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New Insights into Development Policy and the Reform of State Enterprises in China and Viet Nam

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I. Introduction

This paper is a written version of my address made at Xiamen University, China on December 30, 1996. But the content was essentially equivalent to the planned statement on the working hypotheses of the studies on the state enterprise reform in Viet Nam to be made at the Forth Session of Tokyo Workshop held on March 23, 1997, the paper was presented to it as a back ground paper.

This lecture will have two parts. In the first, I will discuss the rethinking of development policy that has taken place at the World Bank, an institution which through its positive development aid has exerted the largest impact on the economic development policies of the developing countries in the world. The main question that the World Bank has rethought is relating to the respective roles of the state and the market in development and their relationship. In conjunction with this, I would like to made some evaluation on this rethinking and discuss our own thoughts. The second part of the lecture will try to derive new insights into a theory of development policy from the analysis of rethinking. As concrete examples of applying such insights, we plan to take up an issue of the state enterprise reform on China and Viet Nam. Obviously, you in the audience are far more familiar with Chinese reforms than I am, but what I want to deal with is not so much facts as it is applications.

II. The Dispute among Development Theorists over the Roles of the State and the Markets

There has been a long dispute among economists on the roles to be played by the state and the markets in creating the factors to drive economic development. As you know, classical economics from Adam Smith onwards has maintained that the smaller a government is the better, and that it should be left to the markets to manage the economy. This has brought about a laissez-faire approach to economic policy. In the eighties and well into the nineties the World Bank has made this approach a cardinal rule of development policy. Developing countries, however, have argued that their market systems and production structures are so underdeveloped that government guidance and intervention are essential. Having developed later than the industrialized countries of Europe and North America, Japan is more sympathetic to the position of developing countries and there have in fact been disputes between the

World Bank and Japanese aid authorities on the methodology of development aid.

In the nineties, however, the World Bank has started to change its thinking. It has reviewed its policies in light of the fact that the countries of East Asia have continued to grow far more strongly than the developing countries of any other region in the world in spite of the heavily state-led development policies that they adopted. By East Asia, I am referring to South Korea, Singapore, Thailand, and Indonesia. In terms of high growth, China should also be included in this number.

This change in thinking can be seen clearly from the *World Development Report*, the World Bank's annual compendium of its most important research into development and development policy. Its 1991 edition, which advocated a "market friendly" approach, became famous for its discussion. Then in 1993 a World Bank Policy Research Report entitled *The East Asian Miracle*, advocated an approach for "non-market coordination." These go beyond merely tolerating the government using market incentives to intervene in resource allocation in the areas known as "market failures" in welfare economics, which also allow for the government to correct market incentives and even to intervene directly without going through the markets. There are, however, conditions on this. Even when the markets are bypassed, there must still be fair, contest-based competition; there must be a skilled bureaucracy and a system of checks and balances; and even if the aims of government intervention are correct, care must be taken not to cause "government failures" that distort the allocation of resources. These are all said to be lessons that can be learned from East Asia's experiences.

A policy rethink of this magnitude brings the World Bank very close to our own policy theory. The remaining difference is that we see developing countries as having different levels of market frameworks: un- and under-developed and in the process of formation. We would therefore advocate the intentional introduction of policies to foster the development of market economies. By contrast, the World Bank tends to treat lightly low levels of market development and does not include these considerations in its policy formation. (We would also note in this context that China has since 1993 had extremely explicit policies for the "cultivation and development" of market systems. This is close to the approach that we would advocate.) What we would therefore suggest is expanding the range of application of the World Bank's latest "conditional non-market coordination" approach to include countries that are in the process of developing market economies. We call this the "market development promotion approach." It has two basic conceptions.

1) The development policies of developing countries, and therefore the development cooperation policies of donor countries, must suit and be palatable to the country's stage of market development.

2) In addition, when a country is in a period of institutional transition, policies must be modified so as to promote a shift from the current stage of market development to the next.

III. Applications to the Reform of State Enterprises in China

To provide a real-life example of how development policies can be put together according to the "market development promotion approach," I would like to focus on the reform of state enterprises in China. It is not the purpose of this lecture to discuss the current status of state enterprise reform, but we must make special mention of the fact that in recent years state enterprises have seen their financial positions deteriorate, their current losses increase, and their defaulted credits mount. This has placed burdens on the management of state finances, since the state is heavily dependent on enterprise income for its fiscal resources. It is also threatening the foundations of state commercial banks. Reforming state enterprises has been a matter of vital—some would even say "life and death"—importance to Chinese economic reforms since the country began moving towards a market economy in 1978. To set the stage for our analysis I would like to bring up two matters.

First, the overarching (ultimate) purpose of state enterprise reform is to improve the performance in state enterprise activities (in production, management, finance as well as the enhancement of enterprises' capacity in longer-term) which have been the basis of the development of modern industries so as to enhance socioeconomic stability and growth, and increase the welfare of the people. During the process of development, there is an evolution in enterprise ownership, in internal and external organizations, and in the attitudes of stakeholders, the evolution that forms what we call "stages." Though it will obviously have the ultimate objective in mind, each stage will have a fairly independent set of challenges and subsidiary goals to achieve. The connection between stages occurs when the subsidiary goals of a stage have been fulfilled, causing "institutional fatigue" to ensue and enterprise results to decline. If at this point it is possible to shift to the next stage, then development continues.

Second, experience shows very well that an enterprise's development process and the problems it encounters will be markedly different depending on factors such as its specific industrial character and the size of the enterprises. We can divide this roughly into "large," "medium," and "small" enterprises. There will also be vast differences in their importance to China's long-term economic development. Our application will concentrate almost exclusively on the Chinese state enterprises that are in "large and medium" industries.

There are three steps involved in policy research under our approach.

In **Step 1**, we clarify which stage of development best fits China's state enterprises in light of the groundwork already laid. To jump right to the conclusion, there are five stages of development that seem to fit China:

1) "Patrimonial" state enterprises (state enterprises created with "bureaucratic capital").
2) Arms factory-style enterprises (state enterprises under the command economy).
3) Enterprises with greater managerial autonomy.
4) corporatized state enterprises.
5) Privatized state enterprises.

With the exception of the last, all of these stages will have periods of institutional stability followed by periods of transition to the next stage. There are four main conditions on the establishment of these contiguous stages:

1) There must be clear tasks to be overcome at each stage. These must be linked together in a progressive manner, and must contribute to the achievement of the overall objective.
2) These challenges must create the necessity for institutional transitions in the transition stage (they must be factors that would promote change).
3) Institutional transitions must be possible. (This will require preparations in terms of organizations of internal social division of labor and the interested party (stakeholder)'s perception structures in accordance with the achievement of the objective described in A.
4) Even when international environment is such that the introduction of particularly internationalized institutional rules has a net benefit for China, the gaps between those institutions and reality must be politically and economically tolerable.

Let us now briefly examine the continuity between these five stages in terms of the conditions for each stage's establishment. The first stage of patrimonial state enterprises was where China was before the inception of the People's Republic. Though enterprises were nominally run by the state, their purpose was in fact to increase the assets of powerful bureaucrats and provide jobs and income for their families. Patrimonial systems do play a role in stabilizing traditional societies, but become an impediment when state enterprises must work in accordance with the country's development objectives.

The second stage of "arms-factory-style" state enterprises is the first step to achieving national development objectives in the new age. The main techniques used are imposition from above of command-style planning indexes and their mandatory achievement. In the third stage, enterprises are provided writ greater managerial autonomy. It was made necessary when within a command system producers and managers lose their initial enthusiasm for serving state goals, causing the production, management, and finances of the enterprises to deteriorate. It is expected to bring new stimulus programs to help reactive them. However, as the enterprises are endowed with more autonomy without necessary prudential rules, "private monopoly" like activities and privileges as well as moral hazards and rent-seeking occur. On the other hand, producers and managers engage in the "insider control". The fourth stage of corporatization intend to eliminate insider control by establishing the rights of corporate owners and obligating managers to "conserve and increase" the value of the state assets held by state enterprises ("corporate governance"). This is also a device to put the state enterprises under competitive condition in similar to the private enterprises. (Level playing field). "Prohibition of Restrictive Competition" must be enforced at the same time with the corporatization. In the fifth stage state enterprises, except for those in areas where their public utility nature, must be maintained, are transformed into private companies that must seek greater managerial efficiency.

Currently, the case of international environment exerting pressure to introduce internationalized institution is seen in the transition to Stage 4 and Stage 5.

Step 2 is to determine which stage of development state enterprises are currently in. This is a relatively easy task when state enterprises are still in the early stages of development, but becomes much more difficult later on. One of the things that sets China apart is that the stage transition has continued to progress even though solution of the tasks facing each stage has been incomplete. To be more specific, first, present-stage China faces tasks of state enterprise reform that range across three stages of development: Stage 3 of increased autonomy, Stage 4 of corporatization, and in some cases Stage 5 of privatization. Second, the challenges from the first two stages have still not been completely resolved. Among the signs that these issues are still unresolved are the so called "sectorial ownership system" (egoism of line ministries), "forced donation" from government institutions (tanpai), the fact that enterprises also serve as social security and unemployment relief institutions, and "soft budget constraints" and "moral hazards." Perhaps these played a stabilizing role in times past, but today they are "residue" that is impeding development. Third, there are also several important factors that have an impact on the performances of state enterprises that goes beyond differences in stage of development and makes it hard to determine which stage of development China is currently at. Among these factors are the surplus of labor throughout society and the underdevelopment of various factors of market economies other than state enterprises, in particular, the underdevelopment of the fiscal and financial systems and the immature government policies on macroeconomic management.

Table 1 classifies the factors relating to the development stages of state enterprise into "major tasks" at each stage, "side effects" of their prescriptions and "residuals" of the same stages left in the nineties. This is to put the conceptions in order to make the tasks in Step 2 easier.

In the end, the task of determining the current stage of development is equivalent to detailed examinations of the three factors, taking into consideration the internationalization factors as well.

Omitting the details of the examination process and getting right to the conclusion, the current stage is generally in the transition from strengthened autonomy to corporatization. This conclusion is further strengthened by the fact that the international environment is seeking the early modernization of China's economic and business laws and ordinances.

Step 3 involves identifying policies that are not simply congenial and appropriate to the stage of development that has been thus determined, but also would promote transitions to the next stage. As we saw in Step 1, when there are large gaps in the stage of development of individual state enterprises, it is unrealistic to write a uniform, "one size fits all" prescription for corporatization or privatization without considering stage differences (thought this is what international institutions are often wont to do). However, in actuality, while writing of prescriptions in the earlier stage of enterprise development is easy, as in the case in step 2, it is no so in the later stages. And this is particularly the case for China at the current time. One of the ways to overcome the difficulty is first to make clear state enterprises' performance at the present stage and next to make appropriate classifications of the different factors impinging on state enterprises as their determinants.

Firstly, as enterprises' performance, indicators such as 1) production, 2) sales and exports, 3) management and 4) finance at the present time need to be made clear. In the next step, 1) the current status of production facilities and technology, 2) the current status of executive managers and leaders, 3) an enterprise's assets and cumulative debt, 4) ability of managers and 5)disciplines are observed to see enterprises' longer-term physical competitiveness.

Secondly, there are three criteria to classify the difficulty as determinants of performance.

1) Difficulties that would be overcome by reinforcement of management autonomy and corporatization, the principal task at the current stage. As for corporatization, there are also difficulties in implementing the policies for corporatization (i.e., elimination of monopoly, privileges and insider control, the difficulty of monitoring the activities of managers from the point of view of enterprise owners).

2) Difficulties in eliminating residual issues from the previous stage (sectorial ownership, lack of separation between enterprises and social programs, "soft budget constraints" and the like).

3) Exogenous factors that impinge on state enterprises (surplus labor, lack of modern fiscal and financial systems, underdeveloped financial markets).

Although we have not discussed it seriously, there is, other than these three types, one special type of difficulties which could be overcome by the effort of improving management practices within the framework of the existing enterprise system and hence in a given stage. This is an area in which mainly the management consultants have a comparative advantage in enterprises reform.

The writing of specific prescriptions begins by elucidating the relative weight of these different factors on state enterprise performances. One way to measure these weights more accurately is a quantitative analysis of data from surveys of a large number of state enterprises, such as are currently being done in a joint project between the Chinese Academy of Social Science and the OECF. When it would become possible to do this, then state enterprise reforms can be prioritized according to weights, and the resources required for reform allocated in such a way as to improve overall effectiveness. If this method cannot be employed, then the alternative is to accumulate several qualitative analyses. The relative weight depends on one's intuition because that is only to enumerate factors that presumably give significant influence on enterprises' performance as prescriptions. Our conclusion is that the state enterprise reform policies from Step 3 will be a combination of four different components (this is in accordance with our conclusion from Step 2) that will need to be implemented roughly in parallel. These elements are: (i) establishment of corporate governance, which is the principle that underlies modern corporate systems; (ii) resolution of the residual issues from previous stages, including "sector ownership," "lack of separation of corporate and social functions," and "soft budget constraints"; (iii) resolution of the external factors that impinge on companies, including absorbing excess labor and

engaging in the modernization of the fiscal and financial systems that is required for sound corporate finances (The reform based on the recommendations of the management consultants could be added to these three) and; (iv) improvement of management in parallel with the above elements or in their current status. Given China's current economic conditions, these are difficult policy tasks that will require time to achieve, but we are confident it can be done.

Let us sum up this section by referring back to our "market development promotion approach." Countries that utilize this approach must search for policies that are suited to their current level of market development and that promote the transition to the next level. This is a fairly straightforward matter in the early stages of state enterprise development, but as we have seen with present-day China, application is much less simple in the later stages. Even if the stage of development can be determined, policies will have to be drafted as a multi-level, multi-dimensional set. This is because of the accumulation of special circumstances in the later stages (such as incomplete stage transitions, the impact of non-enterprise factors) and it does not invalidate this approach. All that it shows is that unless complex factors can be appropriately controlled, a country will be unable to arrive at the core of this approach, which is drafting policies that are not only "appropriate to the stage" but also "promotive of the transition to the next stage."

One means of clarifying the factors in order to control for them would be to draw a diagram of the cause-and-effect relationships that influence the production, management, and financial performances of state enterprises at a particular stage. An example is provided in Table 2. We can use this Table, for instance, to discover what the cause is of expanding enterprise deficits, an issue that has become a serious economic problem for China. Part of this is probably attributable to insider control. This is because insider control manifests itself first as an outflow of enterprise assets and a dilution of the capital share of enterprise net income, and then as an increase in financial losses. This is a "residual issue" from (Stage 3 on stronger autonomy). However, there are other factors that also expand deficits. As residual issues from even earlier stages one could point to the failure to separate corporate and social functions, soft budget constraints, and moral hazards. Also contributing are excess labor and backward fiscal and financial systems. And of course, we should also point out the lack of management capability that is often uncovered in ordinary surveys by management consultants.

Another thing that the prioritization of cause and effect relationships shows is that it will not be enough for state enterprise reforms merely to separate ownership and management or introduce corporate governance systems to eliminate insider control.

IV. Applications to the Reform of State Enterprises in Viet Nam

Viet Nam's market reforms started with the introduction of Doi Moi policies during the Eighth Party Congress of 1986. The preconditions for economic reform were put in place in 1989 with "Big Bang" style price revisions and a strengthening of fiscal and financial disciplines at the behest of the IMF and World Bank. While this is somewhat different from China, economic reforms generally cover the same ground and employ the same "gradual" strategy. The same thing can also be said of Viet Nam's state enterprises, which account for a predominant share of non-agricultural production.

However, there is also a marked lack of general information about Vietnamese state enterprises. While the enterprise reform strategy of Viet Nam is probably similar in the main to that of China, there is much that is not known about the details of strategies (particularly the succession of them) and the results of the implementation of the strategies have not yet manifest themselves visibly in terms of production, managerial, and financial performances. The purpose of this lecture is not to delve into

economic performances, but we should note that the lack of information serves as a major constraint when searching for concrete prescriptions under the "market development promotion approach." Nevertheless, the approach can be applied to get us to one step right before the prescription phase.

We will use the three steps of the approach without modification in our consideration of state enterprise policy in Viet Nam. (The fact that our findings for Chinese state enterprise reform can be used in the form described above is very beneficial for our research on Viet Nam.) We will omit the research process and go straight to the conclusions for each step.

Step 1: The five stages of development seen for China will serve more or less intact as a model of the stages of development for Vietnamese state enterprises. While there will be differences in the form and speed with which transitions are made because of different initial conditions and the domestic and international situation surrounding the establishment of the Socialist Republic of Viet Nam, the stages themselves will be the same.

Step 2: As was the case with China, identifying the stage of development is fairly straightforward early on and much more difficult later. The main reason is that Viet Nam's stage transitions have been incomplete. It has moved on to the next stage without fully overcoming the challenges of the previous stage. The major reforms facing Viet Nam at the present time are to establish enterprises' autonomy (Stage 3), to corporatize (Stage 4), and to privatize (Stage 5). If we must identify a current stage from among these we would have to say that Viet Nam is working hard to establish autonomy and preparing for the next stage: corporatization. While this is similar to China, Viet Nam is in fact at a much earlier stage of evolution. (China is facing greater difficulties from insider control and is acutely aware of the need to solve these problems. Viet Nam is not yet in this stage.) However, from an international relations, Viet Nam is under more pressure to corporatize its enterprises (in particular because of the conditionalities on the structural adjustment loans of the IMF and the World Bank).

