship. At the present, this to a unique style of management is regarded to be the corporations request of time in order to simplify administrative procedures and to help the central government in monitoring and evaluating business activities of the corporations. However, a workable solution to the problem has still not been found yet.

One of the main contents of the policy on enhancing SOEs' autonomy as stipulated in the Law on SOEs is the right of SOEs to voluntarily join general corporations. But in reality, the SOEs are usually integrated by the State into members of corporations, i.e., administratively accountable to and directly regulated by corporations in terms of capital allocations, planning, marketing, and other issues. To a certain extent, this leads to some restrictions in the autonomy of the member-enterprises. What is more, the existing regulations on general corporation have not yet opened an opportunity for the member enterprises' economic cooperation through mutual direct investment forms that would significantly increase their real production capacity.

Theoretical definition and practical distinction between the rights of SOEs as economic legal entities and the rights of the State as an owner, as well as appropriate delegation of the rights to concerned organizations and agencies is considered to be the most important issue arising in implementation of the policy on enhancing the SOEs' autonomy and abolishing the barriers created by the former direct supervision regime. Although today many debates and discussions have been held about the question, a satisfying answer is still not found in practice. For example, some rights of the State as an owner have been stipulated in the Law on SOEs, but execution of the provisions usually encounters a number of difficulties, especially in an attempt to decentralize these rights and to abolish contradictions between the two objectives: (i) to reduce centralism of the current management system in order to gradually eliminate the State's direct intervention into business operation of the enterprises and, (ii) to overcome the consequences of dispersal of operational management functions in the line and functional ministries. One of the most critical problems arising after concentration to the Ministry of Finance of the functions of management over the SOEs' capital and assets is the need for coordination of activities between the line ministries/provincial People's Committees and the Ministry of Finance.

Another significant barrier to elimination of the State's direct supervision and enhancing the SOEs' autonomy is clearly revealed in the lack of "real" rights of SOEs in making decisions on several important problems, such as investments, joint ventures, capital contributions, purchases, sales or liquidations of important assets, etc. So far, decisions on these issues are in fact within the responsibilities of ministries or government agencies.

It is important to note that the enhanced autonomy of the SOEs is not accompanied correspondingly by changes in obligations and incentive systems of both SOEs and management apparatus. More specifically, while the SOEs' autonomous rights have been significantly increased (though there are

still some limitations), the system of stimuli to the SOEs and their management as well as their responsibilities for risk and other market-based uncertainties are not clearly defined. This may be obvious from the fact that some SOEs are bankrupt, but are still supported and maintained by the State through debt rescheduling measures. At present, the SOEs' business activities are carried out using credit with market-based interest rates, but the amount deducted from after-tax income to be added to state-owned capital in SOEs is much larger nowadays than some years ago (50% compared with 35% before). Moreover, business risk and capital and/or assets' loss associated with risk are not regarded as acceptable for SOEs; thus, some regulations are still held by the State on measures for risk reduction, which in fact are restrictions of SOEs' autonomy.

### **III. Rearrangement and Reorganisation of the SOEs**

#### **1. With Respect to Decree No. 388/HDBT**

In order to implement the policy of rearrangement and reorganization of the SOEs, on 20 November 1991, the Council of Ministers (presently the Government) promulgated Decree No.388/HDBT, issuing the regulation on establishment and dissolution of SOEs. Based on this key legislation, other functional state bodies, such as the State Planning Committee (presently the Ministry of Planning and Investment), Ministry of Finance, State Bank of Viet Nam, and the Ministry of Labor, War Invalids and Social Affairs have issued many circulars providing guidelines on the implementation of Decree No. 388/HDBT. At the same time, branches and local authorities also sped up the implementation of the Decree as a crucial step toward the rearranging, reorganizing, and improving the performance of the SOEs. This is actually a sensitive and complex issue which may cause unpredictable socio-economic consequences, and hence requires swift but appropriate steps with a view to avoiding possible obstacles or impediments to the production and business operations of the enterprises and overcoming weakness of the state sector in a market economy.

In an attempt to bring Decree No.388/HDBT into full play, line ministries, localities, and SOEs have reviewed business functions within their units in order to lay a foundation for proper reorganization of the enterprises in conformity with their assigned tasks and functions, to ensure both enhancement of the autonomy of SOEs in their business and production activities, and appropriate state control and supervision at the same time. The objectives of the review process are: the production and business factors such as market, technology, capital, organizational structure, labor, management staff; the criteria for the review are: financial status of the enterprises, status quo of fixed assets and working capital, profits and losses, inventory, corporate debts, compliance with financial and accounting principles and statistics regime, capability to indicate shortfalls, and working out suitable solutions. Through the review, the SOEs may have a better understanding of their current state of affairs and take initiatives in preparing business plans under the new management mechanism on one hand, and the state governance bodies may strengthen their control over the performance of the State sector, which has been loosened for a long period of time, on the other hand. Especially, this rearrangement and reorganization of enterprises has helped to restore a necessary order in development planning in some industries, such as export and import, construction (site investigation and designing), exploitation of natural resources, wood processing, printing and publishing, etc.

After 4 years of implementation of the policy on rearrangement and reorganization of the SOEs, there have been significant changes in the state sector.

The number of SOEs has been sharply reduced from 12,296 enterprises in 1989-1990 to 5,962 re-

established SOEs by the end of 1995 making a dramatic fall of 51.5%. 1,953 enterprises are under direct management of ministries and agencies of the central Government, 2,000 SOEs have been dissolved or equitized and other 4,000 SOEs are reorganized or merged into larger enterprises.

The average capital of each of the enterprises stands at approximately VND 8 billion, making an increase in VND 5 billion compared with that prior to rearrangement. There is also an impressive change in the capital structure of the enterprises, marked by a considerable increase in self-accumulated capital. By early 1995, the self-accumulated capital of the SOEs accounted for 21.32% of their total capital.

Working capital has grown by an average of 29.0% in 1991-1994, in which the self-accumulated capital and loans have amounted up to 18% and 48% respectively. It is noteworthy, however, that production enterprises, especially industrial ones, have been recorded with a lower increase of capital and limited access to loans. Meanwhile, areas where capital is reported to grow at a higher rate are the trade and services sectors, with an yearly average increase of 31%, in which the self-accumulated capital is up to 30.3%; loan capital by 33.8%; and construction ranked the second highest with a 30.7% increase in capital.

A significant reduction in the number of the SOEs has not been accompanied by a corresponding drop in the number of employees. The total number of employees was 1,827 million in 1991; 1,742 million in 1994 and 1,513 million in 1995; of which up to 840,000 employees have been working in the enterprises under the central management making up 55.5% of the total labor, while the remaining 44.5% or 673,000 laborers are employed by the local enterprises.

Collections to the state budget through taxes and fees paid by the SOEs have also rapidly increased: 142.7% in 1992 compared with that of 1991; 154.1% in 1993 compared with 1992; 146.8% in 1994 compared with 1993 and 122.8% in 1995 compared with 1994.

The total revenue from profit tax to the State budget soared four times during the 1991-1995 period. The rate of payment to the state budget from the total turnover was 13.36% and 15.81%, in 1990 and 1994, respectively.

Despite modest efficiency of capital utilization, this indicator has gradually improved year after year. The rate of realized profits to revenues increased from 3.61% in 1990 to 4.98% in 1994, during which the centrally managed SOEs recorded a better increase from 4.86% to 7.2%. By 1995, one VND of capital yielded VND 3.4 of turnover and VND 0.19 of profit. In a number of SOEs, the rate of net profit over the working capital was reported to be between 0.28 to 0.32. At the same time, the number of loss-making SOEs was sharply reduced from 21.7% in 1990, to only 16.5% in 1994, and 10% in 1995.

## 2. The Decisions 90-TTg and 91-TTg

Following Decree 388-HDBT, to continue the re-organization of SOEs, the Prime Minister decided on the promulgation of Decisions 90-TTg and 91-TTg (dated March 7, 1994) on a further re-organization of SOEs and performing the pilot establishment of business corporations.

