Chapter 5 Vietnamese Gradualism in Reforms of the State-Owned Enterprises

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5.1 Introduction: The issue of SOEs in the Vietnamese context

The reform of state owned enterprises (SOEs) may be the most important issue for a country, which is in the transitional process from a planned economy to a market economy. SOEs are characterized as inefficient and therefore become a major factor of economic stagnation and instability. This characteristic is attributed to such factors as the lack of management autonomy and entrepreneurship (directors or managers of SOEs typically behave as bureaucrats rather than entrepreneurs), soft budget constraint, self-sufficiency and also in many cases, the lack of competition.  

However, the reform of SOEs is an extremely difficult task due to some of their other features. One is the social burden borne by SOEs, in the sense that they have to provide social welfare (medical cares, pension, etc.) and social (employment) security for the employees, which are usually excessive. Under a socialist regime, there is a strong tendency for workers to regard the presence at SOEs as if it were their lifetime employment. Therefore, so long as social safety nets, social welfare systems, as well as employment opportunities elsewhere are not widely developed, resistance to reform programs, which may result in the lay-off of workers, is strong. Another feature, particularly for SOEs in China and Vietnam, is associated with ideological principles in countries, which still aim to build socialism, in which the state sector is the mainstay. China and Vietnam currently consider “the socialist market economy” and “the socialism-oriented market economy”, respectively, as the basic path to nation building. Therefore, any reform, which results in a substantial reduction of state ownership, is not permissible at least in the foreseeable future.

From a development economic point of view, the reform of SOEs must be associated with initial conditions for the country in question. The low stage of economic development of a country is characterized by its markets being in the infancy stage, so that the transitional process in such countries involves a long process of market development, particularly that of factor markets. A legal framework and other institutional environments must be built to enhance the development of markets, and this requires a long-run process (Ishikawa 1990).

Maybe the low level of market development and the socialist orientation of reform and development strategy are the two most important features, which differentiate transition economies in Asia from those in Eastern Europe. Due to these two features, in Asia, the gradualism of economic reforms as a whole, and the reform of SOEs in particular, seems to be an optimal and reasonable approach. In this context, the gradualist approach to SOE reforms may be summarized as follows: (a) Along with the enhancement of market development, the government should conduct gradual reforms of SOEs by providing autonomy to the management, and gradually hardening budget constraints. This is done in order to improve their efficiency, and this reform is carried out without privatization, i.e. without changing the ownership pattern of SOEs. (b) In that process, gradually

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1 See Lavigne (1999), pp. 33-35, for example, for a discussion of basic characteristics of SOEs.
promoting the development of the private sector to generate new employment and new fiscal resources, for the government to conduct further reforms in the future. This can be called *macro-privatization*, which will gradually erode the share of SOEs in the national economy, and even though there is no *micro-privatization* (privatization of SOEs), the economy as a whole is de facto gradually privatized.²

This paper attempts to review the case of Vietnam in the reforms of SOEs and provide a tentative assessment of the Vietnamese experience from a theoretical perspective of gradualism.

The remainder of the paper is organized as follows: in Section II, a short overview of overall reform processes, growth performance and the position of SOEs in the Vietnamese economy will be presented. Section III discusses reform measures adopted within SOEs, and the measures aimed at raising the efficiency of SOEs themselves, without changing the ownership pattern. Section IV deals with the issues of SOE reform in a wider context and focuses on the privatization problems. In Section V, an assessment of SOE reforms from a theoretical perspective will be provided. Finally, major conclusions will be summarized (Section VI).

### 5.2 The Vietnamese economy in the transitional process -SOE-led growth?

In Vietnam, a number of initial economic reform measures were launched in January 1981. These measures include the introduction of a product-based contract system in the agricultural sector and the institutionalization of partial autonomy for SOEs.

The comprehensive reform policy, known as *doi moi* (renovation), was set out in December 1986. This showed a firm decision to shift from a socialist model of development and ownership system, to a regime, which emphasizes market mechanisms, the international division of labor in the formation of development policy, and the recognition of non-state ownership in economic activities. In the context of this *doi moi* policy, the Foreign Investment Law was promulgated in 1987, providing the legal framework for foreign firms to operate in the country.

The *doi moi* policy has subsequently been realized actively in the areas of agriculture and the pricing system in agriculture, reforms have been undertaken in the direction of reducing the role of cooperatives, and increasing the autonomy of households. Because of the increasing evidence that the partial reform in 1981 was not effective, since the reform was designed within the framework of agricultural collectivization, which gave few incentives to farmers, the Vietnamese leaders in 1988 decided to give substantial autonomy to farming households. Since then, each farming household has formally been considered a basic unit of production and thus, Vietnamese agriculture shifted from a cooperative basis to a household basis.

Regarding reforms in the pricing system, in March 1989, drastic measures were adopted to respond to the economic crisis characterized by hyper-inflation and the stagnation of production. These measures include the deregulation of prices of most commodities (all but twelve prices were freed), the devaluation of the exchange rate to the black market level, a substantial rise in interest rates to generate positive real rates, and a reduction to zero of budgetary subsidies. As will be seen later, these drastic reforms have resulted in macro-economic stability and a substantial increase in

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² See also the paper by Nakagane in this volume. The terms *macro-privatization* and *micro-privatization* are borrowed from his earlier paper, Nakagane (2000).
Apart from the agriculture and pricing system, however, reforms in other areas, particularly those relating to the ownership system, have been carried out with prudence. As mentioned in Section I, the changes in ownership structure have two sides. One is the change involved in the privatization of SOEs. The other is with macro-privatization (i.e. the expansion of the private sector, including foreign-owned firms, resulting in the decline of state ownership in the national economy). The micro privatization will be treated in details in Section IV. Let us here summarize the developments in the macro-privatization.