Step 3: Having identified the stage of development, the next step is to formulate state enterprise reform policies that are suitable for that stage and will promote transitions to the next stage. In Viet Nam as well, this is easier in the initial stages than later on. Added to this is the lack of information, which among other things makes it impossible for us to know the financial results of state enterprises. We do know that the reinforcement of financial disciplines in the nineties and the weeding out of many ill-performing enterprises by the enforcement of re-registration system have drastically reduced the percentage of loss-making state enterprises and defaulted debts at state commercial banks. State enterprises are also making a large net contribution to state budget get. This would ostensibly seem to indicate that Viet Nam's state enterprises were performing far better than China's, but even in Viet Nam there are interpretations that conflict with this. Stronger financial disciplines have resulted in improvements in some indexes, mostly current balances, but enterprises remain frail and are actually coming under increasing pressure that is having a detrimental effect. One such index is the average ratio of liabilities to assets, which is at 80% (compared to 67.8% in China). Also note that monetary surveys show credit to state enterprises to be worth only about 14% of GDP (compared to at least 44% in China).

To sum up: while it is clear from qualitative materials that the three categories or more of determining factors in enterprise performances found for China (factors that will be solved by corporatization, residual factors from previous stages, and non-enterprise factors and so on) are at work in Viet Nam, there are no quantitative materials available that would allow us to judge their relative importance.

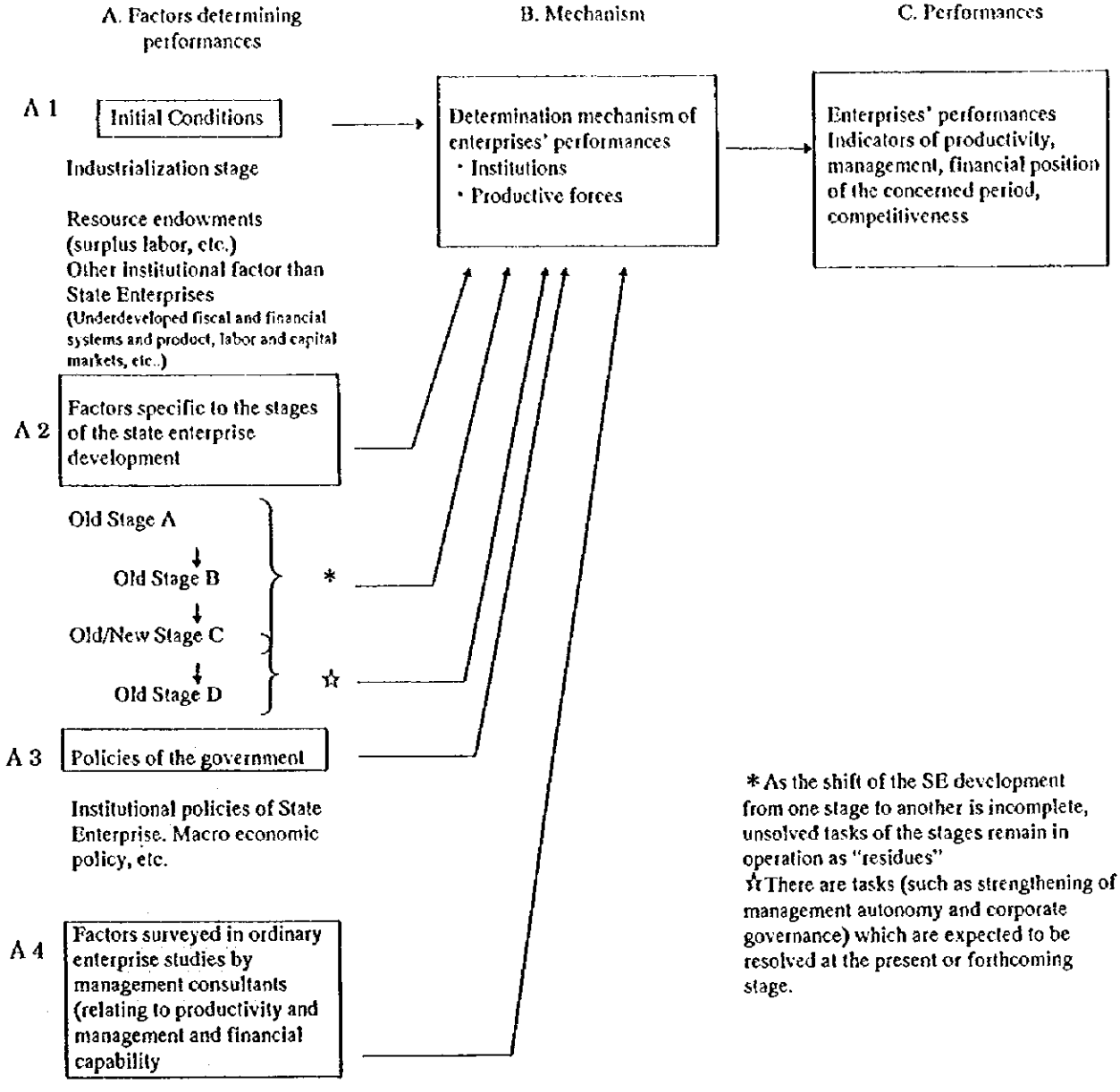
Viet Nam lacks the basic surveys needed for economic policy in a wide range of areas, but it is

especially urgent that numerical data be available on the factors that are required for appropriate implementation of state enterprise reforms. The framework for using it to identify policies is already in place, all we are waiting for is the data.

Table 1 Major tasks and "side effects" and "residuals" at various stages of the state enterprise development

Stages of the state enterprise development	(1) Major tasks to the each stages	(2) Tasks that emerge when major tasks are taken care of and are expected to be solved in the following stage-"side effects"	Existing challenges in the 1990s-"residuals" from the concerned stage
Traditional "patrimonial"	Concede a superior's governing power to bureaucrats. Bureaucrats acquire assets for domination purpose.	The gap between private goals and state goals arise upon economic development. (For example, "bureaucratic capitalism")	-"Sectional ownership system" -"Localism" -"Unit-ism" -"Responsibility due to un-separation of enterprises and society"
Arms factory-style	Draw economic plans in accordance with state goals. Faithful enforcement of plans by enterprises.	Incentive problems (agency problem) appear as initial enthusiasm for socialism (when workers are "masters" of enterprises, i.e. "all-people ownership system") subside.	-"Soft budget constraints" and subsequent "moral hazards" and "rent-seeking"
Managerial autonomy	Endow managers with managerial autonomy.	-"Insider control" problem -Monopoly problem (which emerges when individual enterprises are endowed with the overall freedom to decide price and production in industries seeking increasing returns) -Privilege problem compared to private enterprises (due to preferred allocation to specific enterprises provided by the transitional investment and loan system)	-Monopoly and privileges and subsequent "moral hazards" and "rent-seeking" -"corrupted bureaucracy" "Insider control" and "loss of state enterprises' property"
Corporatization (under state ownership)	Establish the rights of corporate owners. Separate ownership and management. Create and develop "level playing field" with private enterprises.		
Privatization	Privatize except those enterprises that have public utility and special state goals.	Monopoly problem	

Table 2 Causality map relating the state enterprises' performances to the underlying factors determining them -- case of state enterprise reform --



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The Reform of Vietnamese State Enterprises under *Doi Moi*: Past, Present, and Prospect

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I . Preface

This paper, "The Reform of Vietnamese State Enterprises under *Doi Moi:* Past, Present, and Prospect," constitutes the final report on research into "the historical process of Vietnamese state enterprise reform," which is the second sub-topic in the fourth topic ("state enterprise reform (renovation)") assigned to this study. It constitutes a part of the findings from this research.

The descriptions are presented in three sections. In Section Ⅱ, we lay the necessary groundwork for what is to come by considering "Vietnamese State Enterprises Prior to the *Doi Moi* Reforms" (Part 1), and the "State Enterprise Reform Prior to *Doi Moi*" (Part 2). In Section Ⅲ, we consider the process and results of state enterprise reform under *Doi Moi*, arguing that reform has gone through an initial stage in which enterprises were given broader autonomy over their management, to the incorporation stage that began in the early 1990s, and now faces a further stage of equitization. This section has four parts: "Broader Autonomy over Enterprise Management: An Outline of Decision No. 217/HDBT" (Part 1), "The Groundwork for Marketization: Price, Monetary, and Financial Reform" (Part 2), "The Reorganization, Realignment, Incorporation, and Dismantling of State Enterprises" (Part 3), and "State Enterprise Reform Since 1994: The Formation of General Corporations and Business Groups " (Part 4). The descriptions in Section Ⅲ go into particular detail for the period prior to 1994 for two reasons: 1) the strengthening of managerial autonomy was the main topic studied by the writer in his work on this sub-topic, and 2) there was a desire to avoid excessive overlap with the final report on this sub-topic by the Vietnamese partner. Also in order to avoid overlap, Section Ⅳ considers three of the problems and challenges in Vietnamese state enterprise reform that require particular comment and looks at them in more detail than the final report by the Vietnamese partner. They are: "The Management Subcontracting System" (Part 1), "The Strengthening of Insider Control over Enterprises" (Part 2), and "The Soft Budget Constraints on Enterprises" (Part 3). At the end of Part 3 we have also attached a small "appendix" on "Residual Elements of Traditional Society in Enterprise Activities."

II . Vietnamese State Enterprises Prior to the *Doi Moi* Reforms

Very little is known about Vietnamese state enterprises prior to the *Doi Moi* ("renovation") reforms instituted at the end of 1986. There is a particular dearth of information on how the state enterprises actually functioned, and elucidation of this is one of the most urgently needed areas of research. The

description below is a provisional attempt at explaining how state enterprises functioned prior to *Doi Moi*. In writing it, the author referred to the documents in Vietnamese written from the standpoint of present-day Viet Nam.

1. Prior to 1979: The Centralized Command Economy

In the socialized North, Vietnamese state enterprises began to be formed in the mid-fifties by the take-over of companies that had belonged to France, the colonial power. The majority, however, were built during the 1961-1965 period with assistance from now defunct the Soviet Union. After North-South unification in 1976, the important companies of the South were added to this number, as well as new enterprises built around the country. This is the origin of the state enterprises in Viet Nam today. The state industrial sector plays an extremely large role in the economy. State enterprises account for the majority of heavy industry, such as energy, mining, metallurgy, machinery, chemicals, and defense. Even in consumer sectors, state enterprises play a large role in textiles, paper, automobiles, soap, and pharmaceuticals. Indiscriminate nationalization regardless of the size or technology levels of the enterprise has been criticized under the current *Doi Moi* regime as exacerbating the non-ownership of enterprises which invites corruption, waste, theft of state assets and a host of other evils (which, in our view, is what is entailed by a "strengthening of insider control;" see Section IV Part 2).

It was in 1957 that the economic accounting system was brought in for state enterprises, but the centerized command economy did not really begin to function until 1960 when the State Planning Committee (now the "Planning and Investment Ministry") and the Material- Supply Ministry (now defunct) were established. To the extent that enterprises followed statutory targets and input-output mechanisms ordained by fiat (supply of materials and delivery of products according to managed prices), there were limits on their managerial autonomy. On the other hand, this was a planning system that was so hierarchical as to necessitate the "soft budget constraints" described by the Vietnamese term "*bao cap*" (see Section IV Part 3). Any way, it is said that it formed the basic framework for wartime mobilization during the bombing on the North period that ensued after 1965.

Under the command system above, the workers' share followed a strict egalitarianism. In part because the country was at war, basic necessities were rationed for enterprise workers, and the managed prices for rationed goods did not change from 1960 until early 1985, as well as prices for materials and products from 1965 to early 1980.

It is assumed that this command system was fairly rough compared to that of the Soviet Union. In 1981, the statutory targets on state enterprises were reduced to five, but even at the height of the command days, it doesn't seem that there were as several tens of them as the Soviet Union.

One of the reasons the Vietnamese command system was rough was that the country was still at a low stage of economic development and subject to intense regionalism. Like China, Viet Nam was quick to implement a regional decentralization policy (or using the terms of "system theory," "decentralization within centralization"). This decentralization was reinforced in Viet Nam's case by the war, which encouraged enterprises to "evacuate" to outlying regions.

The defects and inefficiencies of state enterprises in a command system had already been recognized by the early sixties. The *Kosygin* reforms in the Soviet Union provided part of the inspiration for introducing a "profit principle" to Vietnamese enterprises in 1971. This "principle" was also applied to the Southern enterprises nationalized after unification. However, the extent to which the principle applied is not clear for either North or South.

Trusts (lien hiep xi nghiep), which served as an intermediate administrative unit between the line ministries and enterprises under the sectorial control system and which themselves constituted large, horizontally integrated enterprises, were already seen in the sixties, but the incentives to their

formation did not come until the "Principles of Trust" in 1978 and Decision No. 156/HDBT in 1984.

2. 1979-1986—The Period of Partial Marketization

After unification, the Vietnamese economy fell into an extreme slump in the late seventies. In 1978, negative growth was recorded. The slump is attributed to three factors: 1) failed attempts in the agricultural collectivization in Southern provinces; 2) the economic sanctions by the United States and other Western countries and the curtailment of Chinese aid over the "Cambodia problem" (1978); and 3) funding problems in general as the Soviet Union and Eastern Europe began charging interest on and requiring repayment of aid provided to Viet Nam.

Since September 1979, the Sixth Central Committee of the Communist Party started to implement a "renovation" of the economic management system in every sector in order to pull Viet Nam out of the slump. This renovation amounted to a partial marketization.

In the reform of state enterprises, Decision No. 25/CP in January 1981 required enterprises to maintain managed prices for materials for which the state could guarantee supplies, but allowed them to purchase according to market prices those goods for which the state could not guarantee supplies. This was done because of the shortages of materials, and is equivalent to the "two-track" system employed by China. That same month, Decision No. 26/CP instructed enterprises to expand the application of "payment by results" for worker wages and bonuses.

After 1981, the managed prices for major materials and products were raised to some extent, but the prices for goods rationed to enterprise workers were held low. The gap between managed and market prices for materials and products (including rationed goods) was covered by financial subsidization of prices—in other words, by issuing more money, which is the equivalent of running a financial deficit. Thus the process of reform also caused inflation to emerge. By 1981, the consumer price growth rate was already 90%, and in 1982 it was 80%. This financial deficit was ultimately covered by aid provided by the Soviet Union in form of trade. During the period in question, Viet Nam was running a 200% net import excess with the Soviet Union.

In June 1985, Viet Nam, advised by the IMF and World Bank and taking a cue from the Gorbachev reforms in the Soviet Union, scrapped the rationing system for state enterprise workers, began paying wages in cash, and introduced sharp hikes in the managed prices for major materials and products. These reforms, which have direct overlaps with *Doi Moi*, were failures however. There were three factors accounting for this failure: 1) paying wages in cash required large amounts of currency; 2) the price of goods imported from the Soviet Union rose in stages, but faster than the managed price system, which was seeking to stabilize prices at relatively high levels; and 3) national banks were required to maintain low discount rates on their loans to enterprises. The fiscal deficit rate continued to grow, and in 1986 yearly inflation rate hit 600%.

This section has provided an overview of Viet Nam during the period leading up to *Doi Moi* and the reforms that preceded it. According to Vietnamese document, *Doi Moi*-period problems like the "soft budget constraints" on enterprises (the contraction and elimination of financial subsidies for prices in the context of an expansion of enterprise autonomy) and the "non-ownership" of enterprises (which the country has attempted to correct within the context of incorporation and equitization) had derived from the way that state enterprises were organized and managed in the pre-*Doi Moi* days.

We must point out, however, that the "strengthening of insider control" over enterprises that was seen and to some extent corrected after *Doi Moi* was also in existence prior to *Doi Moi*. For example, Decision No. 25/CP in 1981 allowed enterprises to increase the income of their workers with independent, non-planned production engaged in after their production plan (defined by enactment targets) had been completed. In the process of applying this policy, which was popularly referred to as

the "third plan" in Vietnamese, there were frequent complaints about enterprises that ignored their real production plans so that they could achieve their "third plans," diverted the materials provided to them for their real plans to use in their "third plan," or even sold materials to other enterprises for profit. According to one piece of research in Vietnamese, even prior to *Doi Moi*, the Workers Representatives Congresses were already so strong that enterprise managers could not ignore their will. The third plan was eliminated in mid-1986, immediately prior to *Doi Moi*.

III. The Process and Results of State Enterprise Reform under *Doi Moi*

With the Sixth Congress of the Communist Party in December 1986, Viet Nam embarked on a policy of "renovation" (*Doi Moi*) in all aspects of the state: politics, economics, society, and foreign relations. The major task of economic *Doi Moi* can be seen as bringing market mechanisms into economic activities in general, but after macroeconomic stabilization had been basically achieved, the Communist Party Meeting in January 1994 added the new tasks of industrialization and modernization, in other words, "economic development." This is a task that remains to the present day.