The re-organization of SOEs by Decisions 90-TTg and 91-TTg has been undertaken on the basis of decided master plans for the development of the national economy, and plans for industrial and regional development in combination with market principles. These decisions were aimed at carefully examining the possibility of establishment of new SOEs in particularly important sectors and industries, where non-state enterprises have not been interested.

Reorganization takes place also in already existing General corporations, what implies that only really effective corporations can be maintained, while others would be either re-structured or closed down.

So far, 150 formerly formed general corporations and unions of enterprises have been re-organized and formed as so-called general corporations under Decision 90/TTg and Decision 91-TTg. By the end of 1996, the Prime Minister had made decisions on the establishment of 82 corporations-general by Decisions 90-TTg and 91 TTg, of which 64 General-compositions under Decision 90-TTg and 18 General-corporations under Decision 91-TTg. The legal documents for the establishment of general corporations by Decision 90/TTg has provided the list of SOEs which have agreed upon joining general corporations as member-enterprises. However, many enterprises which had been effectively functioning still did not wish to join as members of the establishment.

It was found that more than 50 formerly formed general corporations and unions of enterprises did not meet the requirements to be general corporations under Decision 90/TTg. These general-corporations and unions were transformed into SOEs. Administrative divisions of general corporations and unions could also be transformed into SOEs, merged to other SOEs, or shut down. Corporations which can be operate by the model determined by Decision 91/TTg include large scale SOEs, comprised of many member-enterprises having close cooperative relationships in terms of capital and exercising a multi-level accounting system (e.g., a holding company with subsidiary enterprises). Establishment of such corporations aims at obtaining more capital/funds, technology, and information to become more competitive in the marketplace. These corporations are of relatively large scale, and thus are able to engage in different forms of business. They are also allowed to form financial companies for mobilizing funds, and distributing funds for the development and expansion of their business.

By the end of 1996, the Prime Minister also made a new decision on establishment of 18 corporations under Decision 91-TTg. They are: Viet Nam Power Corporation, Viet Nam Coal Corporation, Viet Nam Cement Corporation, Viet Nam Steel Corporation, Viet Nam Gem, Gold and Precious Stone Corporation, Viet Nam Petroleum Corporation, Viet Nam Post and Communication Corporation, Viet Nam Airline Corporation, Viet Nam Marine Corporation, Viet Nam Textile-Garment Corporation, Viet Nam Tobacco Corporation, Viet Nam Paper Corporation, Viet Nam Rubber Corporation, Viet Nam Coffee Corporation, Northern Food-Stuff Corporation, Southern Food-Stuff Corporation, Viet Nam Chemical Corporation, Viet Nam Steamship Corporation.

Among 18 established corporations, 17 corporations (except Viet Nam Gem, Gold and Precious Stone Corporation) have still been operating as the old-type general corporations or unions of enterprises for a certain period of time. After reorganization, some of them become more effective. However, they are confronted with a lot of problems, particularly those derived from the situation that there have not yet been respective by-laws and regulations that would allow timely introduction of the Decisions. First of all, the regulations determining relationships between corporations and the Board of Management, or relationships between corporations and the concerned ministries, branches, government agencies and local authorities. Because of the above-mentioned reasons, some independently-accounting member enterprises are now applying for separation from the corporations. Therefore, it is appropriate to make a review of the principle of voluntary participation stipulated in the Article 7-1-d of the Law on SOEs.

### 3. The Decision 500-TTg

On August 25, 1995, Decision 500-TTg *"On the Urgent Reorganization and Rearrangement of SOEs"* was issued by the Prime Minister.

The purposes of re-organization and rearrangement of SOEs are: to have the SOEs operate and function in compliance with the Law of SOEs, gradually abolish unreasonable interventions by line ministries and administrative bodies into operational aspects of SOEs, and to make a step towards

elimination of the situation where many SOEs are manufacturing the same products, located within the same region, but under the management of different local authorities, government agencies or ministries, especially those in construction and engineering.

Those SOEs which have been re-organized under Decree 388-HDBT are functioning well and satisfying the requirements set in industrial and regional development plans, will be allowed to remain the same.

Re-established SOEs under Decree 388-HDBT, but still ineffective or of small scale, shall be reorganized by means of merging into each other or with other bigger enterprises for better performance, or joining to form bigger SOEs having their own Boards of Directors.

Locally managed SOEs could join centrally managed nation-wide general corporations if this is found to be necessary. On the other hand, those who are found unnecessary to be maintained under management of the line ministry may be transferred to local authority in the reorganization process at both local and regional levels.

The Decision 500/TTg requires a clear-cut classification between SOEs who are to serve public utilities (non-profit SOEs) and profit-oriented SOEs. SOEs standing in between (functioning not for profit only) may be put under careful review to decide whether they may be transmitted to a group of non-profit SOEs or not. Up to June 31, 1997, there have been about 200 non-profit SOEs already established. Furthermore, it is estimated that, to the end of 1997, about 100 non-profit local and ministerial SOEs will be set up. Line ministries and local authorities shall make the list of SOEs which are subject to equitization and implementation of Decree 28-CP. SOEs which have not been restructured by Decree 388-HDBT shall be reorganized or closed down.

Reorganization of the SOEs under Decision 500/TTg has an effect first and foremost on the enterprises' sizes. Specifically, after reorganization in the Ministry of Industry, Ministry of Agriculture and Rural Development, Ministry of Construction, Ministry of Transport, and in some 23 provinces/cities, the number of small-sized SOEs has decreased, while the number of SOEs having more than VND 3 bil. capital and 300 employees has largely increased. Among them, the SOEs with VND 10 bil. capital and 1000 laborers are marked with the largest increase rate.

However, SOEs having capital less than VND 1 bil. still account for a relatively large share (35%) of the total number of SOEs. Among them, 19% are SOEs with capital amounting to less than VND 500 mil. Specifically, in 23 provinces, SOEs with capital of less than VND 500 mil. account for about 25% of the total number of local SOEs, and SOEs having less than 100 employees account for 46%.



Table 1 Change in SOEs' sizes (1996 compared with 1995) (%)

Classification:	1996 relative to 1995
<i>I) by size of business capital</i>	
Up to VND 500 mil.	87.52
From VND 500 mil. to 1 bil.	88.78
From VND 1 bil. to 3 bil.	96.09
From 3 bil. to 5 bil.	116.30
From 5 bil. to 10 bil.	112.80
More than VND 10 bil.	125.51
<i>II) by number of employees</i>	
Up to 100 laborers	92.51
From 100 to 300	99.16
From 300 to 500	107.34
From 500 to 1000	109.84
More than 1000 laborers	123.53

#### 4. The Decree 50-CP

To implement the Law of SOEs, the Government decided to promulgate Decree 50/CP, dated 28 August 1996 *"On the Establishment, Reorganization, Closing Down and Bankruptcy of SOEs,"* and Decree 38/CP dated April 28, 1997, containing some amendments and corrections to Decree 50/CP. In addition, a Circular No.08 BKH/DN, dated June 11, 1997, on *"Instructions for Implementation of the Decree 50/CP and Decree 38/CP"* were issued by the Ministry of Planning and Investment.

Under the Decree, some sectors, areas, and industries are given priority in establishment of SOEs. They are those developments which would promote the growth of a multi-sector economy. The Decree also specifies that the minimum charter capital level of a SOE at its formation can not be lower than the legal capital level defined for the sector in which the SOE will be operating.