The macro-privatization can be divided into two cases: development of the indigenous or local private capital sector and that of the foreign capital sector. For simplification, hereafter the former will be called private sector.

Regarding the private sector, the Law on Companies (which provides the basis for establishing limited liability and shareholding companies) and the Law on Private Business (allowing the private sector to be formally involved in business activities) were promulgated in 1990 but it has taken a long process of trial and error to implement these laws. In June 1991, the National Congress of the Communist Party of Vietnam reconfirmed the necessity of the private sector and encapsulated that policy into the long-term strategy of development characterized as a planned development of a multi-sector commodity economy. The term planned development does not have the sense of economic planning in the period before doi moi. It just emphasize the important role of the state in the economic development. The term multi-sector commodity economy shows a market economy in which non-SOE sectors are developed side by side with SOEs. Recognition of a multi-sector commodity economy was formally indicated in the new Constitution in 1992. In 1994, the Law for Promotion of Domestic Investment was amended to encourage domestic entrepreneurs to undertake investment in the non-state sector. This law played a role complementary to the Law of Foreign Investment, which encourages only the foreign private sector.

In practice however, as seen later, the private sector has not shown substantial development until very recently. The reasons can be summarized as follows: First, even though some related laws have been amended, the quality of the legal environment both in terms of legal systems and enforcement mechanisms has been poor. Second, in many aspects, such as land-use rights and access to financial and other resources, there has been discriminatory treatment between SOEs and private sector. Third, complicated administrative procedures which are required for setting up new businesses and the severe supervision from multi-stratum local authorities on the operation of private firms, have discouraged the development of this sector on the one hand, and resulted in rent-seeking activities on the other. As noted by Reza (1999) and other observers, the inadequacies and complexities in the legal and administrative system cause increased transaction costs and hence poses disincentives for the growth of the private sector. The mass de novo entry of the private sector (Kornai 2000, p. 7), one of main characteristics of gradualist strategy, has been prohibited.

As for the foreign capital sector, Foreign Investment Law, promulgated in December 1987, on one hand provided tax exemption and other incentives to attract foreign capital, but at the same time imposed many regulations and requirements upon foreign investors. In addition to the overall underdevelopment of legal system, the regulations and requirements made the environment less attractive than neighboring countries, and the law has been revised many times since the early 1990s.

As will be noted in more detail later, unlike the private (domestic) sector, FDI inflows into Vietnam have recorded substantial results, at least until 1997, the year of the financial crisis in Asia. The most important reason for this may be that most FDI projects have been undertaken jointly with SOEs. The legal and administrative environment has forced foreign firms to choose SOEs as their local partners. This, however, helped them to avoid the disadvantages the firms in the private sector have faced, as well as to save transaction costs.

The Vietnamese economy has shown a fairly good growth performance since the early 1990s. The success of the reform in agriculture appeared as early as in 1989, only one year after the decision to shift from a cooperative system to a farming household system. The World Bank (1991) highly appreciated this performance and considered this as an export take-off and a good example of the relationship between institutional reforms and exports.

Besides agriculture, most other aspects of the economy also performed well since 1992. As shown in Table 1, since the early 1990s, both growth and stability have been achieved. Along with GDP growth rates of more than 8% per annum until the Asian financial crisis, the hyper-inflation which Vietnam suffered in the early stage of reforms has also been overcome. Substantial improvement of savings and investment as ratios of GDP, were also noteworthy.

Industry was the leading sector in the growth of the economy in this period. From 1992 to 1997, growth of this sector was 4 to 5 percentage points higher than that of total GDP. As a result, the GDP structure has changed remarkably with the expanding share of the secondary sector, at the expense of
the primary sector (Table 2). Industry is composed of mining, manufacturing and public utilities (manufacturing accounted for 80% of total industry in 1997), and all these sub-sectors have expanded in the period under discussion.

<table>
<thead>
<tr>
<th>Year</th>
<th>Shares in GDP (%)</th>
<th>Shares in Employment</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Primary Sector</td>
<td>Secondary Sector</td>
</tr>
<tr>
<td>1991</td>
<td>40.5</td>
<td>23.5</td>
</tr>
<tr>
<td>1992</td>
<td>34.9</td>
<td>23.7</td>
</tr>
<tr>
<td>1993</td>
<td>29.1</td>
<td>28.6</td>
</tr>
<tr>
<td>1994</td>
<td>27.4</td>
<td>28.9</td>
</tr>
<tr>
<td>1995</td>
<td>27.2</td>
<td>28.8</td>
</tr>
<tr>
<td>1996</td>
<td>27.8</td>
<td>29.7</td>
</tr>
<tr>
<td>1997</td>
<td>25.8</td>
<td>32.1</td>
</tr>
<tr>
<td>1998</td>
<td>26.0</td>
<td>32.7</td>
</tr>
<tr>
<td>1999</td>
<td>25.4</td>
<td>34.5</td>
</tr>
<tr>
<td>2000</td>
<td>24.1</td>
<td></td>
</tr>
</tbody>
</table>

In addition to the success of agricultural reforms and reforms in the pricing system, which brought about the stability of the macroeconomic situation, some other main factors accounting for the high growth in the economy in this period can be summarized as follows: first, thanks to domestic reforms combined with an open-door policy, the international environment surrounding Vietnam has been increasingly favorable. ODA and other resources from advanced countries and international financial institutions have been provided to Vietnam on a constant basis since 1993. This not only facilitated the construction of infrastructure and provided intellectual inputs for further reforms, but also reduced the uncertainties in the investment atmosphere of Vietnam. Second, since the early 1990s, the Vietnamese economy has been increasingly intertwined with the dynamic Asian Pacific region. Until the late 1980s, almost 70% of Vietnamese exports had been to the former USSR and other Eastern European countries, which are far away from Vietnam. Now, the same share has been accounted for by the export to the Asian Pacific region. The countries in this region also accounted for more than 70% of FDI inflows to Vietnam in the 1990s.