Two main stages can be seen in the *Doi Moi* state enterprise reforms. The first stage, which extended from 1987 to early 1990 sought to expand the managerial autonomy of enterprises in parallel to the marketization of economic activities in general. The second stage, which began in early 1990 and is still going on, is an attempt to reorganize and realign state enterprises so as to correct the problems that became manifest in the first stage. In particular, this has meant strengthening finance management and discipline, incorporation, and (for enterprises running perennial deficits) dismantlement. We would note that the reorganization and realignment of enterprises has been a comprehensive program ever since the decision was made to pursue full-scale economic development in January 1994 and extends even to the Trusts (now called "general corporations"). More recently, an expansion in the enterprises eligible for equitization has also been put on the table.

In other words, the state enterprise reforms in Doi Moi began at the stage of expanding the managerial autonomy of enterprises, moved through the stage of enterprise incorporation (separation of ownership rights and use rights for enterprise assets), and is now at the stage of separating ownership and management (as evidenced in the expanded eligibility for equitization. The state enterprise reforms in Doi Moi are, in fact, following virtually the same course as state enterprise reform in neighboring China, which is also pursuing "reform and open-door policy."

But there are also vast differences in the state enterprise reforms of the two countries. For example, as we will discuss in detail later on (in Part 1 of this section) the expansion in managerial autonomy has gone forward much more intensively in Viet Nam than in China. This includes the right to make production and management decisions, the right to determine prices for goods and services, the right to purchase materials, and the right to sell goods and services. While the direct purpose of this paper is not to compare state enterprise reform in China and Viet Nam, we will comment further on these points in Parts 1 and 2 of Section IV.

1. Broader Autonomy over Enterprise Management: An Outline of Decision No. 217/HDBT

According to Vietnamese documents, there were three basic operation expanding enterprises' managerial autonomy directly after the start-up of *Doi Moi*: Decision No. 217/HDBT in November 1987 (more accurately, Decision No. 217/HDBT "Enforcement of Policies for the Renewal of State

Enterprise Planning and Socialistic Business Accounting System," which we will abbreviate as "Decision No. 217" in this paper), Degree No. 50/HDBT in March 1988, and Degree No. 98 /HDBT in June 1988.

The most important of these was Decision No. 217, which expanded managerial autonomy 1) initially over the right to make production and management decisions, the right to determine prices for goods and services, the right to purchase materials, and the right to sell goods and services, and also over the right to import and export; and subsequently over 2) the right to hire workers and manage personnel, 3) the right to control after-tax profits, the right to make investment decisions, and the right to distribute wages and bonuses; 4) the right to enter into business alliances and joint ventures, and 5) the right to dispose of assets.

(1) What sets the reforms of this period apart is that they were much more thorough than those of China in its reform and openness period. Viet Nam sought to marketize all economic activities as a means of stabilizing its macroeconomy (reductions in foreign debt, leading to reductions in financial deficits, which were caused in part by financial price subsidies, leading to a quelling of inflation), and in order to achieve this goal it gave enterprises greater autonomy over the right to make production and management decisions, the right to determine prices for goods and services, the right to purchase raw materials, and the right to sell goods and services. In other words, it reduced and eliminated the need to follow statutory targets and input-output mechanisms.

At the central level, the number of enactment indexes over production were reduced from five to three by Decision No. 217, and with Decision No. 195/HDBT in December 1989 were reduced to just one, "profit deductions and transaction taxes" (switched to "profit taxes" and "sales taxes" since 1991). In 1987, there were 98 "controlled items" subject to the decision of the Council of Ministers (at the central level there were also other controlled items subject to decisions of the State Planning Committee; the same applies to the "controlled materials" discussed below), but in 1990 they had been slashed to just 6, and by 1992 to just one, electric power (expansion in the right to make production and management decisions and the right to determine prices for goods and services). Decision No. 195 /HDBT also extended to enterprises, at the central level, the right to purchase materials and the right to sell goods and services, even for enterprises producing "controlled items." As a result, the input-output mechanism rapidly contracted. With this, the number of controlled (purchasing) items subject to the decision of the Council of Ministers was slashed from 95 in 1987 to just 8 in 1990, and just 3—refined oil, nitrogen fertilizer, and steel—in 1992. Decision No. 217 also gave enterprises a clear right to export and import within the context of economic openness, though the range of enterprises enjoying this right was limited (see Articles 54 and 55 of Decision No. 217).

(2) The significance of Decision No. 217 for the right to hire workers was that enterprises recruiting new workers now had the ability to use "labor contracts" rather than having to hire all workers for life, though their ability to do so was limited to hiring that was done "through state service institutions" (Article 48 of Decision No. 217). This amounted to a government-level guarantee of workers' freedom to choose and change their jobs, something workers did not previously enjoy. In conjunction with this, the enterprise directors were also given the right to steer personnel management, at least as far as new hires were concerned (Article 48 of Decision No. 217).

(3) Decision No. 217 included mechanisms for a vast expansion in the right to control after-tax profits, the right to make investment decisions, and right to distribute wages and bonuses. The "profit principle" was replaced with an under taking mechanism for the "profit portion," which was expressed as the remainder when raw materials costs were deducted from sales (including the profit deduction and transaction tax—changed to the profit tax and sales tax in 1991), and for the "wage portion."

Under the new mechanism, enterprises that were in the black (had positive figures for their "profit

portion" and "wage portion") had the right to dispose of as they liked any remainder after payment of the profit deduction and transaction tax (or the revised taxes after 1991) and a minimum wage to workers. They could put the remainder into their "production development promotion fund" and use it to increase their investments (the right to make investment decisions was also expanded by the provisions in Decision No. 217 allowing enterprises to retain within the enterprise 100% of all depreciation), or could use it to increase wages with no ceiling imposed. The mechanism was an attempt to give enterprises entering into a subcontracting relationship with their line ministry an incentive to reduce their raw materials costs and increase the share going to the enterprise and workers. A Vietnamese document refers to this as "income accounting system."

(4) Expansion in the right to enter into business alliances and joint ventures (lien ket, lien doanh) has consistently been an important policy and continues at present. In fact, however, alliances and joint ventures with foreign direct investors are much more important than alliances and joint ventures with enterprises belonging to different ownership sectors than the state enterprises. The "Foreign Investment Law" of 1988 provided for consistent encouragement of alliances and joint ventures between state enterprises and foreign capital (alliances and joint ventures between the non-state sector and foreign capital were only permitted in the 1990 revisions of this law). The law which permits wholly-owned foreign companies has been amended three times, in 1990, 1992, and 1996. The alliances and joint ventures between Vietnamese and foreign enterprises under the law are now defined as a form of "state capitalism" in which the use of alliances and joint ventures is encouraged, but with care taken to protect the interests of the state.

(5) In other areas, Decision No. 217 gave enterprises the right to dispose of assets by leasing and transferring enterprise assets (equipment, factory land, warehouse, transportation equipment) to other economic organizations (Article 18). However, it was not until Stage 2 of the reforms since early 1990 that this policy was promoted and expanded.

2. The Groundwork for Marketization: Price, Monetary, and Fiscal Reform

From 1980s to the early 1990s, in realizing Decision No. 217, Viet Nam also sought the macro-economic policies to ensure the effectiveness of the expansion of the managerial autonomy of state enterprises, aiming at laying the ground work for marketization. Price reform was the most instrumental one.

The price reform that began in 1987 was comprehensive and even extended to a unification of foreign exchange rates. In relation to the reform of state enterprises, prices for almost all consumer goods were liberalized over a one-year period that began in May 1988. During this process, the system of rationing for state enterprise workers was abolished and wages began to move towards market prices. Prices for most materials were hiked to market levels in conjunction with the transition to market exchange rates for the Viet Nam Dong, which was completed by in the first quarter 1989. Prices for controlled, imported materials like refined oil, nitrogen fertilizer, and steel, most of which Viet Nam was heavily dependent on the then Soviet Union for, neared market levels in 1991-1992 in parallel to the former COMECON price reforms.

The result of these reforms was prices for production factors and products in all industries being marketized by 1992 at the latest, excluding certain core industries and heavy industrial sectors under direct central control. This transition ran in parallel to the reductions in controlled items and materials described in Part 1, and during the process the 394.5 billion dong in financial price subsidies recorded for 1988 was reduced to just 74.0 billion dong 1990.

The current price system is basically the same as that defined in Cabinet Decision No. 137 /HDBT in April 1992. In this system, the prices for electric power, refined oil, cement, metals, paper, nitrogen

fertilizer, rice and other "controlled items" and the price for refined oil, nitrogen fertilizer and other controlled imported materials are as follows 1) traditional managed prices, 2) fixed prices with time limits, 3) guided prices, which are a form of managed price that takes profitability into account, or 4) prices with upper and lower limits set.

Monetary reform took place within the context of switching the source of funding for enterprise activities from the state budget to financial borrowings. It began with a separation of national bank functions into central banking and commercial banking during the 1988-1990 period. Then, after foreign exchange rates were moved to market rates in the first quarter of 1989, tight-money policies linking the interest on deposits and corporate loans to the price increase index were adopted. The result was that inflation began to come under control in 1989, and by 1993 had been brought back down within 10% annually.

The foundations of current interest-rate policy were laid with the decision by the national bank in June 1992. The main points were to scrap policies that set interest on loans lower than interest on deposits and policies that set different interest rates for different ownership sectors and industries (nganh nghe). More specifically, the national bank set upper and lower limits on interest rates, within which the commercial banks set their own interest rates.

Financial reform involved a reduction in the financial deficit in conjunction with price and monetary reform, efforts to quell inflation, and two other institutional reforms.

The first was to strengthen financial functions. As part of a program to separate financial and monetary policy, a "National Treasury" was established in 1990 under the Ministry of Finance for the purpose of centralized managing the national finances. Since the state budget was divided into a "current budget" and "development budget" in 1992, the National Treasury has managed development funds on behalf of commercial banks.

The second was to implement tax reforms, a process that has been on-going since the 1990-1991 period. The intent of the reforms is to increase tax revenues and also to transform the revenues that different ownership sectors were required to remit to the state into straight "taxes." In addition to putting in place a new tax structure for commercial enterprises, consisting of a profits tax, sales tax, and special consumption tax (taxation rates have been changed a few times since 1993), the reforms switched the profit deduction and transaction tax that had been charged to state enterprises to a profits tax and sales tax.

The results of these reforms were, at least in form, that Vietnamese economy has been shifted away from the command system, as symbolized by the direct micro-management of activities by in the socialist sector (i.e., the state enterprises) to the indirect and inductive system that left adjustments in the micro-level activities of economic sectors, up to market mechanism, including the private sector, which has been encouraged in Doi Moi, with the role of the government limited to enforcement of laws and macro-level management, with tax rates and interest rates serving as tools of regulation (note that the major state enterprises can also serve as tools of regulation).

The biggest result of the expansion in the managerial autonomy of enterprises and the reforms in the command system was a basic stability to the Vietnamese macroeconomy being established by 1993. We should point out that the reformed State Planning Committee (currently the "Planning and Investment Ministry"), which used to be the central institution in economic management under the old system, now seeks to become an institution for long-term planning, while the Ministry of Materials Supply was consolidated into the current Ministry of Commerce, Sports, and Tourism in 1990. The tasks for Viet Nam in seeking further marketization of its economy are to develop the markets for goods and services and also for production factors (labor, land, etc.). In particular, it needs to develop its capital and stock markets.

3. The Reorganization, Realignment, Incorporation, and Dismantling of State Enterprises

In early 1990, the state enterprise reforms in Doi Moi moved into the second stage of corporate reorganization and realignment.

(1) State enterprises were categorized by this time as "enterprises in the black" that were posting profits and able to pay taxes and "enterprises in the red" that could not do this. In 1990, 30% of state enterprises were in the black, 30% were breaking even (had balances of zero), and 40% were in the red. In terms of industrial sectors and management levels, the heavy industrial enterprises under the direct control of the central government were expanding their business while enterprises under the jurisdiction of ministries and provincial governments, primarily in light industries were posting chronic losses. In the commercial sector, most enterprises were in the red regardless of who their supervisors were.

Much of the Vietnamese documents attributes the polarization of state enterprises into profit-making and loss-making enterprises to whether or not they were able to consistently apply market mechanisms to their activities as their managerial autonomy expanded. In fact, most of the loss-making enterprises carried on in "previous business style," increasing their borrowings from national commercial banks and engaging in debt cross-holdings (what the Chinese call "triangular debts") so that they were already carrying large debt burdens by this period. By 1991, there was an estimated 8 trillion dong in inter-enterprise debt in Viet Nam. However, there were also other, non-institutional factors that had nothing to do with how well enterprises were able to apply market mechanisms. For example, trade with the then Soviet Union and Eastern Europe went into sharp decline at this time, sending many enterprises in this area into difficult straits.

But even these factors fail to fully explain the polarization of state enterprises that occurred at this time.

First, we should note that the loss-making state commercial enterprises and enterprises under local government control (for example, light industrial enterprises) were literally tossed into competition with foreign and private-sector goods in the process of marketization, while the centrally-controlled heavy industrial sectors that saw their performance improve (electric power, oil, cement and the like) were still guaranteed supplies of material and delivery of products in accordance with the enactment indexes and input-output mechanisms that governed them. (We should also point out that basic construction investments in this period concentrated in the electric power and oil sectors). Many of the heavy industrial enterprises that made the transition to "market activities" enjoyed preferential treatment in the application of the new regulatory tools of interest rates and taxation. Interest rates were more favorable in comparison to light industries and commerce until 1992 and taxes have been so since 1991. These factors also played a part in the polarization of state enterprises into profit-making enterprises (heavy industrial enterprises under central control, usually Trusts) and loss-making enterprises (light industrial enterprises under local government control and state commercial enterprises).

Second, and much was emphasized on at that time, there were "more than a few" loss-making enterprises that were counted as profit-making enterprises that were counted as loss-making. This occurred because of the marked strengthening of insider control as managerial autonomy was expanded in the wake of Decision No. 217 (see Section IV Part 2 for more on insider control). Almost universal among the loss-making companies counted as profit-making was the fact that while materials prices had been marketized, the appraised value of fixed assets was not. Because of this, only low depreciation were posted to production costs, inflating the "profit portion" and "wage portion." Among

the profit-making enterprises counted as loss-making were enterprises that distributed wage increases prior to finalizing their tax liability so that they ended up paying less in taxes than the required amount. This was often seen among enterprises controlled directly by the center.

(2) Occurring as it did within this context, the reorganization and realignment of state enterprises that began in early 1990 sought 1) to clarify the condition, and particularly the financial condition, of enterprises (which meant taking measures to strengthen financial management and discipline), and 2) based on these findings to liquidate enterprises that were truly unsalvageable. Looked at from a different angle, this move can be seen as a praiseworthy attempt to rectify the strengthening of insider control (or to contract the "soft budget constraints" that still continued on in modified form; see Section IV Part 3).

In relation to the first goal, it was observed that the lack of separation between ownership rights and use rights exacerbated the "non-ownership" of enterprises that was manifest in the phenomena described above (or other phenomena like corruption, waste, and theft of state assets). Therefore, Decision No. 315/HDBT in1990 separated ownership rights and use rights for enterprise assets, and gave enterprises the use rights.

This resulted in a reappraisal at 1990 prices of the fixed assets of enterprises (appraised asset values have been corrected several times since) and measures to fully incorporate depreciation within expenses. Having done this, and having acquired use rights, enterprises were obligated to create balance sheets that showed their ability to "maintain and increase" the overall value of their assets or at least truthfully indicated whether they were making a profit or not. These measures were applied to all state enterprises under Circular No. 138 of the Ministry of Finance in 1991 and Cabinet Decision No. 332 in that same year (the incorporation of enterprises). As part of the tax reforms noted in Part 2, state enterprises were charged a "capital use tax" as the price of their asset use rights.

Meanwhile, for the second goal (dismantling unsalvageable enterprises), Cabinet Decision No. 315/HDBT in1990 (amended by Decision No. 330/HDBT in1991) set forth guidelines for dismantlement. Long-term loss-making enterprises were categorized according to their degree of inefficiency and the importance of the goods and services they produced (therefore, loss-making enterprises supplying very important goods and services were removed from the dismantlement list). Those enterprises that would not improve even with reorganization and subsidies from their line ministries were dismantled. Dismantlement took the form of a reorganization of assets, either by liquidation and consolidation or by transfer of ownership (lease or outright sale to individuals or to other economic organizations).

The second facet of strengthening financial management and discipline, separating ownership rights and use rights, and liquidating long-term loss-making enterprises involved on obligation to re-register all state enterprises, as called for in Decision No. 388/HDBT in November 1991. Enterprises were evaluated for their enactment funding, transaction volumes, and degree of importance. Those that met standards were re-established, those that did not were dismantled. From that point forward, enterprises became known as "government businesses" (*"doanh nghiep nha nuoc;"* what the Chinese call "state companies") that were equal under the law with enterprises belonging to other ownership sectors.

Stage 1 of the re-registration and re-establishment of state enterprises was finished by early 1994. One result of the liquidations that occurred during this process was that the number of state enterprises was roughly halved from about 12,000 in 1990 to less than 7,000 in early 1994. According to one commentator, the breakdown of dismantled enterprises took place in a ratio of about 2:1 for liquidation and consolidation versus transfer of ownership and sale of assets. For a time in early 1994, less than a ten percent of all state enterprises were loss-making. Consolidated enterprises are said to be able to take advantage of business tie-ups with other enterprises than they were before. In January 1994 as

Stage 1 was completed, a new "Bankruptcy Law" took force.