There some changes and amendments stipulated in the Law on SOEs and related regulations procedures to establishment of an SOE under considerations, specifically:

- 1) Only the Prime Minister, a respective line Minister, or a Chairman of relevant provincial People's Committee can make a decision on establishment of an SOE.
- 2) Proponents of establishment of an SOE may be a line Minister, a Chairman of a relevant provincial People's Committee or of a Board of Directors, or a chairman of a District People's Committee (for non-profit SOEs), or a head of a scientific research institution, a director/rector of a university, college, vocational training school, etc. . . .(for SOEs which are under the management of these institutions).
- 3) The project/plan for establishment of a SOE may be examined specifically by:
  - The Prime Minister, if this is a plan for a general corporation, an enterprise directly serving defense and national security purposes, an enterprise having charter capital at the moment of its establishment equal to the total investment of a project in group A (as provided in Decree 42-CP dated 16 July 1996).
  - Minister of Planning and Investment, if this is a project on establishment of an autonomous business enterprise having a charter capital equal to the total investment of a project in group B (as provided in the Decree 42/CP dated 16 July 1996)
  - As soon as the examination and consideration of the establishment plan is done, and being informed of the agreement on the establishment, the relevant examiner, who is decided by the examination commission, signs the establishment decision of the SOE concerned.

After approval of the project/plan by the examiner, the project will be reviewed by the Project Appraisal Council, and if it is proven to satisfy the necessary requirements, a decision on establishment of the SOE will be signed by the competent person.

The revision of the procedures on SOE establishment which would soon put the Law on SOEs into practice is an urgent request by ministries, local authorities and grassroots institutions. However, it is very important to emphasize that the provisions on SOE establishment procedures should be made in such a way that they would inherit positive and appropriate practices experienced in the past, and would not cause any disorder that may negatively affect the operations of SOEs. These provisions should not, at the same time, be so complicated as to cause disturbances and problems for an SOE.

## **IV. Organization and Management Mechanism of the General Corporations**

### **1. The Process of Reform of Unions of Enterprises and General Corporations before 1994**

General corporations and unions of enterprises were first formed in Viet Nam in 1978 by Decree 302/CP of the Government, dated from December 1, 1978. This implies a closed-end model including all activities and operations from input supply, output delivery, services provision, R & D activities, and training, and highly centralized in terms of planning, financial, and organizational activities, as well as personnel issues and resources allocation among member-enterprises in an effort to fulfill state-decided and top-down assigned targets.

This model of business and management organization helped to concentrate resources for the fulfillment of core, planned targets. However, it was bulky in terms of organization, over-staffed, ineffective, inefficient, and too rigid to adapt to a market mechanism. Therefore, as soon as enterprises were given more autonomy, as provided by Decision 217/HDBT, the general corporations had to undertake re-organization by Decree 27/HDBT, dated March 22, 1989, on enhancing autonomy to general corporations and member-enterprises for better performance and efficiency.

Decree 27/ HDBT classified unions of enterprises into two groups. First, those which are in special areas, like airlines, railways, energy, post and communications, and industries, are to maintain a centrally-managed accounting system (it is often called as Hard Unions); and the second, voluntary unions (or soft unions), which are to maintain a uniform accounting system.

There have been slight changes in the organizational structure of special unions in comparison with general corporations and old style unions. These unions still exercise direct supervision and management over resources allocation and investments, and have still carried out the duty of the "focus points" in coordination with economic cooperative activities, joint ventures, developing and implementing specific business plans, as well as general development strategies of the union. However, there have been dramatic changes in the way these unions do business: improved quality of services supplied, more management delegation, and decentralization between the general corporations and member-enterprises. As a result, the performance of both becomes better.

Major changes taking place in voluntary unions in comparison to the old ones, particularly:

- Enterprises have joined the union voluntarily. Those who do not wish to join may be separated into independent enterprises.
- The highest body to manage the union is the Board of Directors, comprised of directors of member-enterprises. The chairman of the union is elected by the Board. The Board works and

makes decisions on the principle of collective agreement and majority of votes.

- Delegation of more autonomy in doing business to member-enterprises. The regulations on management of industrial State-Owned Enterprises have stipulated that the member-enterprises can be independent in various activities such as marketing, business planning, seeking other sources of funds, entering business contracts with outside partners, purchasing inputs, selling outputs, sharing profits, etc.

The power of unions has declined. They have limited power in working out long-term development strategies and plans, making a summary of results of yearly plans implementation, making financial accounting statements, and undertaking R&D, as well as training activities.

During the process of re-organization and rearrangement of SOEs by Decree 388/HDBT in 1991, most enterprises' unions nearly came to collapse. Many locally managed SOEs were shut down to form independent SOEs. Only some unions in light and food-processing industries, or in agriculture, who broke down to form smaller unions and engaged in direct business activities like import-export could survive. Others got in trouble and have been unable to monitor the operations of member-enterprises.

In this situation, the State had to decide on the reorganization and rearrangement of the unions of enterprises into state-owned corporations by Decisions 90/TTg and 91/TTg.

## **2. The Objectives of the Establishment of State Corporations by Decisions 90/TTg and 91/TTg; and Distinction between Corporations under Decision 90/TTg and the Ones Established under Decision 91/TTg**

### **1) The Objectives of Establishment of the State Corporations are as follows:**

- to create conditions for accelerating concentration, accumulation of capital and development;
- to increase their competitiveness in regional and international markets, and attract foreign partners and investors into Viet Nam;
- to implement the policy of gradual elimination of direct intervention by the line ministry; and
- to gradually remove the discrepancies between centrally-managed and locally-managed enterprises, and strengthen the economic linkage and integration between SOEs and business enterprises in other economic sectors.

### **2) Distinction between Corporations under Decision 90/TTg and the Ones Established under Decision 91/TTg:**

- Corporations governed by Decision No.91/TTg are established in a number of key industries and areas, while corporations under Decision No.90/TTg are incorporated in ministries, branches or provinces, under the decision of line ministries and provincial People's Committees authorized by the Central Government.
- Corporations governed by Decision No.91/TTg are subject to management by the Central Government, while Corporations governed by Decision No.90/TTg are administered by line ministries or provincial People's Committees concerned.
- Corporations under Decision 91/TTg have a minimum legal capital level at VND 1,000 bill. and at least 7 member-enterprises, while the corporations under Decision 90/TTg need only VND 500 bill. and 5 member-enterprises.
- Corporations under Decision 91/TTg have in their organizational structure a financial company as one of their members, but the corporations under Decision 90/TTg have no such institution.

In addition, both categories of corporations are required to follow the same model of the State-owned corporations as stipulated in Decree No.39/CP issued by the Government.

### **3. The Organization and Management Mechanism of State Corporations under Decisions 90/TTg and 91/TTg**

#### **(1) The Organizational Structure of State Corporations**

The organizational structure of a state corporation is comprised of:

- the Board of Directors, which is management for all operations of the corporation. The Board may be a group of five to seven experts;
- the General Director, a chief executive of the corporation, who is to put into practice the decisions and regulations of the Board of Directors. He may have several deputies in charge of different areas of business, offices, or different divisions, to assist him and the Board of Directors in running the corporation;
- an Inspection-Control Commission that is to assist the Board of Directors in supervising operations, particularly the financial activities of the corporation and its member-enterprises.
- The corporation may have the following member-enterprises:
  - independently self-accounting enterprises;
  - dependent accounting enterprises ;
  - professional enterprises, including research institutions, training schools, hospitals, etc.

#### **(2) The Organization of the Board of Directors**

The Board of Directors may consist of 5 to 7 members: the Chairman of Board, the General Director, Head of Inspection-Control Commission, and several part-time members who may be economists, technical staff, financial experts, or lawyers, who must be appointed by the Prime Minister (for corporations established by Decision 91/TTg) or by a line Minister, or a Chairman of a provincial People's Committee, if they are authorized by the Prime Minister (for general corporations under Decision 90/TTg)), or a chairman of the Board of Directors who is not simultaneously a general director.