These external relations have provided both important financial resources and markets for economic growth of Vietnam. In the first half of the 1990s, FDI and ODA accounted for 25% and 11%, respectively, of total investment. In the second half of the decade, the respective figures were 23% (US$ 10 billion) and 14% (US$6 billion). The expansion of exports was also noteworthy. Exports as a ratio of GDP rose from 29% in 1991 to approximately 40% in 1999.

In the context of good performance and an increasingly open economy, what has been the role of SOEs?

Before doi moi, the economy was run by three types of firms: SOEs (national ownership), cooperatives (collective ownership) and household units of production or service. Cooperatives were seen mainly in agriculture and, at a lesser extent, in traditional handicrafts and services. With
doi moi, other types of firms, i.e. private firms and foreign owned enterprises, have emerged, but until the early 1990s such firms had been in small number. FDI flows started in 1988, but a substantial amount of disbursement was recorded only since 1992. The discussion earlier suggested the reasons for the small number of private firms, but during the later stage of the doi moi process, they have emerged increasingly under two types, the single owner company (the sole proprietor enterprises) and the shareholding companies. Table 3 records the share of each of six types of firms in the 1990s. This table shows that share of household companies is quite large and has been kept constant at about one-third of GDP. Foreign owned firms shows an increasing share but the share of private firms (single owner and mixed ownership companies) has been unchanged at a low level.

<table>
<thead>
<tr>
<th>Year</th>
<th>State Sector</th>
<th>Collective Sector</th>
<th>Single Owner</th>
<th>Household</th>
<th>Mixed</th>
<th>FDI-related</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
<td>40.2</td>
<td>10.1</td>
<td>3.1</td>
<td>36.0</td>
<td>4.3</td>
<td>6.3</td>
</tr>
<tr>
<td>1997</td>
<td>40.5</td>
<td>8.9</td>
<td>3.6</td>
<td>34.3</td>
<td>3.8</td>
<td>8.9</td>
</tr>
<tr>
<td>1999</td>
<td>39.5</td>
<td>8.6</td>
<td>3.4</td>
<td>33.1</td>
<td>3.6</td>
<td>9.8</td>
</tr>
</tbody>
</table>

Note: Mixed type is composed of private multi-owner limited liability companies and share holding companies


The position of the state sector is noteworthy. It has risen in the process of reforms, which intended to build up a multisector economy. Due to rapid changes in the industrial structure (Table 2), the collective sector declined in terms of share in GDP, while the state-sector (SOEs) and the foreign-related sector have strengthened their positions in the economy. The state sector mostly has monopoly power in public utilities, transport and communications, and banking and insurance, which have all developed rapidly in the 1990s. This contributed to an increasing share of this sector in the whole economy. In manufacturing, the share of SOEs showed a decline (Table 4) due mainly to the rising share of foreign capital, which accounted for 23% in 1997 (Table 5). Within manufacturing, the foreign sector has been particularly strong in office machines, radio and televisions, cars and motorcycles. Their shares are as high as 70 to 100%. In contrast, the SOE shares are particularly high in such heavy industries as chemicals, metals, paper and non-ferrous metals, and in some other areas like machines, electric and electronic products, cigarettes and textiles. In mining, the foreign sector’s share is particularly high (Table 6) due to the discovery of petroleum in the late 1980s and the rapid development of this product since the 1990s. This production is carried out in a joint venture with the former USSR.
### Table 4: Position of SOEs in the Vietnam Economy (% of SOEs in each category)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total GDP</td>
<td>34.2</td>
<td>40.0</td>
<td>41.2</td>
</tr>
<tr>
<td>Agriculture GDP</td>
<td>4.3</td>
<td>4.5</td>
<td>na</td>
</tr>
<tr>
<td>Manufacturing GDP</td>
<td>67.2</td>
<td>66.5</td>
<td>49.1*</td>
</tr>
<tr>
<td>Total Employment</td>
<td>8.7</td>
<td>4.4</td>
<td>na</td>
</tr>
</tbody>
</table>

* Data for 1997

Source: Central Institute of Economic Management.

### Table 5: The Structure of the Manufacturing Sector in Vietnam (1997)

<table>
<thead>
<tr>
<th></th>
<th>Total Turnover Share of Enterprises (% of Total SOEs)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total Turnover Share of Enterprises (% of Total SOEs)</td>
</tr>
<tr>
<td></td>
<td>1994 Prices</td>
</tr>
<tr>
<td></td>
<td>Total</td>
</tr>
<tr>
<td>Food and Drink</td>
<td>34,015</td>
</tr>
<tr>
<td>Cigarette</td>
<td>4,400</td>
</tr>
<tr>
<td>Textiles</td>
<td>7,261</td>
</tr>
<tr>
<td>Clothes</td>
<td>4,325</td>
</tr>
<tr>
<td>Lather products</td>
<td>6,614</td>
</tr>
<tr>
<td>Wooden products</td>
<td>3,146</td>
</tr>
<tr>
<td>Papers</td>
<td>2,644</td>
</tr>
<tr>
<td>Printing, Publishing</td>
<td>1,620</td>
</tr>
<tr>
<td>Oil Refinery</td>
<td>84</td>
</tr>
<tr>
<td>Chemicals</td>
<td>7,223</td>
</tr>
<tr>
<td>Rubbers and Plastics</td>
<td>3,528</td>
</tr>
<tr>
<td>Non-ferrous Metal</td>
<td>12,223</td>
</tr>
<tr>
<td>Metals</td>
<td>4,000</td>
</tr>
<tr>
<td>Metal products</td>
<td>3,559</td>
</tr>
<tr>
<td>Machines, Equipment</td>
<td>1,674</td>
</tr>
<tr>
<td>Office machines</td>
<td>38</td>
</tr>
<tr>
<td>Electric, Electronic products</td>
<td>1,650</td>
</tr>
<tr>
<td>Radio, Television</td>
<td>3,278</td>
</tr>
<tr>
<td>Medical equipment</td>
<td>239</td>
</tr>
<tr>
<td>Cars and Motorcycle</td>
<td>1,629</td>
</tr>
<tr>
<td>Other Transport equipment</td>
<td>1,815</td>
</tr>
<tr>
<td>Furniture</td>
<td>2,564</td>
</tr>
<tr>
<td>Others</td>
<td>133</td>
</tr>
</tbody>
</table>