There were some problems in the first stage, however. 1) Trusts and other heavy industrial enterprises under the direct control of the central government were exempted, for the time, from re-registration. Thus, while the program succeeded in reducing the number of enterprises in existence, most of those eliminated were the light industrial enterprises controlled by ministries and provincial governments and smaller commercial enterprises (which is why the assets of dismantled enterprises accounted for a mere 3.7% of total state enterprise assets; see Part 1 of this section). 2) according to a Vietnamese document, the enactment funds needed for "re-establishment" were too low, so that many re-established enterprises were still small ones. And 3) the reduction in long-term loss-making enterprises was incomplete. The Vietnamese document notes that one factor in this last criticism was that time was required to evaluate enterprises' assets and financial standing, but because of the deadlines imposed (and the fact that the program did not get fully under way until 1993), some enterprises were allowed to re-establish without undergoing a full review. It appears that the program was applied more rigorously to enterprises under local government control than central government control, and among enterprises under local government control, to those in the South than those in the North.

Note as well that in the course of this program, the state enterprise debts and defaults mentioned on in Part 1 were fixed and repayment began. But while almost all of the liabilities between state enterprises had been taken care of by May 1992, progress was difficult for the liabilities between state enterprises and non-state enterprises and it is not certain whether this has yet been successfully completed or not. Recently, the total liabilities of state enterprises has been on the rise (see Section IV Part 3).

Also important is the close relationship between this program and the equitization of state enterprises that began in June 1992, and the introduction of boards of directors to state enterprises in 1993, both of which were done on an experimental basis. The equitization is discussed briefly in the next part.

4. State Enterprise Reform Since 1994: The Formation of General Corporation and Business Groups

The reorganization and realignment of state enterprises, as well as general reforms of state enterprises, entered a new phase in January 1994 with the Communist Party Meeting decision to pursue "industrialization and modernization."

(1) The second phase of re-registration and re-establishment began in March 1994 as a means of further reducing the number of enterprises. In order to correct the inadequacies of the first phase, the government tightened the standards to be met, for example, raising the statutory funding level five-fold. In August 1995, Decision No. 500/CP was adopted in part for the purpose of reorganizing the construction and machinery industries that had not been adequately covered by the first realignment (see Section IV Part 3). The "Government Businesses Law" of March 1995 resulted in the creation of a new Enterprise Asset and Funds Control Bureau in the Ministry of Finance, which facilitated a more thorough separation of ownership rights and usage rights for enterprise assets. Then in August 1996, Government Decision No. 50 provided comprehensive guidelines for the re-establishment, reorganization, Dismantlement, and bankruptcy of enterprises.

Roughly concurrent to this, Degree No. 28/CP in May 1996 attempted to expand the range of equitization of state enterprises. The policy of expanding the range of equitization had already been advocated by the Communist Party Meeting, and the idea behind the decision was that correcting the "non-ownership" of enterprises that was responsible for corruption, waste, and theft of state assets (the

strengthening of insider control) required both that enterprises be incorporated, as was past policy, and also that ownership and management be separated, which meant equitization.

The equitization of state enterprises had been going forward on an experimental basis since Prime Minister's Decision No. 202 in June 1992, but this experimental equitization had not made much progress. In addition to the objective fact that Viet Nam's capital and stock markets were still undeveloped, there was also a subjective fear among the line ministries, enterprise heads, and workers that they would lose their entrenched interests. By May 1996, only a handful of enterprises had organized themselves as joint-stock companies.

Coming within this context, the significance of Degree No. 28/CP was that it contained concrete measures to give the workers at enterprises opting for equitization greater preference in purchasing the enterprise's shares, thereby encouraging equitization. Though it is not official government figures, the Vietnamese press reported that the country hoped to have at least 150 joint-stock companies by the end of 1997 and 200 by 1998, when the stock exchange was scheduled to open. Currently central and local government agencies are nominating one or two of the enterprises under their control (for a total of about 100) and attempting to move them into joint-stock companies.

One of the things that has set the post-1994 state enterprise reforms apart is that they have attempted to tackle the re-registration, re-establishment, or re-organization of Trusts that had been put off in Stage 1.

Re-organization of Trusts was also advocated by the Communist Party Congress, and the decision has two major implications. The first is to tie the re-organization of Trusts into a gradual elimination of the relationship between enterprises and line ministries (eliminating the line ministry system itself). This relationship is considered to be one of the factors in soft budget constraints and the strengthening of insider control (see Part 3). The other implication is that some of Trusts will be transformed into business groups that are competitive enough to be able to contribute to the industrialization and modernization (economic development) course charted by the Meeting.

In other words, the post-1994 state enterprise reforms have added a new task to the stated goals of the reforms that began in early 1990. The previous goals were to separate the ownership and use of state enterprises and to move them to joint-stock companies (the phase-out of the line ministry system is also a part of this because it seeks to bring in a board of directors for enterprises and to place the board directly under the control of the Government, as will be seen in Sub-part (2) below). The additional goal is to restructure the relationship between state enterprise management and economic development. This new goal came to be emphasized after the international competition brought by open-door policies revealed the backwardness of state enterprise technology levels and the limitations in their scale. In fact, Stage 2 of the re-registration and re-establishment of enterprises and the expanded range of equitization are closely related to the reorganization of trusts. In the pages that follow, we consider only the post-1994 reorganization of trusts and the challenges involved in it. Other issues are not taken up in order to avoid overlapping the final report by the Japanese researcher in charged of Subtopic 3 of this Topic.

(2) After *Doi Moi*, Trusts were baptized to reform (expansion of managerial autonomy so as to make the transition from an intermediate unit of government administration to an economic organization) with such measures as New Trusts' "Enterprise Disciplines" in 1989. But the measures taken for Trusts were not as strong as the measures taken for general state enterprises in general (see Sub-part (1) above) and the re-registration and re-establishment of Trusts was postponed, thus, according to the Vietnamese document, trusts that time can be divided into two types: 1) those plagued by a strengthening of insider control at member enterprises that have vastly expanded their autonomy, and 2) those that have used administrative regulations to curb the managerial autonomy of member

enterprises even though autonomy has officially been expanded. (It is difficult to give exact estimates how many fit which type.)

The reorganization of Trusts that began in March 1994 had two main goals: 1) to turn Trusts into "government businesses" obligated to "maintain and increase their assets" and to dismantle those that served mostly as administrative organizations (Prime Minister's Decision No. 90), and 2) to reorganize some of Trusts into larger "business groups" (Prime Minister's Decision No. 91). These two new types of enterprise groupings are both defined legally as "general corporations" under the "Government Businesses Law" enacted in March 1995. To distinguish between the two, the former are called "general corporations according to Decision No. 90," the latter, "general corporations according to Decision No. 91."

The main differences between the two are that general corporations according to Decision No. 90 require at least five member enterprises, general corporations according to Decision No. 91at least seven. General corporations according to Decision No. 90 also require at least 500 billion dong in statutory funding, general corporations according to Decision No. 91 at least 1 trillion dong. Furthermore, general corporations according to Decision No. 91 are not just limited to horizontal "one enterprise, one industry" integration but are able to seek more diverse or vertical integration, and may establish an internal financial organization that serves the same purpose as "main bank" in Japan. Finally, general corporations according to Decision No. 91 are being reorganized as government-controlled economic organizations with boards of directors but not under the control of their traditional line ministries. What should be clear from this is that it is general corporations according to Decision No. 91 that are seen as the "economic organizations able to contribute to economic development." Their model comes from the *chaebol* in Korea, or more directly from the enterprise groups of China.

When this research was being done in early 1997 there were a bit less than 80 general corporations according to Decision No. 90 and 18 general corporations according to Decision No. 91 (which we will call "business groups" from now on). Business groups have been formed in the industries that had Trusts even prior to *Doi Moi*—heavy industries like electric power, oil and gas, coal, and cement; and former plantation industries like rubber and coffee—and also in such fields as maritime transportation, air transportation, posts, textiles, tobacco, food and food processing, paper, and even national commercial bankings.

Measures are now being taken to lay the legal groundwork for these business groups, for example, the "General Corporation Diciplines" of September 1995 and the Government document on the internal financial organization of General Corporations in May 1996. We can also mention all the names of member enterprises of the General Corporations. However, it is not certain what effect this is having on business activities themselves because business groups are still only in the experimental stage of establishment (the bylaws, for example, are only applied on an experimental basis to a few groups of business groups). This point, and the domestic debate in Viet Nam on corporate aggregations, indicates (in however rough a form) that corporate aggregations face the following challenges:

First, there are problems in the management of the groups. Business groups are under the direct control of the government, but many government functions have necessarily had to be left up to the line ministries to perform as they always have. There are therefore two different lines of authority—from the government to the managing board of groups and from the line ministry to the director of groups—and it is not clear how they interrelate. There are likewise differences of opinion on how authority is divided between the groups and its member enterprises (especially as regards the degree of member enterprises are given in their economic accounting system). In Viet Nam, these problems are referred to as "determining the division of managerial autonomy."

Regarding the first problem, we feel that it would be better to continue to strengthen the line of

authority that leads from the government to the managing board of groups to the extent that doing so would contribute to a correction of the insider control in business groups. The latter question is a bit more complex, however. Giving the business groups more power may help to check insider control over member enterprises, but because the economic accounting system is involved, there are bound to be cases in which the managerial autonomy of member enterprises is subject to needless interference. There is also an idea that business groups could be given a mechanism for controlling the (joint-stock) companies under their umbrella via their internal financial organizations, but this is an idea that must be approached with caution given the fact that soft budget constraints continue to be seen on the monetary side (see Section IV Part 3).

A second problem is that while business groups are deemed to be business organizations that are internationally competitive and able to contribute to economic development, there are several different definitions of what this constitutes and each is biased in its own way: 1) able to expand exports, 2) able to be a core to expand direct investment and to construct bases in foreign countries, 3) able to serve as the Vietnamese partner in joint ventures with foreign multinationals enterprises 4) able to construct and operate industrial parks within export processing zones without relying on foreign capital, or 5) able to create joint-stock companies with provincial enterprises for the building of smaller industrial parks in the rural area.

We will not discuss definitions 3, 4, and 5 because they involve political questions. For 1, 2, until now, Vietnamese researcher have not been discussing them in an economically-oriented manner.

The Ministry of Planning and Investment seeks to orient the reform of business groups in the direction charted in Prime Minister's Decision No. 91 of March 1994, multifaceted and vertical integration. What will be important in this, however, is that the concepts of "multifaceted integration" and "vertical integration" are understood from an economic perspective. All else being equal, both forms of integration are better able to take advantage of economies of scale than are the horizontal integration that have been the main form seen so far. This will lead directly to the achievement of Definitions 1 and 2, i.e., to a strengthening of international competitiveness. With AFTA membership looming, economically-defined multifaceted and vertical integration will be worth consideration as a direction for Viet Nam's business groups in the future.

We must add that both of these forms of integration will do more to reduce the damage from "monopolies" (a subject of constant criticism) than the traditional horizontal business groups being pursued today. The "Law Concerning Antimonopoly Regulation and Competition Promotion" that is scheduled to be promulgated shortly should reflect this point. On the other hand, Viet Nam should also place strict bans on the establishment of general corporations that are nothing more than large enterprise mergers of the kind that have often been seen since 1994.

Finally, the issues concerning these two forms of integration should also be considered in drafting concrete policies for target industries, one of the chief challenges facing Viet Nam at the present time.

IV. Problems and Challenges for Vietnamese State Enterprise Reform under *Doi Moi*

1. The Management Subcontracting System

In providing a prescription for the reform of state enterprises in Viet Nam, it is first necessary to consider whether during the process of *Doi Moi* reforms Viet Nam adopted the same kind of management subcontracting system that China applied in its reform and openness period.

A Vietnamese-article in the December 1993 issue of *Tap Chi Cong San,* a theoretical journal published by the Communist Party, says that "subcontracting" was used in a greater number of state enterprises after *Doi Moi* than before. The article makes two points worthy of note here regarding the subcontracting system. First, during the course of the separation of ownership rights and use rights and the incorporation of enterprises that began in the early nineties, state enterprises were obligated to "maintain and increase" the value of their assets, and undertook (subcontracted) goals for this, for example, asset increase indexes, capital use reward and punishment indexes, and business funds allocation indexes. Second, and also very important, ever since the tax reforms of this period, enterprises have "subcontracted" a profit tax with the tax authorities. This article says that these forms of subcontracting have boosted the incentives to enterprises and their workers, but have been insufficient to cure the negative phenomena (our understanding is that this refers to the strengthening of insider control that will be discussed in the next part) arising from the "non-ownership" of state enterprises and there will therefore need to be further reforms, by which is meant the equitization of state enterprises.

This article was written from the perspective that the incorporation of state enterprises (which refers in this context to the subcontracting system) ought to be taken a step farther to equitization (the separation of ownership and management). This would place the *Doi Moi* state enterprise reforms in Doi Moi along the same path as Chinese state enterprise reforms , which have progressed from the management sub contracting system to equitization.

But when one looks a bit closer at the subcontracting that the article is talking about and compares it to the system used by China, there appear to be significant differences in its degree of application and universality, its purpose and intentions, and even in the way the term is used. They should therefore not be mistaken for exactly the same thing. We have not been able to discover any other documents that discusses in detail the first application of subcontracting, so we will focus our observations in this part to the other "important" subcontracting system, that of setting targets for profit taxes.

The system of subcontracting a tax amount between an enterprise and a tax agency would, for example, take the form of the enterprise and agency deciding before a business year had begun the amount of profit taxes the enterprise expected to achieve during the year (in this sense, the subcontracting system is only a kind of "plan," but we will not delve into that issue here). If the enterprise makes more than its expected profit, it would also get a larger share of the surplus, which gives an incentive to enterprises and their workers.

This sub contracting system is indeed applied to enterprises under the Profit Tax Law in1992 and Decision No. 57/CP, which amended it. However, in this case the subcontracting system is applied only to small family enterprises, peddlers and other specific categories. Taxes on state enterprises and private enterprises in general are subject to discriminatory, non-uniform fixed rates.

State enterprises subject to fixed rates can pay their taxes every month rather than once a year. There is another Vietnamese document that maintains that a profit tax subcontracting system is employed between the state enterprises and the tax agencies in this process, but it is not clear which industries the system is applied to or in what degree.

Another Vietnamese document published early in the nineties states that profit tax subcontracting between enterprises and tax agencies is "currently the universal form of tax collection in Viet Nam." According to this paper, however, the purpose and intention of this subcontracting system is not to give more incentives to enterprises and their workers but to facilitate tax collection for tax agencies that do not have the skill or manpower to sufficiently monitor individual enterprises (state or private). In this case, it would appear that the subcontracting system is a provisional measure that responds to the urgent need for fiscal reform and a fundamental strengthening of national finances as economic

activities on the whole make the transition to market mechanisms.

The usage of the term "subcontracting" is also varied in many Vietnamese documents. In 1981, prior to the *Doi Moi* reforms, a system was introduced that linked state enterprise workers' wages and bonuses to performance. Some commentators call this "subcontracting" (for instance, it appears that the article in the December 1993 issue of *Tap Chi Cong San* referred to above also counts this as a "subcontracting system"). However, this system is one that is set up between enterprises and their workers and therefore, by definition, is different from what is usually referred to as "subcontracting."

The tentative conclusion to be drawn from this is that there has been no Chinese-style "subcontracting system" adopted in the reform of state enterprises under *Doi Moi*. We would note that the final report written by the Vietnamese partner for this sub-topic contains some examples of the application of management subcontracting systems, but even if these are admitted, the degree of application is far from "universal."

In China, the "subcontracting system" was directly linked to the strengthening of insider control. As we will see in the next part of this section, Viet Nam has also experienced a strengthening of insider control since *Doi Moi*. But we will argue that in Viet Nam's case, this is more related to the way in which managerial autonomy was expanded since *Doi Moi* and other factors that coincided with it.

2. The Strengthening of Insider Control over Enterprises

Vietnamese literature does not use the term "strengthening of insider control." However, if one follows some of Vietnamese documents, it is clear that the phenomena that we call "strengthening of insider control" have been in existence prior to *Doi Moi*, even if it is difficult to measure it quantitatively (see Section Ⅱ Part 2).

Since *Doi Moi*, this phenomenon has began to become prominent immediately after Decision No. 217 in November, 1987, the decision that expanded enterprises' managerial autonomy. By the early nineties it had reached the point that corrections were required. A Vietnamese book published in 1994 says that there were many "loopholes" in Decision No. 217 which were not corrected at an appropriate time, and this resulted in sectionalism among enterprises, sectors, and regions, the misuse of enterprise assets for short-term gains, and many other negative phenomena that nullified the regulations of the state. The author argues that Decision No. 217 did not clearly delineate the authority of the enterprise head regarding: 1) transfer and lease of enterprise assets (Articles 2 and 19), 2) accounting and distribution of retained profits (Article 24), and 3) accounting and distribution of the wage and bonus funds (Article 50). This, combined with the fact that the state failed to regulate high incomes at an appropriate time (as we saw in Section Ⅲ Part 1, Decision No. 217 permitted a profit-making enterprise to raise its wages "without setting a ceiling") brought differences in the incomes of workers in different enterprises, and caused the incomes of workers at certain enterprises to grow.