The duties and functions of the Board of Directors:

The Board of Directors is to make proposals on long-term business strategies, business plans, organization and reorganization of the general corporation, member-enterprises, new establishments, mergers, dissolution of member-enterprises; appointment of directors-general, deputy directors-general, chief accountants; investment projects of groups A and B, making joint ventures with foreign partners and submitting them to the state ownership-representative at a higher rank, such as the Prime Minister, line Minister, or provincial People's Committee for approval. The Board of Directors is to approve and make decisions on receiving funds, fund allocation and fund preservation, plans to member-enterprises, organizational regulations of member-enterprises and amendment/revision to these regulations; appoint directors of member-enterprises, joint-ventures, sign domestic cooperative contracts, work out and promulgate economic-technical targets, and decide personnel and labor policy for the corporation and member-enterprises.

#### **(3) The Mechanism for the Corporation's Financial Activities**

The corporation is to receive funds from the state and allocate them to the member-enterprises, who are to be in charge of use, preservation and development of any fund portions assigned to them;

The corporation is responsible for mobilization of funds in different ways to make new investments or extensions of its member-enterprises;

The corporation is to provide a guarantee to member-enterprises to borrow additional funds;

The corporation is to make decisions on the purchase, sales of assets, use as mortgage, collateral and liquidation of assets according to authorities and delegate between the corporation and the member-enterprises;

The corporation is to undertake the control and supervision over revenues, expenditures and yearly financial closing statements of transactions of member-enterprises;

The corporation is to undertake overall economic accounting for independently self-accounting member-enterprises and centrally-planned accounting for dependent member-enterprises.

#### **4. Relationships between the Corporation and Member-enterprises, and State Governance Agencies**

##### **(1) Relationships between the Corporation and its Member-enterprises**

Independent self-accounting member-enterprises, which are autonomous in running their business, maintain a relationship with the general corporation in the following forms:

- Member-enterprises are fully authorized in running and managing their business functions, and at the same time, are liable to contribute to the Corporation's central funds a certain amount derived from the enterprise's depreciation funds and after-tax profits, in accordance with the financial regulations promulgated by the Ministry of Finance.

Corporations also carry out some other management functions in respect to their member-enterprises, particularly:

- Making decisions on appointment, dismissal, reward, or punishment of the director, deputy directors, head of administration, or heads of sections, of the member-enterprises.
- Conducting the functions on approval of the enterprise's business plan, supervision over the plan's implementation, and making decisions on the enterprise's financial documents.
- Making decisions on and approval of the member-enterprise's investments/joint venture projects or cooperative contracts.
- Reallocating financial resources among the member-enterprises, provided that this does not leave the enterprise with lower total capital than its charter capital level has.
- Making approval of payment schemes, wage rates, and measures to be undertaken to ensure sufficient living standards and safe working conditions for workers and employees of the member-enterprise.
- Making decisions on the expansion of, or narrowing the scope and scale of business activities of the member-enterprise on the basis of the general corporate strategy.
- Making approval on the member-enterprise's Charter, or making changes or amendments to the provisions of its organizational and operational Articles.
- Taking control and supervision over the operations of the enterprise and its financial company.

Besides the above-mentioned relations with the respective corporations, a member-enterprise is autonomous in running its business activities within the scope of the organizational articles and financial regulations stipulated by the corporation, specifically:

- Dependent accounting member-enterprises are delegated some management rights by the corporation, such as the rights to enter into economic contracts, to be autonomous in performing business activities, and to make a decision on their own organizational and personnel issues, so that the enterprise can be more flexible and adaptive to market signals.
- Self-financing professional member-enterprises are allowed to seek income sources by

providing services such as research contracts, training activities and other services provided for the enterprises from both within and without the corporation.

## (2) 'The Relationships between the State and the Corporations

*In relations to state agencies:* the corporation is liable to follow the laws, decrees and decisions, and other legislation promulgated by the Central Government, relevant line Ministries, Branches and provincial People's Committees in charge of the corporation and its member-enterprises; to implement sectorial and regional socio-economic development strategies and plans; follow the Government's regulations and rules on the establishment, separation, merger, registration of corporation and its member-enterprises; to comply with the government's policies on personnel, labor, finance, accounting schemes, provisions on statistical issues, the law's provision on the rights and duties of representative of state's ownership of the state agencies in regards to the corporation and member-enterprises; also, the corporation is subject to control and inspection over enforcement of state laws and policies.

Corporations have the right to make comments and recommendations, suggest appropriate measures or mechanisms on state governance policies and execution of state ownership functions within the scope relating to the corporations and their member-enterprises; they are allowed to manage and use funds, assets, land, and other resources assigned to them by the State in order to run their businesses and are entitled to enjoy schemes of subsidies, price subsidies and other privileges according to government regulations.

## 5. Performance and Problems Arising from Implementation of the State Corporation Model

Among 18 general corporations established under Decision 91/TTg (dated March 7, 1994), corporations having a capital amount of more than VND 1000 bil. account for 73%, and ones with more than VND 600 bil. account for 22%; the rest are corporations with capital of below VND 600 bil. The exception is the case with the Gem-Gold and Precious Stone Corporation which has been recently set up, and thus has a smaller capital amount (below VND 100 bil.), although it has been formally classified as a corporation under Decision 91/TTg. On the average, each general corporation has 26 member enterprises; among them 86% are self-accounting, 9% are non-profit dependent members, and 2% are joint ventures.

Table 2 Some indicators of business performance of the selected general corporations, 1996 (%)

Corporations	Profit/operational capital ratio	Profit/turnover ratio	Payment to the State budget/State's capital
1. Viet Nam Coal Corporation	3.16	1.95	21.36
2. Viet Nam Power Corporation	5.68	15.20	7.70
3. Viet Nam Steel Corporation	0.77	0.59	12.14
4. Viet Nam Textile-Garment Corporation	0.61	0.45	13.53
5. Viet Nam Paper Corporation	0.39	0.41	6.53
6. Northern Food-Stuff Corporation	3.88	1.80	21.68
7. Southern Food-Stuff Corporation	2.16	2.09	59.49
8. Viet Nam Cement Corporation	12.09	8.19	36.82
9. Viet Nam Post-Telecommunication Corporation	16.40	2.28	40.98
10. Viet Nam Tobacco Corporation	5.73	1.13	176.83
Average	6.64	3.40	19.83

Most of the general corporations under Decision 90/TTg were established by the late 1995-early 1996. Among them, only 26% have capital amounts above VND 500 bil.; 68% have capital amounts between VND 200 and 500 bil.; the rest have up to VND 200 bil. On the average, each corporation under Decision 90/TTg has 18 member-enterprises; among them 92% are self-accounting enterprises, 7% are non-profit and dependent ones, and the remaining 1% are joint ventures.

Although having started their functioning only recently, the corporations have produced some significant effects on their member enterprises, particularly: promotion of the growth of member-enterprises, attracting additional investments and accelerating export-import activities, mobilizing funds to assist member-enterprises to update equipment and technology, division of markets for realizing products, entering in joint ventures, setting up new contacts with domestic and foreign partners, etc.

Performance of business operations in 10 selected general corporations may be seen as follows (see Table 2 above).