However, the share of SOEs recorded in Tables 3 through 6 may be underestimated, since almost all FDI projects have been undertaken jointly with SOEs and also in most cases, the SOEs’ contribution in these joint ventures has been 30% by providing a fixed asset, mainly land. Thus, if the contribution by SOEs in these FDI related firms was taken into consideration, the share of SOEs would be higher than the figures recorded in Tables 3 to 6. Such an adjustment is attempted in Table 7. In recent years, in industrial production, the adjusted SOEs share rose to between 54 and 57%, about 9 to 10 percentage points higher than non-adjusted shares in this sector.

In fact, the effect of the FDI on the development of SOEs has been stronger than the share figures suggested. By having exclusively undertaken investments and operating jointly with foreign firms, SOEs could be advantageous in supplying inputs to the joint ventures, and in accessing to new opportunities in foreign markets and technologies.
5.3 SOE Reforms Without Privatization

Until recently, the reform of SOEs in Vietnam has concentrated on management systems and restructuring. The reforms on the management system have been aimed at making SOEs more efficient, by hardening their budget constraints on one hand, and giving autonomy to them on the other. The restructuring policy for SOEs has been designed to strengthen SOEs by increasing their scale through merging with small SOEs or the liquidation of ill-managed and financial weak SOEs.

Autonomy and hardening budget constraints

The number of SOEs in 1990 totaled about 12,000, of which approximately 3,000 large and
medium-scale enterprises were centrally controlled under the jurisdiction of the central government, and about 9,000 medium and small scale enterprises were locally controlled under the jurisdiction of provincial or city governments. ³

Initial reforms had been undertaken starting in 1981 when the three part planning system was introduced. Under this system, an SOE can set out three plans: the first plan is to fulfill the quota given by the government, the second one is to deal freely with the products left for the firm after fulfilling the quota, and the third plan is to allocate assets and other resources to the areas in which those resources can be best used, given that the first plan will be attained.

Along with the progress in doi moi policy since 1986, particularly since 1989, managerial autonomy has been further granted to SOEs, with freedom to set output target and prices, disburse bonuses, and retain some profits to fund intra-firm social services. According to Mitsui and Wada (1998, p. 82), which conducted 200 Vietnamese SOEs in the manufacturing sector in 1996 and 1997, almost 90% of the firms surveyed said that they had management autonomy for production structure and output in the 1990s.

On the other hand, the relationship between the government and SOEs has also changed. Traditionally, the government supplied intermediate goods and other inputs to SOEs, which in turn submitted the products to the government on a quota basis. This has changed to the new system in which such transactions are conducted on a contract basis, which takes into account the prices in the markets. Moreover, direct subsidies to SOEs have been greatly reduced and from 1990, SOEs must procure funds from banks to finance their investment, instead of being supplied from the national budget as before.

Budget constraints on SOEs have become increasingly hardened since 1989 when a wide range of price deregulations were realized. This is particularly true since 1991 when transactions between Vietnamese SOEs and the former USSR shifted from a plan-based system with soft conditions for Vietnamese SOEs, to market-based transactions with a competitive market environment. Moreover, increased competition through trade liberalization since the early 1990s also tightened the budget constraints of the SOEs

Under this situation, it has been increasingly recognized that SOEs in Vietnam are too weak to be competitive in domestic and world markets, since the scale of most SOEs is small or medium-sized by international standards, and most of them are fragile in terms of financial, managerial and organizational aspects. In addition, as in other transitional economies, SOEs in Vietnam are also overstaffed and have the function of providing social welfare and security. On the other hand, the Vietnamese path to nation-building is a socialism-oriented market economy, characterized by the leading role of the state sector. In order for the SOEs to play this leading role, it is necessary to restructure and reorganize them into strong firms or groups of firms.

2. Restructuring and reorganizing SOEs

In 1991, the government issued a Decree, which requires all SOEs to re-register, based on new

³ Size of SOEs here is referred to the relative meaning in the Vietnamese context. By international standards, most SOEs in Vietnam are small. In 1992, even after the launch of restructuring policy which resulted in sharp reduction in the number of SOEs due to merger and liquidation, only 255 out
SOE criteria, which allowed only financially viable and potentially profitable enterprises to exist. This led to a sharp decline in the number of SOEs from 12,084 in 1990 to 6,544 in 1993 (Tran 1996) and around 6,000 in the 1994-96 period (Table 8). In this process, more than 3,500 firms were merged with other SOEs and about 2,500 were closed or disbanded. The SOEs which were merged or closed, were mainly the firms controlled by local authorities. In contrast, the number of SOEs controlled and administered by central government agencies has risen during the restructuring process.

Even after this restructuring, SOEs in general are still small and weak. The SOEs, which have less than 100 employees, accounted for as much as 47% of the total number (6,544 firms) of SOEs in 1992. In the same year, the number of SOEs, which had more than 1000 employees, accounted for only 4% of the total number.