Other Vietnamese documents can be used to gain a somewhat more detailed picture of the first point, and also the second and third mentioned above. The first point, transfer and lease of enterprise assets, refers to the practice called "*mua di ban lai*" in Vietnamese in which enterprises use their autonomy to buy unneeded capital equipments and then sell (transfer) them to other enterprises at a profit. The second ("accounting and distribution of retained profits") and third ("accounting and distribution of the wage and bonus funds") phenomena stem from Decision No. 217's "income accounting system" (see Section Ⅲ Part 1). During the process of applying this mechanism, in which the enterprise is responsible for both the profit portion and the wage portion, an enterprise that has income will tend to first raise the wage portion rather than the profit portion, and when it does make allocations to the profit portion, it will tend to boost the "bonus fund" more than the "production and business promotion and development fund." There will therefore be profit-making enterprises in which worker wages rise

faster than worker productivity. Note that this trend was particularly pronounced among industrial enterprises under direct central control. We noted also in Section III Part 3 that there were enterprises that were counted as loss-making because they raised wages in advance and then failed to meet their tax liability. This is another manifestation of the same phenomena.

Some of the phenomena from this period were the result not only of institutional factors caused by the inadequacies of Decision No. 217 but also to some extent of factors stemming from that fact that Viet Nam had not yet achieved macroeconomic stability. With a monthly inflation rate in the double-digit range at the end of the eighties, it is likely that enterprises needed to turn to such practices to protect the livelihoods of their workers regardless of any expansion in managerial autonomy. In fact, the 1994 book referred to above says that the tendency for wage hikes to be delayed caused state enterprise workers to "redistribute" income according to systems other than those defined by the state.

Viet Nam began to deal with these phenomena in the early nineties, as we saw in Section III Part 3. Actually, one of the purposes of the separation of ownership rights and use rights for enterprise assets and the incorporation of enterprises was to serve as a connection to the strengthening of insider control. The books referred to above describes this as "pushing hard on the accelerator but also slamming on the brakes while forgetting to wear a safety belt." It appears that the government of Viet Nam has thought the better of expanding managerial autonomy while delaying measures to correct the strengthening of insider control.

For example, some of the measures taken since the early nineties to rectify insider control as 1) laws regulating the incomes of high-income earners, which have been adopted since 1992 in conjunction with tax reform; 2) reconcentration in the state of all depreciation on enterprise assets beginning in early 1992; and 3) with the promulgation of the "Government Businesses Law" in March 1995, the abolition of Measure 2 in exchange for *de facto* limits on enterprises' rights to use the production and business development promotion fund (i.e., the investment fund). (However, the second and third measures constitute limits on investment autonomy, and so are highly likely to cause plan bargaining and "soft budget constraints" to continue between enterprises and line ministries.) We would also note that the Vietnamese partner for this sub-topic argues that the obligation to maintain and increase enterprise assets, including depreciation charges, resulted in a decline in the number of enterprises that were being counted as profit-making by virtue of under-reporting their depreciation (described above).

A Vietnamese book published in 1997 notes that while it is impossible to quantitatively measure the strengthening of insider control at state enterprises, it has continued to take place since 1993. According to this book, Circular No. 20 of the Ministry of Labor, Wounded and Sick Soldiers and Social Problem and Ministry of Finance amended the system that gave enterprises autonomy in deciding the wages of their workers. Enterprises are now required to set their wages according to one of four standards—units of production, sales and production costs, sales, or profits—thereby forcing enterprises to pay more heed to the principle of profit maximization. However, we will not be able to go into the details of this system here (most enterprises link their wages to sales as they always have). The point is that, according to this book, the application of this system has helped to conserve wage costs and improve labor productivity. But, on the other hand, the author goes on to note that most enterprises did not actually follow the system and as a result when they set their wages are forced to do everything they can to increase the wage portion and reduce the profit and profit tax portions. More specifically, this takes the form of 1) over-reporting the wage portion in reports to the government, or 2) reporting different figures for the wage portion in internal documents and reports to the government (obviously, with the wage portion higher on the internal documents). Therefore, the finding in the survey of Vietnamese state enterprises conducted by JICA (Japan) and Central Institute of Economic Management (Viet Nam) that there had been tendency for state enterprise worker incomes to rise in the

nineties can be explained by two factors, the revision (rise) in the wages of public servants in 1993 and the strengthening of insider control (a point which is confirmed in the book in 1997 referred to above).

For all the policy efforts to counteract it, the insider control over enterprises has continued to growth stronger, and further corrections are necessary. Decision No. 59/CP in of November 1996 raises the portion of retained profits that enterprises are required to put in their investment fund and places strict restrictions on allocations to the bonus and welfare funds. This is a laudable attempt by the government to curb the phenomena we have been discussing. According to recent Vietnamese documents, *"mua di ban lai"* has still been a universal phenomenon that indicates the continued strengthening of insider control. There need to be effective remedies for insider control found in the process of equitization and the transformation of some of Trusts into business groups (ultimately with boards of directors).

3. The Soft Budget Constraints on Enterprises

The concept of "soft budget constraints" was invented by the Hungarian economist J. Kornai and we will follow his ideas in this paper.

According to Kornai, soft budget constraints is a form of rhetoric that describes the defects and inefficiencies of state enterprise activities in socialist systems. An enterprise in a perfectly competitive market would ordinarily seek to maximize its profits within the constraint conditions of its own income. In that sense, the activities of enterprises in perfectly competitive markets follow "hard budget constraints." By contrast, state enterprises in socialist systems that run into difficulties because of deficits can have the state (their line ministry) cover them with subsidies and other forms of assistance. However, if they have reason to expect that the state will shoulder their burdens for them, state enterprises may not necessarily need to rely on their own budget constraints (income) in their business activities. As a result, the budget constraints on enterprises become "soft" and enterprise activities cease to be able to seek efficiency. Kornai lists four phenomena that could result in "soft budget constraints:" 1) subsidies, 2) price formation that is either discriminatory or able to cause "plan bargaining," 3) interest rates that function in the same way, or 4) tax rates that function in the same way. Note that the *"bao cap"* that the Vietnamese documents describes for prices, finance, and investment can all be explained in terms of the concept of "soft budget constraints."

As we saw in Section Ⅲ Parts 1 and 2, it was urgent during the initial stages of the reform of state enterprises under *Doi Moi* that fiscal subsidies for the prices formed by enterprises be reduced. The move to a single exchange rate, the liberalization of prices for materials and products, and the raising of prices to market levels all served to create a drastic reduction in fiscal price subsidies between 1989 and 1992 (see Section Ⅲ Part 2). Electric and water costs, which were added to wages, were also gradually raised at this time, and in 1993 the government began to sell its workers their houses at market prices rather than providing housing at ultra-low rents. Therefore, in general, the soft budget constraints caused by the first two factors had significantly contracted by this period.

According to Kornai, soft budget constraints lead to an "overheating" of enterprise investments, and also to their opposite, a shortage of investment funds. If enterprises are assured that the state will make it up should they exceed their budgets, then they will have an unlimited desire for materials and investment capital regardless of whether they can be used efficiently or not.

This type of investment overheating manifests itself in command systems by a persistent demand for or scattering of budgets by state enterprises. In Viet Nam, this phenomenon was still prominent in the late eighties and early 1990s. According to the Vietnamese document of that time, there was the plan to concentrate investment budget on 38 priority projects in state budget in 1989, but the planners were finally forced to scatter the budgets among 1,700 projects. The total investments in the 1990 budget rose to two and three times what was budgeted for the same reasons. Among the most vociferous in

their demands for investment capital were the construction and machinery industries. Vietnamese documents of the period indicates that if even 20% of the materials obtained and then subsequently left idle by the construction industry could be diverted to other production sectors that really needed them, the "shortages" would be immediately resolved.

This phenomenon is still reported now and again even today, but with less frequency than used to be seen. There are no documents that attempt to quantitatively measure the phenomenon, so hasty judgments should be avoided, but it can be assumed that in the course of reform, and particularly after the separation of fiscal and monetary functions in the early nineties (the obligation to borrow investment capital from banks rather than seek them from the state budget), it has declined. Even the construction and machinery sectors have been subject to reorganization and realignment since June 1995 (see Section III Part 4).

By contrast, the third factor in soft budget constraints, interest rates that are either discriminatory or able to cause "plan bargaining," appears to have increased as the marketization of economic activities forces enterprises to turn to banks rather than state budget for their capital. (It would be possible to verify this for tax rates too, but we will not delve into that here.)

Under *Doi Moi*, the traditional discrimination in interest rates among different ownership sectors and industries was formally abolished in June 1992 (See Section III Part 2), but national commercial banks have the right to set their interest rates as they choose within certain limits, and there appears to have been no basic change in the practice of giving discriminatorily favorable interest rates to state enterprises rather than non-state enterprises, and to heavy industries rather than commerce and light industries (often without even engaging in sufficient credit checks). In addition, while it is hard to measure quantitatively, it is also known that books do not always attempt to collect enterprise debts even when they reach maturity (which itself is a form of discriminatory lending).

In October 1995, the Enterprise Asset and Funds Control Bureau of the Ministry of Finance performed the first full-fledge survey of enterprise debts. It found that the total debts of all state enterprises had risen from 20 trillion Dong in 1992-1993 to 279 trillion dong at the time of the survey. This included 91 trillion Dong that had come due, of which more than 2 trillion dong was not expected to be recovered.

The rise in enterprise debt has been given much attention recently in relation to international financial crisis, and one of the factors behind it is that when the Vietnamese economy added the goal of economic development to its goal of marketization, the essential shortage of capital that it labored under became more serious than in the past. However, it is also certain that there are still soft budget constraints (caused by Factor 3) at work and un-remedied. Decision No. 59/CP in November 1996 was issued in part as an attempt to solve this problem, but according to an article analyzing the decision in the paper Dau Tu (Investment Review), one factor in the increase in enterprise debt is that enterprises have used borrowings to rapidly expand the scale of their investment beyond their actual capacity.

To remedy this increase in enterprise debt brought about by a form of investment overheating (which as we have seen is caused by soft budget constraints), Decision No. 59 included a ban on borrowings in excess of enterprises' enactment funding. However, this provision was opposed by industries like electric power that require large amounts of new investment capital all at once and so had not ever been enforced. It appears that the government forced to amend the provision in 1997, bowing to the wishes of industry and setting discriminatory borrowing ceilings for each industrial sector.

To sum up, under *Doi Moi*, soft budget constraints have gone from Types 1 and 2 to Type 3 (and Type 4), but they still continue to be observed. Certainly one of the purposes of the re-registration and re-establishment program since the early nineties was to counteract this phenomenon, and at one point only a teen percent of all state enterprises were in the red, but recent documents reports that this has

expanded to 30% or so again. This, and the fact that the Bankruptcy Law that took effect in January 1994 has hardly ever been applied to a state enterprise also indicates that the phenomenon continues. (Obviously, both of these observations, and particularly the former, can also be discussed from the perspective of the strengthening of insider control dealt with in the previous part). Kornai says that behind soft budget constraints one will find state "paternalism," but it is worth pointing out that an excess of paternalism in the form of unnecessary financial assistance and reluctance to use bankruptcy provisions will in the end only have detrimental impact on the economy as a whole by prolonging the defects and inefficiencies of state enterprises.

We have described soft budget constraints as a legacy, in modified form, of the command system. Our personal opinion, however, is that this is also an issue that needs to be considered in light of the problems caused the traditional social elements that still inform the activities of state enterprises in Viet Nam (the problems that are recognized as social problems or issues of social policy in Viet Nam).

Appendix

Residual Elements of Traditional Society in Enterprise Activities

The extent to which traditional social elements—"the principle of social community," "master-worker relation," and "than phai" (in Chinese) and so on—remain factors in the management of state enterprises was one of the questions that we attempted to answer in this topic. However, these are issues that it is extremely rare for Vietnamese documents to deal with, and that prevented us from tackling them head-on here. The comments that follow should be considered nothing more than reference material on this problem that go no farther than what can be found in a handful of Vietnamese documents.

According to a Vietnamese book published in 1995, the main purpose of state enterprises in the past was to provide "jobs." Under the command system, enterprises saw their managerial autonomy severely curtailed, but their workers were assured jobs and wages regardless of whether plans were realized or not. This aspect of state enterprises was intended to provide a safety net for the many unemployed workers produced by economies that are still underdeveloped, and was also meant to provide reinforcements as many enterprise workers left for the front lines of the war. Because they were carrying excess staffing, enterprises had already developed into a kind of "social community" prior to *Doi Moi*.

In addition to their business activities, state enterprises in Viet Nam were also required to provide a wide range of social services to their workers in place of the government, and particularly the local government. (lack of separation between business functions and social functions. Social services were provided with the welfare fund, to which the enterprise contributed a part of its retained after-tax profits. For example, Decision No. 217 in November 1987 lists six uses to which the welfare fund can be put: 1) increase, expansion, and repair of housing, community halls, lodgings, day care centers, cafeterias, stores, and athletic and sports facilities; 2) purchase of tools, pharmaceuticals, equipment for cafeterias, stores, community centers, and day care centers, equipment for sports and athletic facilities, and spending on day care centers; 3) loans of funding for outside businesses conducted by workers; 4) partial coverage of the costs of education and training in remedial, cultural and mandatory technology; 5) subsidies to local governments in shortfall; and 6) bonuses to workers employed in the enterprise's day care centers, cafeterias, health clinics, and hospitals.

The use of the welfare fund was thus broad. Indeed, it seems appropriate to define it as all of the retained after-tax profits not covered by the production and business development and promotion fund and the bonus fund.

After Decision No. 217, the Workers Representatives Congress saw its authority to use and manage the welfare fund greatly expanded, but as the Japanese findings for Subtopic 1 of this Topic indicate, it is questionable whether Vietnamese state enterprises, unlike their Chinese counterparts, really had adequate welfare functions to provide many of the services listed above or not. There is even some doubt as to whether enterprises were able to increase their welfare funds. According to Vietnamese documents, during the marketization reforms in Doi Moi, loss-making enterprises (see Section III Part 3) had difficulty even retaining their welfare funds, so at the most it was only the profitable enterprises (and those mostly large enterprises) that were able to do so. However, according to the Vietnamese partner for this subtopic, there were indeed enterprises that diverted part of their welfare fund to

increases in workers' income (which relates to the discussion of the "strengthening of insider control" in Section IV Part 2), though it is difficult to give an exact estimate of how much was involved.

The welfare fund was not just for the enterprise's workers. It was also used to discharge the social responsibilities of the enterprise to the residents of the district in which it was located. In other words, part of the fund was contributed to the district's general welfare fund and used for social redistributions, above and beyond taxation (necessitated by the lack of separation between the social services provided for by enterprise finance and government finance). There has been legal rationale for this practice until very recently, for example, Article 24 of Decision No. 217.

There was a certain logic to having this system while the market economy was undeveloped, but there are also negative phenomena associated with it. For instance, the local government (or enterprise director) might demand a larger contribution from the welfare fund to the local government than was actually needed and embezzle the excess. While quantitative measurement is again difficult, such phenomena appear to have taken place (according to information provided by a Vietnamese researcher to the author during the course of this project).

This phenomenon, called "than phai" in Chinese, is also confirmed in a 1994 Vietnamese book, although the examples differ a bit. According to the book, after Decision No. 217, the financial oversight institutions were not given clear authority to act as tax organization and because of this, "the monitoring and auditing of enterprise finances by many tax organization became lax and haphazard, and the authority to seek the interests of the organization and individual was abused to the point that it created problems and burdens for enterprises." That is the author of the book points to incidences in which money and goods were given to financial oversight institutions by enterprises for unjustifiable reasons, in other words, cases of "than phai."

Below is an overview of how Viet Nam has responded to these problems and the situation observed in the country today.

Turning first to the problem of excess staff, the first phase of reform allowed enterprise to use "labor contracts" to recruit new workers, while in Phase 2 enterprises were reorganized and realigned. In both cases, solving the excess staff problem was one of the main goals. However, particularly for the latter (although also for the former), a major reason why the program was incomplete was that enterprises moved to defend their "social community." While the writing is abstract, many Vietnamese documents point to the contradictions between the ownership of the people, which does not need to be maintained in the form of state ownership, and the need to appropriately protect the interests of individual workers. In other words, it says that there are social problems, or at least problems with social policy.

The lack of separation between enterprises' business and social functions has been improved by the establishment of a social insurance system and the promulgation of the Labor Law (1994). Prior to this, Circular No. 138 of the Ministry of Finance in 1991 noted that as enterprises were given the right to use their assets, they were also given authority over part of their retained profits—their production and business development and promotion funds and their bonus funds—but not over their welfare funds. It would seem that this measure is related to attempts to curb insider control, but this is not certain.

Given the economic conditions in Viet Nam, the welfare fund will continue to exist, according to virtually many of scholars in Viet Nam. But, on the other hand, Vietnamese government advocates the "socialization" of social policy that began around the time of the Eighth Communist Party Congress in 1996.

For "than phai," Article 9 of the Government Business Law in March 1995 gives enterprises the right to "refuse or seek judicial redress" for unjustified demands for money from outsiders. This represents the first time that "than phai" has been banned by law. In conjunction with this, Decision No. 59 /CP in November 1996 (superseding Decision No. 217) does not contain any requirement that part

of the enterprise welfare fund be remitted to the district's general welfare fund.