Despite their current business performance, the corporations are facing some problems and shortcomings as follows :

- 1) No sufficient legal framework for clarifying relations between the corporation as legal entity and independently accounting member-enterprises: The corporation is a legal person; so are its independently accounting member-enterprises. So, how to make a clear cut between duties and functions of the two entities remains unclear.
- 2) Although, theoretically, the corporation has delegated some authority to its member-enterprises, in practice, the corporation still intervenes in the daily activities of its member-enterprises, leading to restriction of their autonomy, activity, and efficiency in running their business.
- 3) The corporation is established in almost all industries and areas of manufacturing and trading at central and local levels, creating the danger of a rising monopoly, limitation of competition, and impeding the growth of medium-and small-scale enterprises, especially the non-state sector enterprises.
- 4) In the corporation model having a Board of Directors, the management rights of the Board of Directors, in terms of exercising several rights of state ownership delegated by the government have been clearly distinguished from the management functions of Director-General. However, in reality, the business activities and functions of the Board of Directors and Director-General often overlap. In many corporations, the roles of the Board of Directors, Director-General, and Vice Director-General are integrated to become "a collective leadership" in deciding management issues and running activities of the corporation. In this case, the managerial and control effects of the Board of Directors become ineffective. In some corporations, the Board of Directors and the Chairman of the Board of Directors carry out functions of the Director-General, and reciprocally, the Director-General bears the responsibility for the main part of management activities of the corporation. As a result, the decisions or solutions made by the Board of Directors are merely legalized forms of decisions made by the Director-General.
- 5) In a number of the corporations, management personnel lack sufficient knowledge and managerial skills necessary for them to meet with the needs and requirements of their duties.
- 6) As the proposed regulations on the functioning mechanism of financial companies have been in contradiction with many aspects of the banking ordinance, so far none of them have been yet established in the corporations, although it is stipulated in the corporation model that each corporation can have in its membership a financial company. As a result, capital mobilization through the companies still can not be realized.
- 7) Management over the corporations established under Decree 91/TTg is delegated by the central

government to different line ministries and branches, which causes the corporations to be under variety of “pressure” and to go through “many doors” simultaneously. This, on one hand, significantly reduces the efficiency of the State governance, and on the other hand, causes additional trouble for the corporations.

## **V. Financial Management of the SOEs**

### **1. Financial Management in SOEs after Decree 217/HDBT (14 Nov. 1987)**

Decree 217/HDBT had been issued on 14 Nov. 1987 in order to reform planning and commercial socialist accounting activities in SOEs. Some time later, the Council of Ministers issued the “*Statute of SOEs*” and “*Statute of Union of SOEs*,” which clarified responsibilities and rights of SOEs, and rights of SOEs’ executive managers and functional agencies of the government. In 1990, the government conducted an experiment in which fund management and rights on fund allocation and fund conservation have been directly delegated to SOEs. In 1992, the government expanded the experimental process which stated the liabilities of SOEs in maintaining the State’s funds. Also in 1990, the government eliminated the direct contribution regime by SOEs to the budget and promulgated three tax laws: law on turnover tax, law on excise tax and law on profit tax; the laws are uniformly applied to all businesses in all economic sectors to ensure equality in contributing to government revenue. In parallel with delegation of autonomy to SOEs, the government reduced subsidies and privileges to SOEs step-by-step through low prices of materials and equipment for production, as well as subsidies in kind for SOEs’ employees; also, it reassessed property of SOEs taking into account market prices, and eliminated covering SOEs’ losses from budget resources.

Generally, after the issue of Decree No-217/ HDBT, there are some important points, specifically:

- An initial legal framework has been formulated and significantly improved to create a relatively sufficient legal base for SOEs’ operations.
- SOEs obtain more and more autonomy and freedom in business operations, in management, and in use of funds and assets. The government intervention in management of operational activities of SOEs has been gradually removed.
- System of budget subsidies for SOEs has been eliminated. Market-based accounting system in SOEs has been encouraged. SOEs have to compensate for costs with their revenue. They have to save and mobilize funds to invest in development.
- Equal environment between SOEs and enterprises in other economic sectors has been created initially. This has helped promotion of competition between SOEs and other businesses in domestic and foreign markets.

#### **1) Features of the financial management of SOEs**

- 1) SOEs have rights to manage, use funds and properties to do business, to contribute to joint ventures, and to participate in other forms of economic cooperation. At the same time, SOEs have a duty to maintain and develop the funds assigned to them by the government in accordance with government regulations.
- 2) SOEs have rights to mobilize funds to do business and are responsible for commitments of mobilized funds.
- 3) SOEs are responsible for their own business performance. The government takes control over some expenditures only, such as depreciation of fixed capital, salary expenditures, transaction



costs, or reception expenditures in the total cost of SOEs.

- 4) After-tax profits of SOEs are distributed to different funds; first of all to the production development fund, the minimum level of which is set by the State (with no limit on maximum level). Maximum levels of bonus and social welfare funds are fixed by the State.
- 5) SOEs have to conduct their accounting system in accordance with government regulations and to report the balance of payment to government authorized agencies quarterly and annually. The agencies will consider and approve the reports.

## **2) Shortcomings and problems in implementation of the financial management mechanism in this period**

- 1) Even though SOEs have rights to manage and use funds, the government has still intervened heavily in fund allocations, e.g., in making decisions on sales, transferring or liquidating SOEs' properties, making decisions on changing production structures, capital contributions to joint ventures, etc. Thus, the autonomy of SOEs in fact is very limited.
- 2) Funds of SOEs are divided into two categories: fixed capital and working capital; with different rules for their use. This limited the flexibility of doing business in SOEs.
- 3) Principles for solving problems relating to liquidation, sale and transfer of property, property loss, bad debts, price depreciation of reserved goods, etc., are not consistent with market mechanisms and international standards.
- 4) Regulations on establishment of funds in SOEs seem inappropriate and thus do not much encourage SOEs to invest their savings to expand business. There are no regulations on establishing a risk fund to cover losses.
- 5) Responsibilities of SOEs' managers in cases of bad business performance or loss-making are not clearly clarified. There is no clear definition of the role of the government in controlling and inspecting business operation and fund management.
- 6) The old accounting system is backward and does not meet the requirements of the market mechanism; more than that, it is not consistent with international standards. Regulations on an auditing system for SOEs and publication of SOEs' financial statements are not yet implemented.

## **3) Owing to the renovations of planning functions and the accounting system in SOEs, and enhancing SOEs' autonomy in doing business and managing funds, as well as owing to the success of other renovations, the SOEs sector developed well during the period 1990-1995.**

Contribution of SOEs to the government budget has continuously increased, reaching to 7.7 times in 1995, compared to 1990. Revenue from SOEs accounts for about 65% of domestic revenue.

Many SOEs are efficient, their profits has significantly increased (ex.: air transportation, telecommunications, alcohol and beverages, cigarettes, cement industries). The SOEs can not only maintain but develop their state funds and expand the scale of their businesses.

## **4) Apart from the good performance of some SOEs, there are many SOEs with very poor business performance**

Most of them are small enterprises with very old equipment, backward technology, lack of funds, and unable to adapt to market conditions. More than that, the inappropriate principles presently used in financial and accounting activities do not let the SOEs truly reflect their business performance. Allowing SOEs to include some losses in the depreciation of fixed capital, to

suspend property loss, or failed property, does not include hardly claimed loans in the costs, and leads to "*artificial profit, true loss*" and SOEs lose property.

## **2. Financial Management Mechanisms and Mechanism of Management over the SOEs Capital and Assets as Stipulated in the Law on SOEs**

The National Assembly approved the Law on SOEs on 20 April 1995. This is an important milestone in the renovation of the financial mechanism in SOEs. The main objectives of the financial mechanism in SOEs are:

- To separate the state governance functions from the functions of business management. To delegate more autonomy in doing business, and managing the State's funds and assets, to SOEs' management. The functional agencies of the government execute the control and inspection over the SOEs on behalf of the government as a property owner, but do not intervene in operational aspects of business of the SOEs.
- To first put the objective of fund maintenance, then to take business efficiency as a criterion for assessing performance of capital and assets management in SOEs. To facilitate SOEs in developing funds and property to expand business, change equipment and technology.
- To reach international standards in financial activities of SOEs; to ensure equality among enterprises in all economic sectors.

After the Law's promulgation, other regulations also have been issued, such as Decree 59-CP, dated 3 Oct. 1996, from the government, which stipulated the rules on management of State assets and implementation of market-based accounting in SOEs; and other supporting documents issued by the Ministry of Finance.

The main contents of the mechanisms for managing finance and state assets in SOEs may be stated as follows:

### **(1) Capital and Assets Management in SOEs:**

The present regime clarified the government's responsibilities in investing into SOEs to ensure necessary conditions for SOEs' efficient business activities.