With this situation, and inspired by the strength of company groups in Japan or the *chabaol* in Korea, in 1994, a program began for the establishment of large-scaled corporation groups, aimed at strengthening international competitiveness via concentration and separating management from ownership. In 1994, the Prime Minister issued Decisions 90 and 91 to group about half of the SOEs under a number of holding companies known as General Corporations (GC). Decision 90 (issued on March 7, 1994) created 76 GCs, usually called GC90, each with at least 5 voluntary members and minimum legal capital of VND 100 billion, and Decision 91 called for much larger corporations with at least 7 SOEs members and a minimum capital of VND 1,000 billion, resulted in only 17 GCs, which are called GC91. All 17 GC91 and 76 GC90 combined have a total members of 1,392 SOEs, accounting for 24% of all SOEs in terms of number and 66% and 55% in terms of capital and employees, respectively. 4

Since 1995, SOE reforms have been carried out with the implementation of the Law on State Enterprises, gradually abolishing the supervision of line ministry and experimenting with the separation of GC91 and the government. The aim is that SOEs retain the status of state ownership but are operating as units in the market economy, exposed to competition with other types of firms.

At the current stage, SOEs as well as the reform of SOEs in Vietnam still encounter a number of problems: first, it is not clear who is the real owner of SOEs since there are too many organizations involved. The lack of clear ownership identification undermines corporate governance as it leaves open the issue of who exactly should be monitoring the managers. Since 1995, the capital and assets of SOEs have been put under control of the Ministry of Finance, but the operation of SOEs is still supervised by their respective line ministry or local government. That is the reason the directors of SOEs are still constrained by regulations from many organizations. In addition, along with the establishment of GCs, member firms in each GC are gradually losing their autonomy; in other words, the autonomy previously provided to them has transferred to the GC Board of Directors.

Second, with increasing autonomy but without a controlling system, directors tended to privatize national assets in their own enterprises. The financial situation of SOEs is generally unknown. Nobody, including the government (who is the owner), is well informed about the financial conditions in the SOEs.

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Third, budget constraints turned from “soft” to “hard”, but recently tended to return to “soft” again, particularly in large SOEs. The reason is that since the latter half of 1997, along with the adverse effects of the Asian crisis, many SOEs encountered financial difficulties and the government extended assistance to protect the large SOEs, which must play a leading role in a socialism-oriented economy. In a survey carried out in 1997, Wada (1998) also showed that in the area of finance, difficulties increased so that SOEs tended to depend on government assistance, therefore intervention from the government has become strong again.

5.4 Reforms with Privatization

Since the early 1990s, as an effort to reform the SOEs and to realize the development strategy of a multi-sector economy, a program was launched for the transfer or diversification of SOE ownership and to encourage development in the private sector. However, until very recently both micro-privatization and macro-privatization had not been put forward smoothly.

5.4.1 Equitization of SOEs

With the Cabinet Decision No. 143 in May 1990, the government decided to undertake a pilot plan of equitization for several SOEs. In 1992, seven SOEs were indicated to be objects of this pilot plan. In 1993, the government formally encouraged other SOEs to prepare for equitization. The purposes for the equitization policy were to improve the efficiency of the SOEs by renovating the management and working atmosphere, changing the attitude of managers and employees, and to raise funds for investment.

Regarding this process as well as the pace and the measures to realize this program, three points can be raised. First, the process of equitization has been at a slow pace. Even though the policy decision was in 1990, by 1997 only 18 firms had been equitized (Table 8). Second, only small SOEs have been chosen to equitize. Third, the scope of individuals and organizations that can buy the shares of equitized SOEs, has been expanded step by step. In the initial period, only employees of the SOEs to be equitized could buy shares, then this was expanded to outsiders but limited to Vietnamese residents. Recently, all parties can be buyers, including foreign-related firms. However, in most SOEs, which have been equitized, the state, or internal parties (employees and managers of the firms concerned) usually hold the majority shares.⁵

Until 1996, the equitization was realized on a voluntary basis. Only the SOEs which wanted to be equitized registered with the government and prepared the necessary procedures. Since 1997, the Prime Minister gave quotas to line ministries or provincial and city authorities to select a target number of SOEs to be equitized. By 1998 however, as recorded in Table 8, only 57 firms had been equitized. The reasons for the slow pace of equitization can be summarized by the following.

First, directors and managerial staff at SOEs tend to protect their vested interest in the SOEs, and given the lack of a social safety net or other security measures, employees in SOEs also tended to resist the drastic change in ownership. Unemployment is a serious social problem in Vietnam. Even though the economy has had high growth in most years of the 1990s, the industrial and service sectors have not generated enough employment to absorb redundant labor in both rural and urban areas. Still nearly 70% of the labor force remains in the low productivity agricultural sector (Table 2). The unemployment rate in the urban areas reached 20%. SOEs currently have about 1.6 million employees, accounting for about 4% of the total labor force, or about 34% of the secondary sector, where most of the SOEs reside (Table 4). In the re-registration and restructuring in the early 1990s, many SOEs were merged or disbanded, resulting in a sharp decline of SOE labor as a share of the total employment (Table 4). However, at that time most of the disbanded SOEs were so small and located in such local areas, that they could not resist the restructuring policy. In existing SOEs, it is estimated that the rate of overstaffing is in the range of 20-30% (World Bank, 1998).