However, according to the one of the Vietnamese partners for this subtopic, only general principles have been set forth for the ban on "than phai" and there have yet to be any decisions or enforcements that attempt to put them into effect. Nor is it the case that the legal rationale for "than phai" has completely disappeared. The new accounting system that took effect in January 1996 still lists spending for non-enterprise mass cultural activities, charitable assistance to areas struck by natural disasters and charitable organizations in the breakdown of uses for the welfare fund.

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18. *Tap Chi Phat Trien Kinh Te* ["Economic Development," the Journal of the Ho Chi Minh City College of Economics]
19. *Bao Dau Tu* ["Investment Review," the news paper of the Planning and Investment Ministry of Viet Nam]
20. *Bao Thoi Bao Kinh Te Viet Nam* ["Viet Nam Economic Times," newspaper]

5

Legal Aspects of SOE Reform

Eri Habu

Tohmatsu & Co.

Ⅰ. Study on the Legal Framework of State Enterprise Reform

1. Introduction

Through this passage of renovation, Viet Nam is striving to build a state based upon the rule of law. Viet Nam is implementing an open-door policy to the world and this effort eventually leads to the need of a legal environment compatible to international practice, especially in the field of economic law.

Laws and regulations are an inevitable demand for a market economy and are in fact the premise for fair competition. However, actual operation of the market economy in Viet Nam has sometimes restricted and negated itself. Therefore, a complete set of laws and regulations are of great importance in guaranteeing the smooth operation of a market economy. After decades of accumulation, countries with modern market economies have already formed a complete legal system; and compared to them, Viet Nam still has a long way to go. The legal framework the planned economy required, differs completely from that of the market economy.

Reform of state enterprises (SOEs) will be a complex task, but must be performed lawfully and uniformly. It is fair to say that State Enterprise reforms have been lagging behind economic and legislative reforms as well as reform in other areas. One reason, has been the absence of a clear legal framework.

2. Objective of the Study

To attain the objectives of economic development, Viet Nam will have to complete reform of its state enterprise sector. There are two objectives to be attained by the Government's reform:

1) Transform actual SOEs into modern corporations in accordance with legal orientations;
2) Achieve more profitable and more productive performances, so as to increase the productivity for the entire economy acting as a leading agent of the socialist market economy;
3) Reduce the borrowing requirement of the state sector in order to remove the burden of the state budget.

The aim of this study is to analyze the legal environment surrounding Vietnamese SOEs considering the lawmaking process and its consistency among different laws and regulations. In addition, special attention should be focused on the legal framework of the governance system of SOEs.

The study will concentrate on laws and regulations related to SOEs such as various economic laws including SOE law, Company Law and Foreign Investment Law.

To ensure a clear picture of the legislative procedures and legal system of Viet Nam, Chapter Ⅰ will

find out the law making system and actual legal environment related to economic activities of SOEs.

Chapter II will describe the historical background of legal reform related to SOEs and the following, Chapter III, will focus on analysis and findings of current legal environments surrounding SOEs.

Subsequent Chapters IV and V will describe the actual situation on international aid and possible legal solution related to restructuring of SOEs.

And finally, Chapter VI will try to analyse legal issues and options for effective SOE reform.

3. Study Team

Japanese Group
(Academic Group)
-Prof. Shigeru Ishikawa
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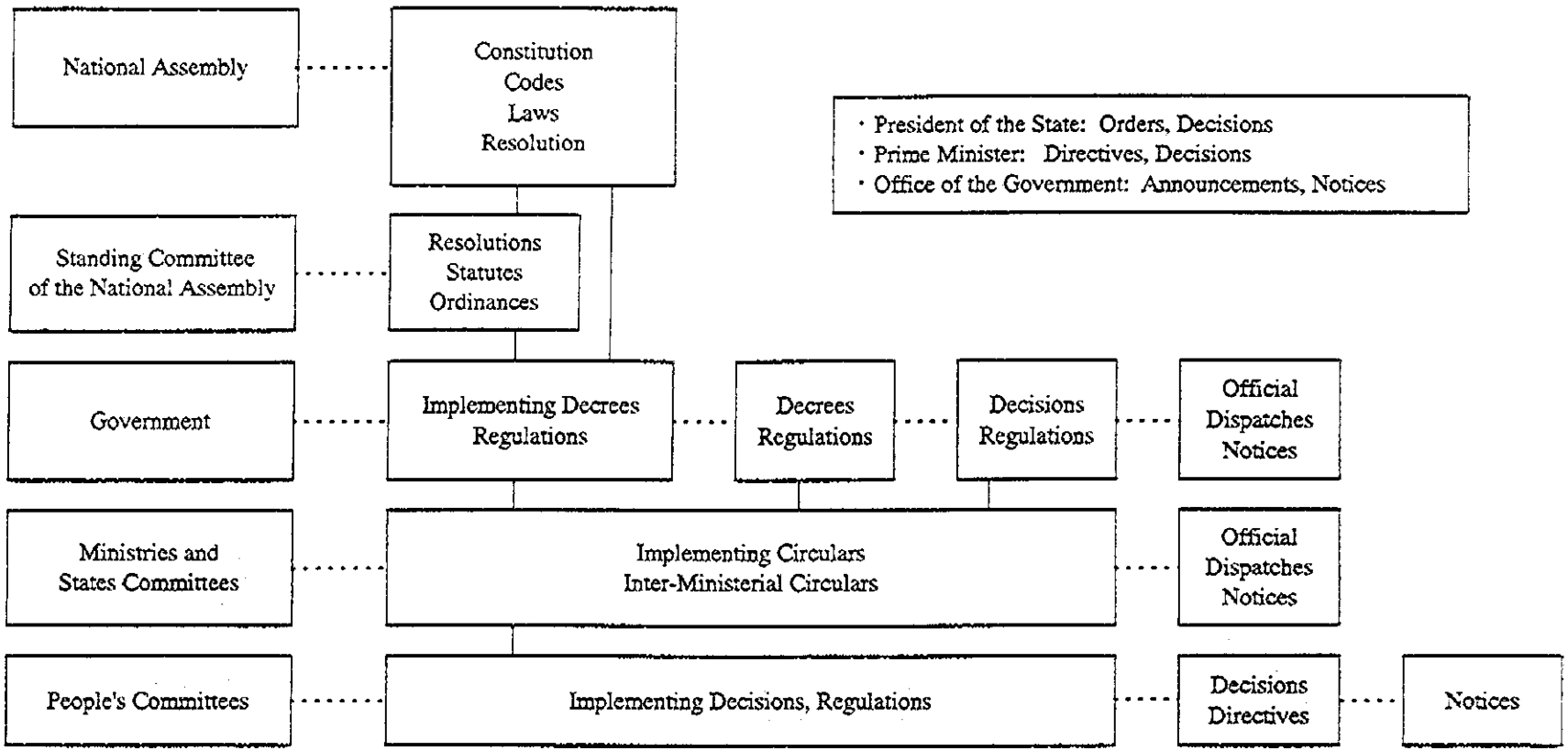
-Eri Habu

Vietnamese Group
-CIEM team

The study was conducted by collecting and analysing the comprehensive law documents provided by the government supported by interview results from various governmental sources.

4. Profile of the Vietnamese Legal System

Type of Legislative Documents	Classification of Legal Document	Issuing Bodies	Alphabetical Designation
Law Documents	Constitution Laws/Codes	National Assembly	QH (Quoc Hoi)
Sub-Law Documents	Resolutions	National Assembly	QH
	Ordinances Statutes Resolutions	National Assembly Standing Committee	UBTVQH (Uy Ban Thuong Vu Quoc Hoi)
	Orders Decisions	President of the State	L/CTN (Lenh/Chu Tich Nuoc)
	Resolutions Decrees	Government	CP(formerly HDBT) (Chinh Phu)
	Decisions Directives	Prime Minister	CP
	Decisions Directives Circulars	Ministers	NV, NG, QP, TP, TC, TM, XD, NHNN, LDTBXH, etc.
	Resolutions	People's Council at different levels	depend on each agency
	Decisions Directives	People's Committee at different levels	
	Instructions	Various Governmental Agencies	



Vietnamese legislation and its promulgation

5. Structure of the Vietnamese Legislation

One peculiarity in Viet Nam is the multi-layered system of legislation, including primary, statutory and administrative measures. In Viet Nam, right of enacting laws and by laws is distributed to several agency levels and each agency issues varied regulations. This implies that, while in Japan each governmental agency only issues one-layered regulations limited to its agency level, in Viet Nam one governmental agency issues multi-layered legal documents. This fact contributes to the high complexity of the laws and regulations making difficult simple understanding of them. This fact is not directly related to SOE reform, but more complex the law is, more difficult will be its implementation and enforcement.

6. Legal Framework of Companies in Viet Nam

A market economy requires transparent and reliable laws for the establishment, operation, transfer, and termination of enterprises. Otherwise, it would be very hard to create confidence among entrepreneurs and investors. On the other hand, too many rules would make access to business difficult hindering creation of new businesses.

Several economic laws have been enacted since late the 80s and their influence has been great over the activities of SOEs. The most relevant laws are:

(1) Civil Code

The Civil Code enacted in November 1995, is Viet Nam's largest statute composed of 838 articles. The Civil Code took almost ten years to be drafted and marked the cornerstone of the Vietnamese legal system. The articles specifically related to SOEs are Chapter 3 of Part I, related to juridical persons, Part II, devoted to property and rights of ownership and Part III, governing civil obligations and civil contracts. However, detailed provisions related to Chapter 3 on juridical persons are referred to in several company related laws to be discussed later.

(2) Commercial Code

The Commercial Code passed by the National Assembly this year (1997) aims at providing a comprehensive legal framework for commercial activity. Provided that it is properly implemented, it will certainly mean an improvement of the legal protection of market transactions of SOEs.

(3) Law on Foreign Investment (1987)

The Law on Foreign Investment allows foreign investors to invest in any sector of the Vietnamese economy but encourages foreign investment in areas that are labor intensive, generate exports and which utilize domestic raw materials. This law also regulates joint ventures between SOEs and foreign partners.

The Law on Foreign Investment is the first comprehensive law recognizing the legal status of companies in Viet Nam. Since its establishment, several other enterprise laws were enacted to give legal base to the existing Vietnamese domestic business entities such as the Law on Companies, Law on Private Enterprises and finally, the Law on State Enterprises.

(4) Law on Companies (1990)

Two types of companies may be established in Viet Nam under this law; limited liability company and shareholding company. However, only 46 provisions related to establishment, organisational

structure and disclosure requirement, are insufficient to ensure stable operation and accountability of companies established under this law. A second revision of this law is currently being drafted and it is desirable to put the revised and expanded law into effect as soon as possible.

The Law on Companies will be, in the future, the most comprehensive and important law regulating enterprise activity in Viet Nam.

(5) Law on Private Enterprises (1990)

Under this Law a Private Enterprise may be established. Private Enterprises are becoming a dynamic part of Viet Nam's business environment but given their generally small size, the influence in the economy is still limited.

(6) Law on Enterprise Bankruptcy (1993)

According to the Law on Enterprise Bankruptcy, the criteria for declaring an enterprise bankrupt are comprised of two elements: sustaining significant losses due to inappropriate management, and inability to repay its debts when they become due. The presence of both factors constitutes ground for the court to declare an enterprise bankrupt. The threat of bankruptcy is designed to make SOEs responsible for their economic performance and as a result, more efficient and productive. Both the LSOEs and the Law on Enterprise Bankruptcy aim at increasing responsibility and accountability of SOEs, to integrate them as a pillar of Vietnamese market economy and to make bankruptcy the ultimate penalty behind the drive to reform SOEs.

(7) Land Law (1993)

Under the Land Law, land is the property of the people, placed under exclusive administration of the State. The 1992 Constitution clarified the principle that land use rights were transferable. There are still several controversial points related to this law, but due to the complexity of the issue, it will remain a task for the future.

(8) Law on State Owned Enterprises (1995)

Together with the transformation of the national economy from a centrally planned and State subsidized one to a multi-sector market economy (Article 15 of the Constitution 1992), the question of legality of the existence of SOEs has been placed under consideration.

The LSOEs play a key-role in the revival of SOEs. Details on this Law will be discussed further later.

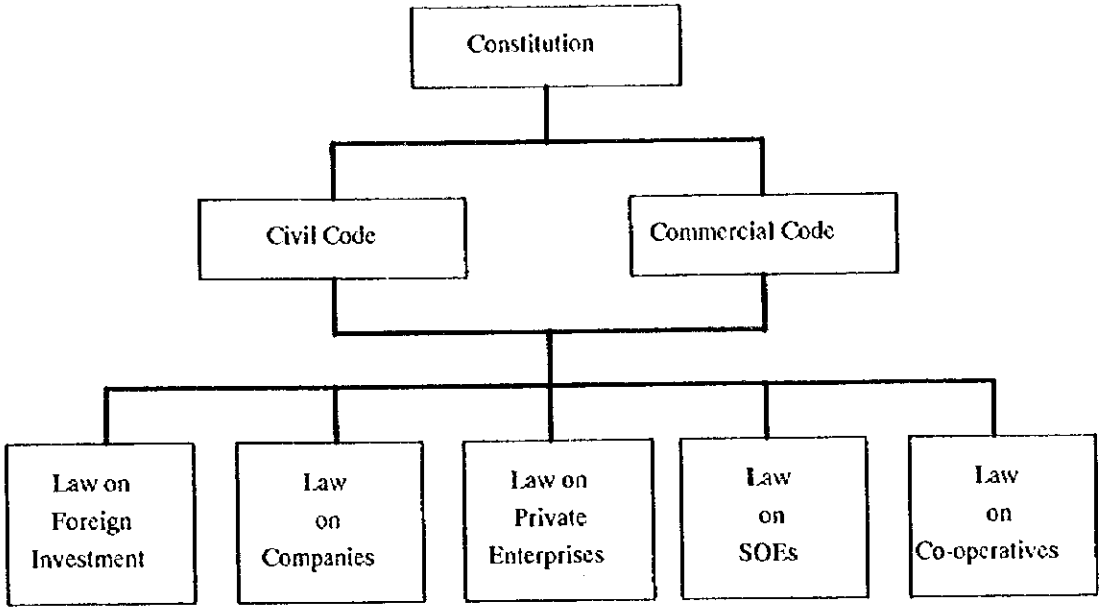
(9) Law on Co-operatives (1996)

Numerous "Collectives" constitute an important component of the multi-sector economy of Viet Nam. Collectives are co-operative economic entities made up of economic units, created and operated by capital contributions of private individuals.

A remaining problem is that the above laws for state enterprises, private enterprises, and enterprises with foreign investors have developed separately and are therefore incoherent. Enterprises are therefore subject to different regulation, even when engaged in similar activities. This causes uncertainty, conserves inefficient structures and is harmful to fair competition. The LSOEs deserves special attention since many SOEs suffer from chronic red figures, but due to the lack of comprehensive regulation on asset/debt evaluation criteria, a lot of SOEs cannot be subject to bankruptcy.

For instance, despite the bankruptcy law, the first case of implementation arose only in early 1997.

As with most legislation though, there is an enforcement problem which suffers from a lack of reliability.



Relationship between the laws governing companies and the constitution

II. Background of Legal Reforms on SOEs

1. Historical Background

The most important form of economic organisation the socialist framework created was the SOE . According to Article 19 of the 1992 Constitution, the State sector has to be revitalized and developed in order to constitute the "pillar" of the national economy. As a result of reform programs, all SOEs were required to reorganize and re-register under the Law on SOEs enacted in 1995. The Law on SOEs is of vital importance in governing SOEs, which guarantees legal independent status to SOEs. The main objective of this reorganization was to create a legal background for SOEs which enabled them to operate in accordance with market principles.

The current legal environment surrounding SOEs is far from sufficient to ensure proper and stable operations under the socialist oriented market economy. There are still several detailed provisions to be promulgated to complete the Law on SOEs.

2. The Law on State Owned Enterprises (LSOEs)

Specifically, the Law on State Owned Enterprises (LSOEs) enacted on 20 April, 1995 presents many ambiguous aspects when correlated with other enterprises related laws, and sometimes, even among specific chapters of the same law. It is true that other decrees, ordinances, decisions and circulars were issued after the enactment of the LSOEs. However, those legal documents do not solve the ambiguity incurred in the LSOEs which precedes the others. A higher degree of uniformity and coherency is desirable, since only an adequate and reliable legal framework can facilitate the transition of the SOEs

into a competitive market economy.

One of the aspects of LSOEs which is ambiguous are the chapters related to rights and obligations of SOEs. On one side, the law ensures the independence of management but on other side the law enforces the direct intervention of specific State agency.

In the future, a desirable solution would be to expand and improve the Law on Companies to include both whole SOEs and equitized SOEs.