The government continues allocation of funds, their use, and rights and responsibilities for the funds' maintenance to SOEs. The direct recipient of the funds from the government is the Board of Directors (for SOEs having a management board), or the SOEs' Director in case of the SOEs not having a Board of Directors. The chief accountant is not the funds recipient and is not responsible to the government for the efficient use of the funds. The State carries out control over capital maintenance and development through the mechanism of capital assignment and capital maintenance determined by the State.

Capital of SOEs is not divided into fixed capital and working capital as it was previously. SOEs have full rights to use the funds authorized by the government flexibly, or to change property structure in accordance with the requirements of production and business processes. Besides the funds given by the government, SOEs have rights to mobilize funds from other sources, such as banks, financial organizations, enterprises, individuals, employees of the SOEs, foreigners and foreign organizations. Mobilization forms may be borrowing, contribution to joint ventures, integration, bond issues and other forms in accordance with legal regulations. The funds mobilization should not change the ownership of the SOEs. The SOEs should be responsible for the use of the mobilized funds, and have to return both the principal and interest to lenders in accordance with contract commitments. Procedures for funds mobilization should be consistent with legal regulations. For public utility SOEs, fund mobilization

should be approved by the founder of the SOEs after the appraisal of the government agency responsible for managing state funds and property in enterprises.

SOEs have rights to use the assets which belong to their legal rights to invest outside the enterprises. The Board of Directors, or the Directors of SOEs without a Board of Directors, are responsible for investment efficiency to the government. Within SOEs having Boards of Directors, the management boards approve cooperation with other domestic enterprises. To do joint ventures with foreign organizations, the Board of Directors has to submit a proposal to the body who established the SOE for approval after the government agency responsible for the managing the state's assets and property in enterprises has appraised the joint venture plan. For joint ventures with domestic enterprises or foreign partners, the Director has to complete a plan, then report it to the founder of the SOE for approval after the agency responsible for the state's assets and property in enterprises has appraised it. Procedures to invest outside should be consistent with legal regulations. The provision aims to ensure State-as-owner control over capital and assets in the enterprises.

SOEs have rights to mortgage, rent, transfer, sale, or liquidate the assets belonging to their legal use rights. In transferring property, the SOEs have to establish an evaluation commission, and to publicize and organize bids in accordance with legal regulations. The balance between revenue from the assets' sale/liquidation and the book value remaining in the records and costs of the sale can be included in the business results of the SOEs.

Mortgage, transfer, sale, liquidation of the two category of assets: a whole production line or its main part, playing a decisive role in production activities of the SOEs, should be agreed by the founder of SOEs after the appraisal of the government agency responsible for the state's assets and property in enterprises. The transfer or sale of these properties to foreigners or foreign organizations should be approved by the Prime Minister.

For the loss of capital or assets in SOEs, responsibilities should be traced to individuals and collectives causing the losses. Boards of Directors, and Directors of the SOEs with no management boards, have to determine the level of compensation in accordance with legal regulations. Insurance agencies have to compensate for the assets insured. The difference between the value of the lost property and the compensation by the responsible person or the insurance agencies can be covered by the financial reserve fund. If the compensation is still not enough, the remainder can be included in the costs. If the loss is too large to include in the costs, the SOEs submit a report to the Ministry of Finance for consideration.

Losses arising from bad debt can be covered by the reserves fund especially assigned for this purpose. If this is not enough, the losses can be included in the production costs.

SOEs' assets can be reassessed only in the following cases:

- There is a government decision on taking stock inventory or reassessment of the assets.
- The asset will be contributed to a joint venture.
- When the SOEs are equitizing.
- Price adjustment to increase property value in accordance with the decision of the government.
- Assessment of properties to record increases or decreases in capital.

Depreciation of the assets is carried out by SOEs in accordance with the decision of the Ministry of Finance. SOEs register depreciation levels in accordance with the time frame of the property use as stipulated by the Ministry of Finance for each kind of the property. The depreciation level will be stable for at least three years. The government does not consider increasing or decreasing the depreciation level registered by the SOEs.

SOEs maintain their assigned funds by buying insurance, including some costs into the reserve

against the price decrease of the inventory, bad debts, or decrease in financial investment portfolio; SOEs can use before-tax profit to compensate for the previous year's loss; SOEs can establish a reserve fund to cover loss risk; SOEs can use after-tax profit to cover losses after the expiration of the period during which the before-tax profit can be used for compensation.

The enterprises have to determine the regulations for capital and property management and for debt management according to government policies and their own practical situations. These regulations have to clearly specify the rights and the responsibility of each collective and individual in managing the capital, property, and debts of the enterprises. The Boards of Directors, or the Directors of the enterprises with no Board of Directors, are responsible to the Government for efficiency in using the capital and property of the enterprises. The punishment measures that are applied according to the extent to which the damages are incurred are administrative warning, material compensations, and criminal prosecution. If the government inspection agencies fail to fulfill their responsibilities, and as a result, damages are incurred, they are also legally responsible for it.

## **(2) Income and Cost Management**

The enterprises have to take control over their regular income from business and financial activities, as well as for occasional income. Any commodity used for internal needs, or any gift for a guest must be valued at market prices.

The cost evaluation has to be carried out corresponding to specific input factors.

When evaluating expenses of the materials, the enterprises have to set up their economic-technical norms based on government standards. At the end of each year, the enterprises have to make accounting reports in which the actual demand for materials is compared to specified norms and to the volume used in the last year to identify responsibility for the use of materials and the management of individual units within the enterprises.

The enterprises have to determine labor requirements as a basis for wage and price settings and for payroll management. Principally, non-profit business enterprises are allowed to pay wages and salaries in accordance with the levels of professional skills of the workers, and to the positions and responsibilities of the managers. The profit business enterprises, in addition, are allowed to pay wages proportional to their business performance, but the growth in payroll should not exceed the growth ratio between profit and government capital. The wage payments that are not done corresponding to regulations or with deficits have to be returned and transferred to the budget; the person who made the wrong decision on such payments has to bear an administrative punishment.

The enterprises are allowed to include into production accounts expenses for warranty, for property insurance, or commission fees to brokers; the enterprises have to explicitly declare the commission rates for agents and brokerages. The Directors of the enterprises have the rights to define these commission rates and are responsible to the laws for the payment of these fees.

The enterprises have to set up the norms for the indirect costs to manage the expenses for the meetings, transactions and guest receptions. The enterprises have the rights to decide on payments for these specific purposes and have to be responsible to the government for these payments.

The calculation of the production costs for the finished goods is done according to international principles, including only the expenses for materials, the direct cost of labor, and other expenses incurred during the production process. The expenses of product sales and for management of the enterprises are included totally in the values of the products sold and services given in the accounting period.

In addition, the regulations on cost management also define which items are prohibited from inclusion into the cost accounting of the enterprises. Expenses for the wrong purposes have to

compensated for by the person who decided such payments.

### **(3) The Profit Distribution Regime**

The current profit distribution regime places a strong emphasis on the capital maintenance and development for enterprises, while paying very modest attention to the interests of the employees, contributions to the budget, or ensuring equality between the economic sectors. Particularly, the rate of profit tax is reduced so that the enterprises can have the opportunity to expand their production scale. The after-tax profits may be used to make payments on the use of capital from the budget (before these payments were included into the production cost), or to set up financial funds for unexpected circumstances, such as the risk of capital losses. The minimum level of the development investment is allowed to increase to 50% of the after-tax profits. The limits for the bonus and welfare funds are reduced and depend on the efficiency of the business performance achieved by the enterprises that is based on the ratio between the profits and the government capital during this year over that of the last year.

### **(4) The Accounting and Auditing Regime in the Enterprises**

The enterprises have to conform the accounting regime regulated by the Minister of Finance. The new accounting regime has to be matched to international standards and to the new financial mechanism. It has to meet the requirements of the business administration of the enterprises and the management requirements of the government-authorized agencies. The issues that are related to the internal auditing and the autonomous auditing have been mentioned in the accounting and auditing issues, and the issues of the financial reports of enterprises. The enterprises have to implement openly the financial regime according to the indicative numbers involving capital, property, debts, results of business performance, and transfers to the budget. The enterprises have to be responsible to the laws for the openness of their data. The government should eliminate its control regime over the enterprises' accounting; instead, it should control the financial report regime of the enterprises.