Second, the preparation of the security market has taken more time than anticipated. Even though the preparation started in 1994, the market was just opened in July 2000, and so far the

<table>
<thead>
<tr>
<th>Year</th>
<th>Equitized</th>
<th>Sold</th>
<th>Transferred</th>
</tr>
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<tbody>
<tr>
<td>1989</td>
<td>12,000</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>1992</td>
<td>6,545</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>1993</td>
<td>6,264</td>
<td>0</td>
<td>4</td>
</tr>
<tr>
<td>1994</td>
<td>6,019</td>
<td>0</td>
<td>5</td>
</tr>
<tr>
<td>1995</td>
<td>5,962</td>
<td>5</td>
<td>8</td>
</tr>
<tr>
<td>1996</td>
<td>6,025</td>
<td>5</td>
<td>8</td>
</tr>
<tr>
<td>1997</td>
<td>5,873</td>
<td>18</td>
<td>8</td>
</tr>
<tr>
<td>1998</td>
<td>na</td>
<td>57</td>
<td>12</td>
</tr>
<tr>
<td>1999</td>
<td>5,700</td>
<td>370</td>
<td>12</td>
</tr>
<tr>
<td>2000</td>
<td>5,280</td>
<td>451</td>
<td>20</td>
</tr>
</tbody>
</table>

Note: SOEs which have been equitized, sold and transferred are on a cumulative basis. Source: Central Institute of Economic Management (Vietnam).

6 According to the survey on 195 SOEs, conducted in 1999 by the Central Institute of Economic Management (CIEM), a research organ of the Vietnamese government, the average rate of overstaffing was 14.6%. CIEM (2000).
impact of this market on SOE reforms is almost negligible. By the end of 2000, only 4 firms (originally SOEs which were equitized) are listed in the market.

Third, information on each SOE is almost undisclosed. As noted earlier, nobody, including the government is well informed about the financial situation of SOEs. The problem is so serious that one of the current assistance programs that the Japanese government provided to Vietnam is to investigate financial and other various management situations in 100 selected SOEs, in order to diagnose the problems and create new reforms in this sector.

Since 1998, the equitization and other measures for diversifying ownership of the SOEs have been put forth rapidly. The Prime Ministerial Order No. 20/1998/CT-TTg, issued on April 21, 1998 classified SOEs into two groups. Group I is composed of important SOEs for which 100% state ownership should be maintained. These SOEs should be strengthened in terms of management, organization, financial capacity and operation in order for them to play a leading role in the modernization and industrialization of the economy. This group also includes major public service enterprises, and firms which at the moment do not have the conditions for equitization.

Group II is comprised of the SOEs whose ownership pattern should be changed. The SOEs in this group can be reclassified into some sub-groups, depending on the extent to which the state should hold the dominant share of the equitized SOEs. For the SOEs which are too small (i.e., with a capital of less than VND 1 billion), the government decided to transfer partially or entirely the ownership to non-state interests, contract out the management or lease the assets to private managers.

In order to speed up the equitization of SOEs, the Prime Minister requested the line ministries, the local authorities and GC91 to select a number of SOEs which can be equitized and which do not need the dominant ownership of the state. Also according to that request, this number must be large, equal to at least 20% SOEs under their respective administration.

With these strong policies and efforts, SOEs equitized in 1998 and 1999 jumped substantially in number and the SOEs sold and transferred also show a marked change (Table 8).

There are a number of reasons accounting for the rapid progress of micro-privatization since 1998. First, the restructuring and re-organization undertaken since the early 1990s had not met the initial purposes, which aimed at strengthening the SOEs structure, and make them operate efficiently in a market economy. The firms, which run losses, still are a high share of the total SOEs, and such firms within each GC tend to be an increasing burden preventing the efficient operation of GCs as a whole. These trends have been more pronounced since the financial crisis in Asia. Second, pressure from the integration into the world market, increasingly strong in the late 1990s, has forced Vietnam to hurry up the rationalization programs to strengthen international competitiveness of the national firms, which are virtually all SOEs. As a member of ASEAN since 1995, Vietnam joined this group’s free trade area (AFTA) in 1996 and will have to fulfill its duty of free trade with other ASEAN countries until 2006. In addition, negotiations with the US to sign a trade agreement have been underway since 1998 (in fact, the Vietnam-US trade agreement was signed in July 2000) and

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7 According to the document of the Central Committee for Renovation of Enterprise Management, quoted in Thoi bao kinh te Saigon, May 4, 2000, there were 732 public service entreprises (out of 5280 SOEs) in the mid of 2000.
prospective membership in the WTO which is expected in a foreseeable future have brought about many challenges for SOEs in a new era of competition in their own domestic market.

Since the re-employment of the labor, which became redundant as a result of equitization is a critical issue, in order to facilitate the equitization program, in 1998 the government set up the National Target Program on Employment (1998-2000) and a National Fund for Employment Promotion to provide financial support. In accordance with the Three Year SOE Reform Program launched in 1999, a Special Fund for Reorganization and Equitization was set up to support the Program by issuing separation allowances and providing retraining to the laid-off workers. This shows that such institutional setting has been necessary and provided the preconditions for pushing SOE reforms. Until recently, micro-privatization has not progressed, due partially to the lack of such institutional infrastructure.

5.4.2 Development of Private Sector

The role of indigenous private capital still remains marginal even though legislation (such as Law of Companies promulgated in 1990) has been introduced to allow development of various forms of private ownership since the early 1990s. By 1995, there were only about 1,800 joint stock (shareholding) and limited liability companies in manufacturing, and these firms accounted for only 8% of the total registered capital. Sole proprietary ownership, which is the most numerous form of enterprises (5,030) in manufacturing, accounts for about 3% of registered capital (UNDP and MPI 1997, p. 63). 8

From 1995 to 1998, the number of private firms rose but their role in the economy was still small. The main reason was that the economic environment remained significantly biased against the private sector vis-à-vis the SOEs, which were manifested in discriminatory incentive structures of both a financial and an institutional nature.