3. Legal Documents Related to SOE Reform

(1) Resolutions

Resolution No. 156/HDBT	Reform of Management in SOEs (draft)	30/Nov./84
Resolution of the Politburo	Reform of SOEs	8/Apr./86
Resolution No. 10/NQTU	Reaffirm the role of SOEs as a pillar of the state economy towards the year 2000	17/Mar./95

(2) Constitution

Constitution of the Socialist Republic of Viet Nam	Establishes the political regime, economic system, social and cultural institutions, the fundamental ideology of Viet Nam	15/Apr./92

(3) Laws

Law on Foreign Investment	Highest legal document governing Foreign Investments	1987
Law on Private Enterprises	Highest legal document governing private enterprises	1990
Law on Companies	Highest legal document governing companies	1990
Law on Revenue Tax	Regime of revenue tax	8/Aug./90
Law on Special Consumption Tax	Regime of Special Consumption Tax	8/Aug./90
Law on Profit Tax	Regime of Profit Tax	8/Aug./90
Law on Organisation of the Government	Highest legal document governing Organisation of the Government	30/Sept./92
Law on Business Bankruptcy	Regulation on bankruptcy of business entities	30/Dec./93
Law on State Owned Enterprises	Highest legal document governing SOEs	20/4/95
Law on Corporate Income Tax	Amended Law on Profit Tax	1997
Law on Value Added Tax	Legal document establishing regime of Value Added Tax	1997
Law on Co-operatives	Highest legal document governing Co-operatives	1997
Law on State Banks	Highest legal document governing State Bank	draft
Law on Banks and Credit Organisations	Highest legal document governing Banks and Credit Organisations	draft

(4) Decrees

Decree No. 302/CP	Union of SOEs charter	1/Dec./78
Decree No. 25/CP	Providing autonomy to SOEs	1981
Decree No. 50/HDBT	Replacement of the old SOE charter promulgated with Decree No.93/CP Provide clarity on the rights and obligations of SOEs	22/Mar./88
Decree No. 93/CP	New SOE charter	8/Apr./88
Decree No. 98/HDBT	Right to collective ownership by employees in SOEs	2/Jun./88
Decree No. 161/HDBT	Charter on foreign exchange management	18/Oct./88
Decree No. 25/HDBT	Charter on the accounting regime in SOEs	18/Mar./89
Decree No. 26/HDBT	Charter on chief accountant in SOEs	18/Mar./89
Decree No. 28/HDBT	Charter for joint-ventures	22/Mar./89
Decree No. 27/HDBT	Replacement of the old union of SOEs charter stipulated by Decree No.302/CP	23/Mar./89
Decree No. 64/HDBT	Regulations on imports and co-operation with foreign partners	10/Jun./89
Decree No. 196/HDBT	Redefinition of responsibility, authority and tasks of the ministries in exercising state control of economic life	11/Dec./89
Decree No. 388/HDBT	Regulations on the establishment and dissolution of SOEs	20/Nov./91
Decree No. 15/CP	Redefinition of responsibility, authority and tasks of the ministries in exercising state control of economic life	2/Mar./93
Decree No. 58/CP		30/Aug./93
Decree No. 178/CP	Defining tasks, power, structure of the Ministry of Finance	28/Oct./94
Decree No. 70/CP	Establishing the state audit agency	11/Jul./94
Decree No. 189/CP	Guidance on implementation of the Law on Business Bankruptcy	23/Dec./94
Decree No. 34/CP	Definition of tasks, power and organisation of the general department for management of the state capital and property at enterprises	27/May./95
Decree No. 39/CP	Promulgating the model statute on organisation and operation of SOEs	27/Jun./95
Decree No. 28/CP	Equitization of a number of SOEs	7/May./96
Decree No. 51/CP	Settling demands by the labor collective at the enterprises not allowed to go on strike	29/Aug./96
Decree No. 50/CP	Establishment, reorganization, dissolution and bankruptcy of SOEs	28/Aug./96
Decree No. 56/CP	State Public Utility Enterprises	2/Oct./96
Decree No. 59/CP	Regulation on financial management and business cost accounting of SOEs	3/Oct./96

(5) Decisions

Decision No. 146/HDBT	Revised Decision No. 25	25/Feb./82
Decision No. 177/HDBT	Regime of transfer of foreign funds(abolished by Decision No.218/CT in 1989)	15/Jun./85
Decision No. 76/HDBT	Temporary legal regulations on the autonomy of SOEs	26/Jun./86
Decision No. 217/HDBT	Policy for reform planning and business accounting in SOEs	14/Nov./87
Decision No. 38/HDBT	Economic co-operation in production, distribution and services	10/Apr./89
Decision No. 93/HDBT	Depreciation regime for all state sectors funded by state budget	24/Jul./89
Decision No. 218/CT	Regime of selling foreign currencies to central funds	18/Aug./89
Decision No. 195/HDBT	Regime of asset recording and inventory valuation at SOEs	2/Dec./89
Decision No. 182/CP	Description of the obligations of employees' general meeting and the Enterprise Council	
Decision No. 143/HDBT	Instruction to the relevant sectors and localities to review the implementation of Decision No217/HDBT, Decree No.50/HDBT and Decree No.98/HDBT -experiment in setting up a board of directors -equitising SOEs -leasing out SOEs -legal document to cover the bankruptcy of SOEs	10/May/90
Decision No. 144/HDBT	Strengthening the management of SOEs and regulating enterprises with high income	10/May/90
Decision No. 315/HDBT	Reorganisation of the operations of SOEs	1/Sept./90
Decision No. 317/CT	Restoration of discipline in wages and bonus payment in SOEs	1/Sept./90
Decision No. 332/HDBT	Preservation and expansion of capital of SOEs	23/Oct./91
Decision No. 378/CP	Provision of legal capital concerning the working capital requirement of SOEs	16/Nov./91
Decision No. 202/CT	Concerning the continuance of the implementation of the pilot scheme for converting SOEs into joint stock limited companies Implementation of Decision No.143/HDBT of 10/May/90	8/Jun./92
Decision No. 203/CT	Providing detailed list of SOEs to be converted into joint stock companies Implementation of Decision No.143/HDBT of 10/May/90	8/Jun./92
Decision No. 96/HDBT	Supplement to Decree No.388/HDBT Provision for the liquidation or merging of SOEs	1992
Decision No. 84/Ttg	Experimental equitization of SOEs and measures to diversify ownership of SOEs	4/Mar./93
Decision No. 90/Ttg	Restructuring of SOEs arranged and registered under Decree No.388/HDBT, further reorganize and re-register other State enterprises, unions of enterprises, corporations and large companies (known as Corporation 90)	7/Mar./94

Decision No. 91/TTg	Experimental restructuring and establishment of business groups (known as Corporations 91)	7/Mar./94
Decision No. 51/TTg	Setting Regimes for basic discount on fixed assets in SOEs	21/Jan./95
Decision No. 61/TTg	Issue of the statute on the organisation and activities of the state audit	24/Jan./95
Decision No. 361/TTg	Formation of a preparatory Commission for Stock Market	20/Jun./95
Decision No. 397/TTg	Transfer of the task of managing the capital and property under state ownership at enterprises	7/Jul./95
Decision No. 185/CP	SOEs of the special category	28/Mar./96
Decision No. 186/CP	List of SOEs of the special category	28/Mar./96
Decision No. 548/TTg	Establishment of the equitization steering committees under Decree No. 28/CP	13/Aug./96
Decision No. 01/CPH	Procedure for transforming SOEs into joint stock companies	4/Sept./96
Decision No. 1062/TC	Regulation on management, use and depreciation of fixed assets	14/Nov./96

(6) Ordinances

Ordinance on Accounting and Statistics Principles	Accounting and Statistics Regime for SOEs and other economic entities	29/Sept./88
Ordinance on Economic Contract	Regulating various forms of economic contracts	29/Sept./89
Ordinance on Economic Arbitration	Regulating arbitration concerning economic disputes	12/Jan./90
Ordinance 84/Ttg	Accelerate the pilot programme for the equitization of SOEs	Mar./93

(7) Circulars

Circular No. 34/CT	Guiding the implementation of Decree No. 388/HDBT	28/Jan./92
Circular No. 1/TT/LB	Guidance on procedures for property mortgage and pledge by SOEs and procedures for the notarization of pledge, mortgage and guaranty contracts for borrowing of capital from banks	3/Jul./96

(8) Directives

Directive No. 316/CT	Entrusting the user right and responsibility to preserve capital to SOEs	1/Sept./90
Directive No. 408/CT	Continuous revamping of financial management and accounting in SOEs	20/Nov./90
Directive No. 138/CT	Delegation of right of use of capital and responsibility for its preservation to SOEs	25/Apr./91
Directive No. 331/CT	Perfecting the financial management apparatus at SOEs	23/Oct./91
Directive No. 393/CT	Guiding the implementation of Decree No. 388/HDBT	25/Nov./91

Directive No. 272/TTg	Calling for early completion of the reorganization of the unions of enterprises and corporations	3/May/95
Directive No. 368/TTg	Practicing thrift and fighting wastefulness in state owned businesses	22/Jun./95
Directive No. 500/TTg	Urgently re-organising SOEs	25/Aug./95
Directive No. 573/TTg	Creating conditions for State Corporations established by decision of the prime minister to early start stable operations	23/Aug./96
Directive No. 748/TTg	Implementation of the regulation on financial management and business cost accounting by SOEs issued together with decree No.59/CP	10/Oct./96

4. Composition of LSOEs

The LSOEs are composed of nine chapters totaling 58 articles divided as shown below:
Chapter 1 General Provisions
Chapter 2 Rights and Obligations of State Enterprises
Chapter 3 Establishment, Reorganisation, Dissolution and Bankruptcy of SOEs
Chapter 4 State Management and Exercise of State Ownership over the State Enterprises
Chapter 6 State Corporations
Chapter 7 Management of State Owned Share of Capital in SOEs
Chapter 8 Handling of Violations
Chapter 9 Implementation Provisions

However, several implementation provisions are issued and there are still, other detailed regulation currently in formulation. As a result, roughly more than a hundred of legal documents issued by various governmental agencies have important influence on SOEs .

5. LSOEs Implementation Provisions

LSOEs Chapter 1 Article 4	Decree No. 56-CP (Oct. 2, 1996)	State Public Utility Enterprises
LSOEs Chapter 2 Article 8	Decree No. 59-CP (Oct. 3, 1996)	Regulation on Financial Management and Business Cost Accounting of SOEs
LSOEs Chapter 2 Article 12.2	Circular No. 73	Auditing, Inspections of Accounting Books of SOEs
LSOEs Chapter 3 Article 16.1	Decree No. 50-CP (Aug. 1996) Decree No. 38-CP (Apr. 1997)	Appraisal Committee of SOEs
LSOEs Chapter3 Article 23.2	Decree No. 50-CP (Aug. 1996)	Establishment, Reorganisation, Dissolution and Bankruptcy of SOEs
LSOEs Chapter 4 Article 28.2	Decree No. 59-CP (Oct. 1996)	Regulation on Financial Management and Business Cost Accounting of SOEs
LSOEs Chapter 6 Article 44.3	Circular No. 1141	Regulation on Financial and Cost Accounting System of General Corporations

As shown in the above list, the complex structure of the legal environment surrounding SOEs make difficult the comprehension, interpretation and dissemination of LSOEs.

III. Analysis and Findings on the Current Legal Framework Related to SOEs

This topic will focus on the analysis of LSOEs which is the most comprehensive legal document regulating SOEs. A few comments on undefined issues will also be introduced.

1. Enterprise Ownership

Chapter 4 of the LSOEs defines the role of the State, dividing it into State Management and Exercise of State Ownership. Here, the State management has the authority to promulgate policies and mechanisms of management, to decide on protective measures, incentive policies, subsidies, price subsidies and other preferential treatment.

Furthermore, the State organises the drafting of plans for development and strategies of SOEs, to plan training measures for managers and executives of SOEs, to organise control and inspection of the enforcement of laws, policies and regimes.

Exercise of State ownership means basic decision on establishment, merger, splitting dissolution and transfer of ownership and other relevant matters including setting up or changing of objectives of the enterprise, drafting of statutes, decisions on investment, etc. Ownership rights here are very similar to those of modern corporations, however, the right of the Director General is significantly reduced. Thus, we can reach the conclusion that the main decision making rights remains with the State. For example, the State reserves the right of disposal of important fixed assets and decisions on wages. Furthermore, the State not only supervises the Director General through the Board of Directors, but has the rights to enforce direct control on the Director General of SOEs. This implies that the control mechanism of the SOEs is multi-layered permitting dual or more command lines without co-ordination.

2. Role of State Management

Resuming the characteristics of management or internal governance of SOEs, as shown in the chart referred in 3.3, the organisational structure of SOEs has a three level hierarchy. The State reserves the right to control directly the Director General and the power of the Board of Management is limited compared to the State's. If this structure is to be maintained, the right to control directly the Director General of the State should be reduced in order to expand the power of the Board of Directors to attain the effective operation of each player. Clear division of rights and obligations for each level of management is desired and the role of the State should concentrate more on monitoring work. In addition, State control is biased, divided into the control of Department for Management of the State Capital and Property of the MOF and the line ministry. It is recommendable to unify the managerial line and streamline administrative burdens between directors and the State and clarify the right of each player in order to attain effectiveness of SOE operation.

The scope of liability of SOEs, defining the judiciary person referred to in the Civil Code (Part I Chapter 3), clearly indicates that the SOE is a limited liability company.

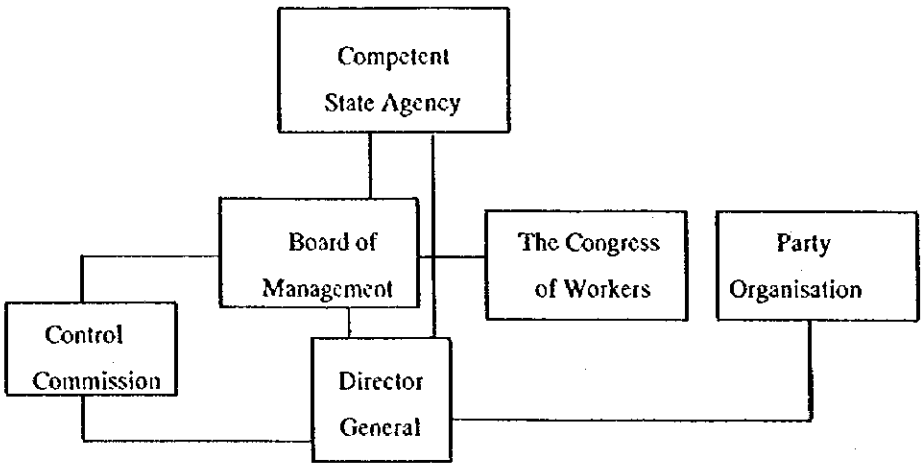
However, the extent of liability of SOEs is not defined in any part of the LSOEs. The lack of this provision allows the State to bear unlimited liability on loss making SOEs. The LSOEs should clearly define the lawful liability of the State as an investor and an owner of SOE.

3. Organisation of SOEs

As shown in the chart below, the organisational structure of SOEs is a three level management hierarchy. However the State reserves the right to control directly the Director General, and the power of the Board of Management is limited compared to the State's.

If this three level hierarchy is to be maintained, to attain the effective operation of each player, the right of the State that permits direct control of the Director General should be reduced, the decision power of the Board of Management should be strengthened and the role of the State should be concentrated into the monitoring work.

According to the LSOEs, the organisational chart of SOEs may be represented as follows:



According to the LSOEs, an SOE is a distinct legal person owned by the State. The owner the SOEs could be line ministries, provinces or cities, under direct jurisdiction of the State. Under a competent management agency, the Board of Management is set up. However, small SOEs are not required to form the Board of Management. Under the Board of Management, the Director General and other directors handle daily business operations.

Article 41 of the LSOEs determines that the Congress of Workers can exercise the rights to introduce candidates for the Board of Management and the Control Commission, and discuss and adopt the regime of use of the funds directly related to the interest of the labourers, etc.

Only a few lines of Article 5 defines the role of the Communist Party organisations in the SOEs. Thus the relationship between the Party organisations and the SOEs is not clearly defined. However, it is said that the Director General and the Secretary of the Communist Party have equal ground in the SOEs, where the Director General should follow Party orientations.

4. Activities

According to the LSOEs, there are two types of SOEs:

1) Business State Enterprise
2) Public Service Enterprise

The Public Service Enterprise is defined in Article 2 and engages in manufacturing and provides public services or is directly involved in the discharge of defence or security tasks. Such an enterprise

enjoys the right of receiving subsidies from the State.

In this study, special attention will be paid to the characteristics of the Business State Enterprise.

5. Bankruptcy

The LSOE does not contain detail provisions with respect to the bankruptcy of an SOE. It merely provides that bankruptcies shall be resolved in accordance with the Law on Enterprise Bankruptcy. One of the issues this raises is who will assume an SOEs debt obligations once it is dissolved.

It is said that a lot of loss-making SOEs are currently still running operations. Enforcement measures strictly observing the criteria of the bankruptcy declaration should be enhanced, and a social safety network system for unemployment should also established.

6. Civil Responsibility of SOEs

Other relevant topics are the scope of the civil responsibility of SOEs.

Section I, Chapter II of LSOEs limit the lawful rights of SOEs as follows:

Article 6.2 An SOE engaged in business requires authorisation from the authorities on important equipment and factories;

Public service SOEs requires authorisation from the State Management Agency on the disposal of properties under its management;

Article 7.1e Business SOEs require authorisation from the State agency to engage in complementary trades;

2c Public service SOEs needs authorisation from the State agency to invest, enter into joint-venture co-operations and contribute equity shares.

However, there are no clear statements defining the civil liability of SOEs on activities not authorised by the competent agency. It is necessary to define the civil liability of SOEs who do not comply with the LSOEs and perform activities without permission of the competent state agency. Liable persons at the SOE should be determined in the event such lack of conformity should occur. Without this definition sound business relationships involving SOEs would be threatened.