To summarize, the financial management regime and the management regime for the capital and property that are specified in today's enterprise law, enhance the rights and responsibility of the managers, the leaders of the enterprises. These regimes give them more freedom in management and use of capital and property, clearly specifying their responsibilities in the efficient use of the government capital and property allocated to them. The government-authorized agencies are not allowed to interfere in the business administration of the enterprises; instead they have to fulfill control and inspection functions, and at the same time have to be responsible for the decisions made by them. The new financial regime gradually comes into line with international principles and requirements of the market economy. However, this regime has just been adopted; its efficacy needs time and practice to prove successful.

## **3. Performance of Implementation of the New Financial Management Mechanism**

Implementation of a new financial management mechanism promulgated by the end 1996 has brought about some positive results which can be seen as follows:

- 1) The new mechanism has helped increase an interest and responsibility of the SOEs' managers in the enterprises' financial issues and performance of capital and assets management. Previously, the main attention of SOEs' management was only on direct results of business, but today the rights, duties, and responsibilities of the enterprises' managers in such important issues as financial management, efficiency of the state's capital and assets realization, production cost management, financial statement etc., have been substantially increased.

2) The expanded autonomous rights of SOEs in financial management and execution of the state's capital and assets have largely improved the enterprises' capital and assets realization. A significant proportion of the stagnant accumulated capital and assets has now been mobilized to business operations. Flexibility of capital allocation also increased. In a number of general corporations, specific regulations on financial activities have been promulgated to serve as standards for business management. A special focus has been made on efficiency of capital realization and capital maintenance in the enterprises; particularly, significant efforts have been made to increase accurateness and credibility of calculation and registration of deducted fixed assets, as well as to minimize costs.

3) Direct intervention by the state governance's bodies as a representative of ownership into business operations and financial activities of SOEs has largely decreased. Today, the state's functional agencies' major attention is on setting up regulations, which serve as a legal background for the SOEs functioning. New control and inspection measures have been intensively undertaken in the financial area. Abolition of procedures on direct approval of balance sheets have made the SOEs more responsible for their accounting documents and financial statements. This also has created more favorable conditions for the financial agencies to undertake control and check over the SOEs' financial statements.

On the other hand, a number of shortcomings and constraints have been revealed in the process of implementation of the new mechanism, indicating a big need for further improvement, specifically:

1) Reassessment of the SOEs' assets on the basis of the price prevailing at the time the assets were assigned to the SOEs, as well as an inventory and capital maintenance, has met with several difficulties. In fact, it seems impossible to end with the enterprise's financial problems arising prior to assets assignment, merger, or separation of the enterprises.

2) Restriction of the amount of mobilized capital below the amount of the SOEs total legal capital has not been affirmed by practices. Although the restriction helps to protect the interest of creditors, the amount of the state's capital in the enterprises is too modest, so it can create a necessary barrier to business activities of SOEs on one hand, and to unreasonable accumulation of capital in a bank on the other hand.

3) Existing regulations on procedures in making mortgages, collateral, liquidation, transfer or sale of the assets which are not authorized to SOEs, also have created additional troubles for the enterprises and have made the state agency in charge of the state's assets and capital in SOEs to carry out functions such as appraisal of plans/projects on making mortgages, collateral, liquidation, sale or transfer of the assets beyond the responsibilities of the SOEs before the founder of the SOEs has a decision on the matter as stipulated in Law.

4) The regulations allowing SOEs to make price adjustments in accordance with changes in market prices and to include the price differences into the State's capital in the enterprises may lead to miscalculations of business performance and even to the state's "capital drain."

5) Regulations forbidding inclusion of some special types of expenditures (for example: awards to innovators, premiums, "lunch subsidy" to workers, etc.) have been not affirmed by practices, and lead to restrictions of the competitive movement in the enterprises, or created additional inequality between SOEs and enterprises of other economic sectors.

6) Further implementation of budget subsidies has limited capital accumulation in SOEs, which afterwards would lead to some restrictions in business extension.

7) System of sufficient criteria for the SOEs classification into profit-oriented and non-profit (public goods supplying) categories of enterprises has not been clarified and not affirmed by the practices.

The mechanism for financial functions in non-profit SOEs also has not been defined yet, especially for the enterprises standing in between the two categories.

8) While the rights of SOEs managers and executives have been significantly expanded, their responsibilities and duties have not yet been specified correspondingly, especially their material responsibility in case of loss-making or "capital drain" in SOEs.

## **VI. Equitization of the SOEs**

### **1. The Policies on Equitization of the SOEs**

In the process of implementation of equitization policies, the government has approved various decrees, decisions and regulations to determine the specific steps or methods needed for equalizing the State-owned enterprises. For example: Decision 143-HDBT, dated 10 May 1990; Decision 202-CT on 8 June, 1992; Decree 84-TTg on 4 March, 1993; and recently Resolution 28-CP on 7 May, 1996, issued by the Government.

In the current situations of Viet Nam, in equitization of the SOEs, special focus is made on the following objectives:

First, the SOEs now have a small scale of obsolete technology and equipment, weak management methodology, and low economic efficiency. The partial equitization of SOEs can be taken as one of the solutions to the above shortcomings and weaknesses.

Second, the large amount of idle funds held by the population is still not mobilized for business activities. Meanwhile, the shortage of investment needed to renovate and modernize technology and equipment and to expand the business of the SOEs is very serious. By partially equitizing the number of SOEs, the idle funds held by the population can be mobilized to accelerate the economic growth rate, and to deal with the difficulties in investment encountered by the enterprises.

Third, by equitizing the rights and the responsibilities of the employees, business efficiency is enhanced. The responsibility shouldered collectively and individually by the managers is strengthened. By doing so, the necessary lessons needed to construct the policies and regulations towards the SOEs may be concluded.

Fourth, by equitizing the number and the size of SOEs, they may be reduced to an appropriate level so that the management is arranged, and the investment mobilization is intensified to increase the efficiency of the SOEs, to guarantee a key leading role in the economy.

### **2. The Equitization of the SOEs in the Recent Years**

So far, the number of the equitized SOEs is still limited to only 14 enterprises. The SOEs being equitized belong to the category of small-scale enterprises that have certain opportunities in their production and business activities and in their product realization. The equitization is carried out in the form of partial selling of the property of these enterprises. Among the equitized SOEs, the most early equitization was conducted in the Company for Transportation Agents under the Navigational Development Corporation (Ministry of Transportation) that started its operation based on the company law from July, 1993. In 1993, two other enterprises were equitized; in 1994, one enterprise was equitized. After equitization, these enterprises have operated stably, achieved moderate growth, and contributed much more to the budget. According to data collected from 5 equitized enterprises with an operating period more than one year, the following results are observed: an increase in capital of 45% per year, an increase in turnover of 56.9% per year, an increase in profits of 70.2% per year, and an

increase in workers' income of 20% per year.

According to Decision No.548/TTg, dated August 13, 1996, the government estimates it will equitize about 150 SOEs in the coming years. In preparation for fulfillment of the target, SOEs equitization commissions have been established in many line ministries and provincial People Committees, to make a short list of the SOEs to be equitized. Undoubtedly, the Government has to overcome plenty of uncertainties and difficulties to reach this end.