Along with the slowdown in economic growth since 1998 however, Vietnam decided to promote the private sector by substantially removing regulations and promulgating the Enterprise Law (which replaces the Company Law and the Private Enterprise Law, both promulgated in 1990), effective January 2000. If implemented effectively, this law is expected to improve the climate for private enterprises and to increase employment. Currently, there are about one million (or approximately 3% of total 36 million employed Vietnamese), who are actually working in the formal private corporate sector.

There were skeptical views on the effectiveness of the new law. For instance, according to the World Bank’s East Asia Quarterly Brief, published on January 31, 2000, it may take another two to three years before the new law can operate effectively, since some of the key supporting legislation is still missing, and there are numerous laws and regulations that are inconsistent with the new law that need to be abolished or revised. However, combined with the removal of more than a hundred

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8 According to Vietnamese law, limited liability company has more than two owners or more than one organization, sole proprietor company is small scale one owner unlimited company, and shareholding company was determined from 1990 to 1999 as a company having more than 7 shareholders with a minimum legal capital but since January 2000, under the newly promulgated Enterprise Law, the only requirement is more than 2 shareholders.
business licensing requirements, the law has generated a strong response from the domestic private sector. In the first 5 months of 2000, the number of non-SOE firms, which registered, rose to 5,100 companies, with a breakdown as follows. 2,652 sole proprietor enterprises, 2,244 limited liability companies, and 204 joint stock companies. By August 2000, the total number rose to more than 7,000 companies and by December of the same year, about 14,000 new firms have registered. In addition, the deregulation on export activities since July 1998 has resulted in a jump in the number of non-state export firms.

It seems that the year 1998 showed a turning point in the economic reforms in Vietnam. While SOEs have to continue further reforms in terms of efficiency improvements, both micro and macro-privatization were promoted.

5.5 The Vietnamese Experience from a Theoretical Perspective

5.5.1 Performance of SOEs in Vietnam

As seen in Section I, the position of the SOEs in the Vietnamese economy has risen during the reform process, and in this process, the Vietnamese economy has experienced considerable growth. In other words, the reforms so far have yielded high growth for the economy as a whole, and within that process SOEs have grown at a higher rate.

In order to have a more accurate evaluation of the performance of SOEs, however, we have to examine the technical efficiency of their growth. Have SOEs improved their technical efficiency during the reform process? What market conditions have they faced after being granted the management autonomy? However, due to limited data, a thorough analysis of these issues is not possible. In the meantime, we have to rely on results from a number of field surveys and other sources of information to have an assessment.

A survey conducted by the State Planning Committee (the current name is Ministry of Planning and Investment) of Vietnam, and the Overseas Economic Cooperation Fund (OECF) of Japan conducted in late 1994 on 208 manufacturing firms (148 SOEs and 60 private firms) in Hanoi and Ho Chi Minh City, recorded and analyzed in Ohno (1996), showed that during the 1991-94 period, many SOEs improved their performance in terms of their capacity utilization rate, changes in nominal profitability and the ratio of redundant labor to total labor, and their competitiveness to domestic products and imports. The study also suggested that the ownership pattern has not influenced the performance of the firms surveyed, rather the factors specific to each enterprise such as managerial autonomy, and size and degree of competition were more strongly associated with performance. The study supported the “gradualist” approach to the reforms of SOEs, i.e., reforms without changing the ownership of the firms.

However, more recent surveys and information on the current situation of SOEs tend to suggest that the performance of SOEs seems to have deteriorated. For example, based on the results of the survey conducted by the OECF and the Central Institute of Economic Management (CIEM) within the MPI between 1996 and 1997, covering the performance of 200 SOEs in the manufacturing sector for the 1991-95 period, a study by Mitsui and Wada (1998) showed that the Vietnamese SOEs experienced a steady increase in labor productivity. But this increase was attributed to the steady rise in the capital-labor ratio, due to the expansion of investment by these firms. The study also showed that while most SOEs are competitive in domestic markets due to their superiority in facilities, tech-
nology and skilled labor, compared to other types of firms, but they are not so in international markets. Another finding was that while sales and other growth indicators showed a substantial increase, the profitability of most SOEs has deteriorated considerably.

Even though there is no comprehensive data, since the mid-1990s, various sources of information on the financial performance of SOEs have made both foreign and Vietnamese observers frequently warn about the inefficiency of SOE operations in Vietnam. “Most SOEs were reported to operate with obsolete machinery and equipment, with low productivity and quality as a result. Due to their low productivity, many SOEs were forced to borrow capital from other state enterprises, the banking sector, and other capital sources, which created a complex maze of cross-subsidization and indebtedness” (Kokko, 1998, pp. 320-1). According to Dapice (1999), which quoted the World Bank source, out of 5,800 SOEs in 1997, only 37% were said to be profitable. At the end of 1997, SOE debts amounted to VND 170 trillion, more than half of that year’s GDP and fully 45% of the debts were past due. In addition, three-fifths of the SOEs surveyed, which were unprofitable, had debts about double the value of their state capital.

The sources from the government of Vietnam also revealed the severe situation of SOEs. According to the survey by the Vietnamese Ministry of Finance and IMF, about 40% of SOEs run profitable in 1997. However, the more recent report by the Ministry of Finance showed that at the end of 1999 only 20% of the SOEs were operating efficiently in terms of generating profits and the capacity to maintain its capital and assets, paying debts and contributing to the government budget. My own interview with the Central Committee for Renovation of Enterprise Management, conducted in Hanoi in January 2000, also confirmed the deterioration of SOE performance.