7. Decision Making and Responsibility of the Board of Management

The Government has promoted the introduction of new internal management structures of SOEs with intention to give managements more independence and power to decide business affairs. The LSOEs provides for various internal management structures.

8. The Role of the Board of Management

The Board of Management performs the function of managing the activities of the enterprise, approves business plans formulated by the Director General and acts as a liaison between the company and the State. Basically, the Board of Management comprises the chairman, the Director General or Director and other members. The term of a member of the board is limited to five years and a control commission is set up by the Board of management to assist it in controlling and supervising the executive work of the Directors and other matters. It also assures their compliance with the enterprise statute and legal requirements.

9. The Powers and Duties of the Director General

Apart from the Director General, there are other executives such as the Deputy Director General, Deputy Director and Chief Accountant. These executives are appointed by the state agency on recommendation of the Director General through the Board of Management. This fact itself shows the limited power of the Board of Management.

The Director General is the legal representative of the enterprise and elaborates long and short term business plans submitted to the responsible state agency. In addition The Director General submits proposals on the salary of employees, unit price of products and conducts other daily affairs of the SOE.

In this context, the Director General tends to enjoy more practical decision power and keeps relative independence toward State management. The fact that the decision power of the Board of Management is limited due to the retained power of the State itself in companies affairs, permits the Director General to act more freely without strong managerial and monitoring control over the daily operations of SOE.

10. Scope of Liability of SOEs

Concerning the scope of liability of SOEs, definition on judiciary persons referred to in Chapter 3, Part I of the Civil Code clearly indicates that the SOE is a limited liability company. In this context, what is the extent of the limited liability of SOE? The LSOE does not refer to this subject. This implies that despite definition of the Civil Code, the State has to bear, somehow, unlimited liability with respect to losses of SOEs. The LSOE should clearly state the liability of the State as a owner of SOEs, limiting this amount as equal to the capital the State invested in the SOE.

11. The Model Statute of SOEs

The lawful definition of SOEs statute requirement is mixed and overlapped with the model statute stipulated by Decree No. 39 issued in June 95. To simplify the statute and ensure transparency of the activity of SOEs, lawful definition of SOEs stated in the model statute should be defined in the LSOE.

12. Right of SOEs and Applicability of Private Law

The LSOE limits the lawful right of SOEs and at the same time, requires the approval of responsible ministries concerning determined business operation.

Subject on which SOEs require approval from the competent authorities, according to Section I, Chapter II of LSOE are as follows:

Art. 6.2 Business SOE requires authorisation to transfer, lease, rent and mortgage important fixed asset;

Art. 6.3 Public service SOE requires authorisation to transfer, lease, rent and mortgage the properties;

Art. 7.1e Business SOE has the right to ----- engage in complementary trade with due authorisation from the competent State agency;

Art. 7.2e Public service SOE has the right to ----- invest enter into joint-venture ---- if and when authorised by the competent State agency.

However, there are no regulations on business operations conducted without approval. Without clear definition on this subject, it could harm the secured operation of the business counterpart of the SOE concerned. Official interpretations on this topic should be made public.

13. Conclusion

It is not fair to assume that the undefined and unclear aspects of the LSOEs are the cause for the low pace of SOE reform, since the law itself is the loyal reflection of the governments policy. If the policy on SOE is not clearly defined, it will be impossible to introduce clear a definition and legally consistent framework into LSOEs. Theoretically, law never can be established beyond the scope of policy framework. To improve transparency and the scope of applicability of LSOEs, clear and determined policy over the SOEs should be formulated by the government as a priority.

Division of Right among the State, the Board of Management and the Director General according to articles 27, 29 and 36, 37 and 38.

Role	State	Board of Management	Director General
Establishment, Merger, Splitting, Dissolution and Transfer of Ownership of SOE	Decides		
Objectives, Tasks, Development Strategy and Orientation for Business Development Plan	Decides		
Statute of the SOEs	Promulgates Approves	Submit to the State	
Allocation of Initial and Additional Investment Capitals	Decides	Receives	Uses
Disposal of Assets		Approves	
Financial Statement	Approves	Submits	Elaborates
Disposal of Important Fixed Assets	Approves	Not clear	Not clear*
Borrowing	Approves	Decides Plans	
Investment	Approves	Submits	Proposes
Appointment of key Personnel	Appoints	Recommends Director General	Recommends
Wage		Submits	Elaborates
Business Plan	Approves	Submits	Elaborates
Organisation		Approves	Submits
Price			Decides

* Concerning disposal of important fixed assets Article 27 does not indicate who is entitled to submit the proposal to the State. Article 38.3 suggests that the Director General could perform such a role. This point should be further clarified in the LSOEs.

IV. Legal Reforms Assisted by International Lending Agencies

1. Legal Aid Provided by International Co-operation Agencies

The amount of support within the legal area is rapidly increasing. UNDP, Canada, and Australia have started extensive programs. There seems to be a increasing interest to support the legal system. Some programs have started to show positive results, especially in the drafting area of legal documents. Donors involved in this area are Australia, Canada, Japan and the UNDP. However there are urgent needs to provide for a comprehensive database to classify existing legal document in accordance with current validity. Actually, even the drafting agencies and legislative bodies are disturbed as to how to identify the right legal document currently in effect after repeated amendments and provision of new regulations to determined issues.

Summary of external assistance to legal reform area

Donor	Legal Drafting	Training	Basic Legal Education	Institutional Strengthening
Australia	Construction Law (MOC)	English Courses		
Canada	Ocean Act (Continental Shelf Committee), Marine Pollution Prevention (MOJ, MOSTE), Constitution Rights (Institute of State & Law), Admiralty Laws & Regulations (MOJ), Petroleum Legislation & Regulations (OOG, MOSTE), Property rights (MOFI)			Capacity Building (LCNA, MOJ), Assist in establishment of Economic Courts (MOSTE, MOJ)
France		Training programs, seminars		
Japan	Civil Code	Training, seminars & courses on Nationality & Commercial Laws		
Sweden	Competition, Arbitration & Company Law; Civil & Criminal Procedure Codes; Marriage & Family Law (MOJ)	Legal English (HLU)	Legal teaching (HLU)	Legal information (MOJ)
ADB	Financial Sector Review; Commercial Banks Review (SBV)	Environmental training	Legal training Institutionalising legal training	Support to institutional strengthening
FAO	Law on Environmental Protection in Fisheries (MOFI)			
NGOs	Non-profit Law; Law for NGOs			
UNDCP	National Drug Legislation System (various Govern. Agencies)	Seminars		
UNFPA	civil Registration			
UNDP	Building up legal framework (MOJ, ONA, OOG); drafting specific laws: Mineral Law (MOHI); Petroleum Legislation & Regulations (OOG, MOSTE); Contribution in SOE Law, Labour Law & Land Law.	In-country & overseas training		Strengthening Leading Legal Group; Preparing Governance projects with ONA, Supreme People's Court, Supreme People's Procuracy
WB	National Water Policy & Legislation (MOWR), National Procurement Legislation, Legislation on Land Use Rights; Support in Law on Enterprise Bankruptcy; Domestic Promotion Investment Law, contribution to SOE Law (various Government agencies)	Training courses, seminars, workshops		Support MOJ in implementing VIE/94/003

Note The Netherlands & Denmark have no present activity in this area but planning to support administrative court (Holland) & Supreme People's Court (Denmark)

Abbreviation

MOJ:	Ministry of Justice	MOHI:	Ministry of Heavy Industry	ONA:	Office of the National Assembly
MOWR:	Ministry of Water Resources	OOG:	Office of the Government	HLU:	Hanoi Law University
MOFI:	Ministry of Fisheries	SOE:	State Owned Enterprises	SBA:	State Bank of Viet Nam
LANA:	Legal Committee of National Assembly				

V. Required Legal Measures to Restructure SOEs

1. Factors having an Impact on Corporate Performance

(1) Internal Organisation and Governance Systems

1) Four Corporate Attributes

As a general principle, company law in most countries requires that a modern business corporation have at least the following four basic structural attributes:

1) Separate Identity - The corporation is a legal entity distinct from its shareholders, with a clear definition of, and accounting for, its own assets and liabilities;

2) Limited Liability for Shareholders - Shareholders risk of loss is limited to their contribution to the corporation's capital;

3) Centralised Management - The day-to-day affairs of the corporation are conducted by one or more persons chosen by the shareholders; and

4) Transferability of Shares - The shareholder's ownership interest are transferable, and a corporation with respect to its own assets and liabilities.

These attributes combine to enable the corporation to mobilise resources and to undertake commercial activity on a large scale with a clarity and singleness of purpose. The absence of one or more of these attributes significantly impairs the corporation as an effective vehicle for efficiency.

Positive Factors of Internal Incentives	Negative Factors of Internal Incentives
Separate Commercial from Social Objectives	Create Multiple and Conflicting Objectives
Clarify Owner/Manager Relationship	Permit Ad Hoc Political Interference in Running of the Company
Pay Market-Determined Salaries to Managers and Provide Similar Incentive Packages to workers	Link SOE Managerial Salaries to Civil Service Pay Scales
Appoint Private and Union Representatives on Boards	Staff Boards with Politicians and Civil Servants
Appoint Strong, Independent Commercial Oriented CEOs	Appoint CEOs Responsive Primarily to Governmental Agendas
Minimise Bureaucracy in the Organisation of the Firm	Create Large Holding Company Structures Multi-layered corporate structure creates margin for dependent character of subsidiaries since the loss of the subsidiaries are diluted in the consolidated financial statement

2. Issue of Corporate Governance

In countries throughout the world, corporate owners have faced the challenge of how best to structure the corporate organisation and regulate its operations in a manner that assures attainment of the goals of efficiency and profitability. A key issue in meeting this challenge is how owner-shareholders (principals) have held managers (agents) accountable while permitting them adequate autonomy to operate the corporation profitably in a market environment. Primary participants in a modern corporation are:

(a) the shareholders;

(b) a supervisory board; and

(c) the executive, sometimes referred to as officers, management or managing directors.

The shareholders provide risk capital for which they have certain rights:

(a) to elect and remove the board;

(b) to approve or disapprove fundamental or non ordinary changes (such as changes in the corporate charter, mergers, increase/decrease in capital); and

(c) to determine and receive dividends. Boards manage the corporation on behalf of the shareholders through appointment and supervision of executives, and by reviewing and ratifying all major decisions not reserved to shareholders. The executives are usually a set of persons elected by the board, who undertake the day-to-day affairs of the corporation.

3. External Discipline to Achieve Efficiency

While internal incentives are necessary to achieve efficiency, they are insufficient. Rather, external incentives also must play a role. They are influences that are outside the direct control of the corporation but which promote management accountability to shareholders. Those factors are:

(a) Product Market Competition
(b) Competitive Capital Markets
(c) The "Market for Corporate Control"
(d) Well Developed Labour Markets
(e) The Corporation's Legal Obligations
(f) Bankruptcy

Positive External Incentives	Negative External Incentives
Encourage Competition Between SOEs and with Non state Firms(foreign and domestic)and Open Trade and Investment Channels	Prohibit Competition in Product Markets; Support a Monopoly or Oligopoly
Eliminate Fiscal and Financial Subsidies	Allow SOEs to accrue Arrears Among Themselves or with Banks, or Avoid Taxes and Customs Duties
Diversify Sales of SOE Equity Shares	Prohibit Diversified Ownership of SOEs
Allow Labour Markets to Operate Freely	Restrict the Operation of Labour Markets
Encourage the Development of External Independent Auditors	Rely on Internal(SOE) Auditors
Avoid Complex External Performance Monitoring Schemes	Establish Complex, Ambiguous Performance Contracts
Establish Internationally Accepted, Rule-based Company and Security Laws	Rely on Ad Hoc Rulings on Legal Issues Relating to SOE Performance

4. Reform of SOE Law

(1) Preconditions for effective SOE reform

The evidence from international experience suggests that certain preconditions must exist if such reform is to be successful in Viet Nam. They are:

1) Administrative Changes for the State
2) Separation of Ownership and Government Functions
3) Designation of an Ownership Agency
4) Management and Social Objectives
5) Clarification of Regulation and Ownership Roles
6) Internal Governance.

VI. Legal Issues and Options for Effective SOE Reform

1. Legal Reforms

Implementing a legal framework for SOE reform will allow government owners to make clear demand on SOEs to improve financial returns on investments, and accord management sufficient autonomy and authority, with ex post accountability to achieve those results.

2. Building a System for Implementing Market Economy Laws

The market economy laws if implemented accordingly, will help promote competitiveness and accountability of SOEs

Measures include the needs for the following administrative measures:

Implementing the modern accounting system with publicly registered and audited balance sheets and income statements for all state enterprises above a determined size by law.

Allowing the incorporation of enterprises under the Company Law currently in the process of amendment, regardless of financial performance. This measure will make profits and losses more transparent, establish book values of assets and clarify ownership.

Define the government as a owner investor, consolidating government representation to replace line bureau's.

Enhance power of the Board of Directors and set clear commercial objectives through government representation on the board of directors. The main objective of this representation should be to demand maximisation of the value of a company's assets.

Set clear, responsibility of the board of directors in order to be able to hold management accountable for achieving enterprise objectives, rewarding and penalising them in accordance with financial performance.

Grant management maximum autonomy in its decision-making as well as some sharing in corporate profits to spur efforts at profit maximisation.

To start effective reform of SOEs, implementing the GAAP for major SOEs should be a national priority. The absence of reliable financial information on enterprise performance inhibits debt restructuring efforts with creditors, impedes adequate valuation procedures when equitising SOEs, and prevents holding management of large firms responsible for performance. Reliable financial information is necessary for banks to evaluate loan applications, and for firms to enter into business with other partners or foreign investors. It is also necessary for future listing of enterprises non stock exchanges, and for authorities to calculate taxes on lawful profits of SOEs.

3. Developing the Institutional Capacity

Viet Nam needs to dedicate considerable effort to establish a system for enforcing socialist market economy laws. The key issues to achieve this objective are:

(1) Building a contingent of legal profession

As the result of reform process, the range of legal consultancy services will widen and more problems will appear. It is necessary to enact a law to improve the management of the profession, protect lawyer's rights and interests and ensure that they fulfil their duties, safeguard effective law enforcement and protect the rights and interests of the parties concerned.

(2) Tightening supervision and inspection over law enforcement systems

Although existing laws and regulations are not sufficient giving margin for loopholes, if they are strictly observed, the SOEs reform would have accelerated progress. Therefore, a strict law enforcing mechanism setting aside political influence should be established.

(3) Strictly enforcing laws, improving the judicial and procuratorial systems

To standardise the behaviour of judges and public procurators and improve the judicial and procuratorial systems, laws shaping a complete and systemic structure within which judges can operate should be established.

4. Developing the Law Popularisation System

Government departments should upgrade their standards of managing the national economy according to laws so as to permit all economic sectors strictly adhere to them.

Legal education should be integrated with public security measures, closely combining education with cracking down on and preventing crimes.

Effective work measures such as law popularisation system, departmental law enforcement responsibility system, and legal knowledge testing system for leading cadres and SOEs managers before they take office should be enhanced.

Appendix

Disclosure System in Japan

The purpose of this paper is to describe the general framework of the Japanese financial disclosure system. Due to the complexity and detail of the subject matter, here are only outline key points based on the laws, regulations and standards in effect as of 1995.

1. Disclosure Requirements under the Commercial Code

The disclosure requirements of a joint stock corporation under the Commercial Code are oriented toward creditors and shareholders.

2. Disclosure Requirements under the Securities and Exchange Law (SEL)

Disclosure requirements under the SEL are oriented towards general investors. Only public corporations are subject to these disclosure requirements.

3. Regulatory Agencies

The Ministry of Justice is in charge of disclosures under the Commercial Code, and the Ministry of Finance is responsible for those under the SEL, respectively.

The differences, as previously described, between the two regulations are related to the fact that SEL covers public corporations; in other words, it is intended to protect investors in general.

4. Auditing

Audits conducted by certified public accountants or audit corporations in Japan may be broadly classified into two types. One is an audit of financial statements by CPAs required by laws (statutory audit). The other is an audit in which corporations have their financial statements audited by CPAs on their own accord (voluntary audit).

(1) Statutory audits

Statutory audits consist mainly of those performed as required under the Securities and Exchange Law and under the Commercial Code. The former was put into effect in 1951 with a limited scope and in 1957, the audit coverage was expanded to a full-scope examination of financial statements. The audit of semi-annual and consolidated financial statements became requirements under the SEL in 1977.

The requirements for an independent audit under the Commercial Code were instituted in 1974 in order to meet the need for sound development and strengthening of corporate accounting systems.

(2) Voluntary audits

In addition to the above statutory audits, corporations have voluntary audits to obtain an independent attestation regarding the accuracy and reliability of their financial statements.

5. Audit under the Securities and Exchange Law

Corporations which are required to disclose their financial information to the public under the SEL are obliged to appoint independent CPAs and have them audit their financial statements.

6. Audit under the Commercial Code

Under the provisions of the "law Concerning Special Exceptions to the Commercial Code Relating to Audits, etc. of Joint Stock Corporations", presently only large corporations (capital stock of ¥500 million or more or total liabilities of ¥20,000 million or more) are required to have their financial statements examined by CPAs.

CPAs should be appointed as independent auditors at the general shareholders' meeting.