The reasons for slow equitization of SOEs in Viet Nam may be seen as follows:

- The mechanism and policy on equitization are still incomplete and inconsistent. Before Resolution 28-CP, there were the Decision by the Chairman of the Ministry Council (now the Prime Minister) and some other regulations by the various Ministries about equitization experiments. Many problems were still not specified enough, for example: equitization procedures, pricing for bidding in the SOEs, privileges for the equitized SOEs and their employees, using the earnings from selling shares of the SOEs. Therefore, the enterprises do not have incentives to equitize; so they try to prolong the equitization process.
- Lack of knowledge and awareness about the needs and benefits of equitization. Managers and employees in the enterprises are afraid that equitization may take away their power, rights, privileges and permanent jobs.
- Some socio-economic conditions are not mature enough to facilitate equitization; among these conditions are the problem with evaluation of the enterprises, and the lack of a stock market. Therefore, the evaluation of enterprises has been facing plenty of difficulties and has basically relied only on the values recorded in the accounting books. This does not reflect the business advantages, reputations or quality of the goods produced. The selling of shares has also been in trouble because there is still no market; information about business situations within the enterprises is still limited, thus they are not attractive to investors.
- Some policies related to the equitization process, such as interest rates, profit distribution, the ceilings for bonuses and social welfare funds, nomination of the directors of the enterprises, and regulations dealing with the employees, are still not clearly specified.

### **3. The Measures Undertaken and that will be Undertaken to Accelerate the Equitization Process of State-Owned Enterprises**

To further improve mechanisms and policies formulating the legal framework for SOEs' equitization, the government issued Decree 28-CP, dated 7 May 1996, on transferring some SOEs to shareholding companies, and Decree 25-CP, dated March 26, 1997, containing some amendments to the above-mentioned Decree, which included provisions stipulating that today the central government is responsible for SOEs with more than VND 10 bil. capital only (before, the amount was VND 3 bil.). According to the Decision, instructions of the Decrees should be comprehensive, timely and complete. The stages, methods of equitization, and responsibilities of each administrative level, must be clearly determined. Also there must be a clarity of the responsibilities and interests of the enterprises, and of the enterprises' managers, employees. Only by this way the equitization can be done quickly and effectively.

Improve the understanding of government agencies related to equitization. Apart from propaganda on the Party's and the government's policies and directions, it is necessary to publicize the equitization regimes to all interest groups in society, so that everybody can understand the equitization policy correctly and fully.

The ministries and provincial People's Committees should sort SOEs to clarify which SOEs can be equitized. It is necessary to try to put the most efficient, highly profitable SOEs into the equitization



program to attract people. Except for selling a part of a SOE' property, it is necessary to experiment in equitizing a part of the enterprise by issuing shares in order to mobilize investment funds for expanding production.

Hasten the establishment of the exchange market, publicize the SOEs' finances, provide timely information on the performance of the equitized SOEs. In this way, provide convenient conditions for investors to select investment plans.

Improve the regime on using the earnings from selling shares of the SOEs so that the earnings can be easily, efficiently and flexibly used in accordance with the objectives of equitization and government regulations. Thus, the improvement of the regime on using earnings from selling shares is very urgent. This will not only mobilize spare funds, but speed up the equitization program.

To improve the management mechanism for share-holding companies it is, firstly, to establish a management regime for state funds in the share-holding companies, so that the government can control and manage its funds in the companies, and the company's efficiency, without direct intervention in their business activities.

To improve the organization and leadership for equitization from the local level to the central level, so that the organizational system is flexible, dynamic and useful. To improve control and inspection by the government agencies over the equitization in order to ensure the government's and Party's policies and directions are followed.

## **VII. Stages of the SOEs Reform in Viet Nam**

The five above-mentioned five problems should be regarded as the basic contents for formulating the major directions in SOEs reform in Viet Nam. However, each stage of SOEs reform has its own characteristics specifying a methodology and schedule of implementation. The process of SOEs reform in Viet Nam can be divided into some major stages, each of which is characterized by the following basic characteristics:

### **1. The Centrally-planned Stage**

This stage was prolonged from 1950s to the early 1980s. The basic characteristics of this stage may be seen as follows:

- The State undertook direct management over SOEs through the plans made by Central Government and imposed by the State on the enterprises. Performance in implementation of the planned targets was the most important task and efficiency indicator of the SOEs. The SOEs played the role of a government agency in fulfilling the orders, directives and system of directed targets that were centrally planned and detailed by the State.
- The State applied a system of heavy subsidies to the SOEs. The relation between the State and SOEs was the providing-and-delivering. The SOEs did not have to bear any direct responsibility for their financial activities: their profits were held totally by the State, and their losses were covered by the State budget.
- The market signals were totally ignored in this stage. More specifically, elements such as price, cost, profits, losses, wages, etc., were not determined by market supply and demand, but by the targets given in the government's socio-economic plans.

In this stage, some efforts were made to improve the SOEs' management. However, these efforts were mainly confined to the random adjustment and partial improvement derived from the centrally-

managed model with administrative bureaucratic subsidies.

## **2. The Stage with Limited Autonomy**

This stage started from the beginning of 1980 and continued till 1987. After having passed the Decision 25-CP, dated 21 January 1981, whose basic contents were on permitting the SOEs to utilize and mobilize the additional potentials to produce main products and by-products, the SOEs were given some limited autonomies as follows:

- The SOEs were allowed to expand the range of products with materials and inputs mobilized by themselves (not provided by the State) after fulfilling the targets plans on the items; inputs of which were supplied by the State.
- The SOEs were allowed to exchange their products in the input and output markets after having fulfilled the plans determined by the government.
- The SOEs were allowed to recruit for additional employment or to change the production profiles, or to enter joint ventures and other forms of economic cooperation, including cooperatives.
- Centralism in the plan was reduced to a certain level. The plans for the enterprise consisted of 3 parts: planned items whose input factors were totally supplied by the government; products with the inputs and materials mobilized by the enterprises; and by-products made from waste and junk not subject to designed duties and tasks of the enterprises. The number of directed targets was reduced for a range of products provided by the enterprises themselves.
- Autonomy of SOEs in mobilizing the labor resources for fulfillment of their "own" production plans that were carried out with the inputs mobilized by the enterprises themselves and for production plans of by-products was to some extent enhanced. The enterprises were also given economic incentives and rights in using income obtained from the plans' inputs, which were provided by the enterprises or from their by-products.
- Some additional powers and rights were given to the Directors of the enterprises. Specifically, the Director was able to sign the contracts with the suppliers who could provide the inputs factors, instead of the proportion supplied insufficiently by the State. The Director could also make the decisions on reward or punishment of employees.

## **3. The Stage of Increasing Autonomy to the Enterprises**

This stage started after the promulgation of Decision 217-HDBT. It has continued until this time. The most striking feature of this stage is reflected in expanding business activities and increasing the SOEs' autonomy by removing direct intervention in the SOEs' operations. The major contents related to these issues have been mentioned in Part II above.

## **4. The Stage of Ownership and Management Forms Diversification and Transformation of the SOEs to Shareholding Companies**

This stage started in the early 1990s, and has created a basis for the current reforms in SOEs.

This stage has marked the starting point of transformation of the SOEs into the other forms of enterprises, particularly:

- Equitization of SOEs, transforming them into shareholding companies, transferring a certain part of the state-owned property to a private one, or allowing the private sector to contribute capital to SOEs in order to form shareholding companies.
- Transferring parts of state-owned property within SOEs to the private sector by selling or

liquidating the property, which has been undertaken in the process of rearrangement, registration, and dissolution of SOEs carried out since the early 1990s.

- Combining mixed ownership forms of the enterprises by creating joint ventures with foreign investors, or by establishment of new shareholding companies, whose shares are held by the State and by private sectors simultaneously.
- Developing hiring-by-the-piece, leasing forms, and production contracts to strengthen responsibility and efficiency in managing and using the State's assets and capital in SOEs.

Generally, this stage reflects the combination of various measures that were used in previous stages, including: a) enhancing the SOEs' autonomy; b) Rearrangement and reorganization of the SOEs; c) Reorganization of the previously existing general corporations; d) Strengthening financial management of the SOEs; e) Diversification of ownership and management forms; f) Transformation of SOEs into shareholding companies.