Regarding market conditions, it is possible to divide SOEs into three types. Each one is facing different market environments. One type is the monopolist SOEs in the non-traded sector such as telecommunications, transportation, construction and public utilities. These firms enjoy monopolistic market power and are reportedly very profitable since the prices they charge are very high (international telephone charge in Vietnam is among the highest in the world). The second type is SOEs in heavy industries such as steel, cement, metals, or machines, which are capital intensive. These firms were monopolistic or oligopolistic in domestic markets until the mid-1990s, but have been increasingly exposed to competition with imports, due to trade liberalization under the AFTA regime, and also under stronger pressure from domestic users. These two types of SOEs are mainly controlled by the central government. The third type is small and medium-sized SOEs, principally controlled by local government authorities, which are seen in labor intensive industries. In terms of the factor intensity of their operation, these firms are operating in Vietnam’s comparative advantageous sectors, but due to their outdated technology and financially weak structures, many of them are not competitive with imported products.

The second type of SOEs as well as some SOEs in the first type (such as construction firms) have enjoyed a privileged position in accessing government credit, and they have expanded rapidly in the reform process. This fact is consistent with the observations by many watchers of Vietnamese economic reform and development that the Vietnamese economic growth in the 1990s has been characterized by increasingly capital-intensive industrialization, import substitution bias, and thus

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With these qualifications, the expansion of the SOE sector and the growth of the economy as a whole may be referred to the case pointed out by Krugman (1994) on the economic growth of East Asia. He argued that East Asian growth has been input-driven, not by technical improvement, since their total factor productivity has been low. 10

5.5.2 SOEs Reform in Vietnam and the Theory of Gradualism: A Tentative View

From the preceding analysis, the characteristics of SOE reforms in Vietnam may be summarized as follows:

First, along with agriculture, SOEs have been the targets of reforms since the early stage of the transition process. SOE reforms have been started by granting autonomy to the management, then hardening the budget constraints as well as restructuring and grouping, to create larger and stronger SOEs for effectively competing in the market economy.

Second, privatization of SOEs has been conducted in the later stage of transition, and confined to small SOEs.

Third, the development of non-SOEs or the macro-privatization has been formally accepted in the reform and development strategy but so far has not shown substantial performance, except for the foreign invested sector, which has been strongly associated with SOEs.

Fourth, consequently, the position of SOEs has been strengthened in the reform process. However, in terms of growth and stability, the Vietnamese economy so far has shown a good performance. The increasingly strong position of SOEs and the favorable performance of the economy may be the most important features of the reforms in Vietnam.

These characteristics may be attributed to two factors. One is the ideological principle of the Vietnamese leadership aiming to build a socialism-oriented market economy, in which SOEs are considered keystones. This principle tended to allocate resources to the SOEs by providing various financial supports and administrative encouragement from the government. According to Ishikawa (1999, p. 319), during the reform process in Vietnam, budget constraints have been hardened for small SOEs but not necessarily for larger ones. Since 1998, due to the downturn of the Vietnamese economy, SOEs have encountered more severe market conditions and this situation tended to make the government further soften the budget constraints on SOEs. Another factor is that the institutional building which is essential for the non-SOE sectors to be developed, has been undertaken at a slow pace. Particularly, efforts in setting a legal framework have been done in a long trial-and-error process and thus the investment environment for non-SOE sectors has not been stabilized. In addition, due to the legacy of war, Vietnam is lacking human resources for building an institutional framework, as well as an efficient administrative mechanism.

The conventional view of gradualism, or the two-track approach to economic reforms suggests that,

10 This view has been controversial and is not necessarily convincing. My comments on this point are recorded in Tran (2001). However, for the reasons just cited, the input-driven growth hypothesis seems to be relevant to the case of Vietnam.
the reform of SOEs should be undertaken in the long-run, and that during a long-term process, the strategy should have different treatments towards the SOE sector and the rest of the economy. For SOEs, due to the low stage of market development and to the political and social sensitivity, the initial reform is to improve the efficiency of the firms without privatizing the ownership, including measures to harden budget constraints and granting autonomy to their management. On the other hand, various efforts are made to expand the non-SOE sectors for generating employment and building an institutional framework, which both prepare essential preconditions for further reforming the SOE sector in the next stage. Figure 1 illustrates such a path of reforms. With deregulation in the non-SOE sector, this sector expands at a much faster speed than that of SOEs. SOEs almost remain the same size as in the pre-reform period, but their relative position declines in the reform process.

In the case of Vietnam, as seen above, even though the two track approach has been adopted and the economy has performed well in the reform process, the SOE sector has expanded in both absolute and relative terms. The reasons have been explained above. This case may be illustrated by Figure 2.

![Figure 1: Conventional Path of Gradualism: Non-SOEs-Biased Shift of SOEs_Related Industries](image-url)
5.6 Concluding Remarks

SOEs in Vietnam have gone through a long process of reform. The first stage, reforms without privatization, was for improving the efficiency of SOEs by granting them partial autonomy (1981) and later giving more substantial autonomy (1987) to their management, followed by hardening budget constraints (1989-91), restructuring (1992) and grouping of SOEs (1994). Micro-privatization had been postponed until the late 1990s and macro- privatization had not also been substantial until the late 1990s except for the foreign investment sector, which has been strongly associated with SOEs.

The Vietnamese economy has shown a remarkable performance so far and the position of SOEs has risen during this process. In that sense, Vietnam has taken a path of gradualism, which is different from the conventional view. However, this path seemed to bring about some mis-allocation of resources. With the constraints of institutional resources and political factors, however, such a path could be judged as inevitably the second best way. However, in the second stage of reforms (which can be marked as a period beginning at the late 1990s), Vietnam should move to the conventional path of gradualism with the expansion of the non-SOE sector and development of comparative advantage industries. The increasing pressures of globalization may speed up that process.
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