VIETNAM DEVELOPMENT REPORT 2012

MARKET ECONOMY
FOR A MIDDLE-INCOME VIETNAM

Joint Donor Report to the Vietnam Consultative Group Meeting
December 06, 2011

Consultation Draft

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VIETNAM GOVERNMENT FISCAL YEAR

January 1 to December 31

CURRENCY EQUIVALENTS

(Exchange rate effective as of November 30, 2011)

Currency Unit US$1.00 = VND21,008

Weights and Measures

Metric System

ACRONYMS AND ABBREVIATIONS

ADB	Asian Development Bank
ASEAN	Association of Southeast Asian Nations
BIDV	Bank for Investment and Development of Vietnam
CAMS	Changing Attitudes toward Market and State
CEOs	Chief Executive Officers
CIEM	Central Institute for Economic Management
CPSEs	Central Public Sector Enterprises
CPI	Consumer Price Index
CPV	Communist Party of Vietnam
EGs	Economic Groups
EVN	Electricity of Vietnam
EZ	Economic Zone
FDI	Foreign Direct Investment
GCs	General Corporations
GDP	Gross Domestic Product
GSO	General Statistics Office
IMF	International Monetary Fund
IP	Industrial Park
IPO	Initial Public Offering
JSB	Joint Stock Bank
JSC	Joint Stock Company
MOT	Ministry of Transport
MOU	Memorandum of Understanding
MPI	Ministry of Planning and Investment
PFM	Public Finance Management
PIM	Public Investment management
PMB	Provincial Management Board
PMS	Performance Monitoring Systems
PPC	Provincial People Committee
ODA	Official Development Assistance
SCIC	State Capital Investment Corporation
SEDP	Socio-Economic Development Plan
SEDS	Socio-Economic Development Strategy
SEG	State Economic Group
SOCB	State-Owned Commercial Bank
SOE	State-Owned Enterprise
TEU	Twenty-foot Equivalent Unit
VCCI	Vietnam Chamber of Commerce and Industry
VDR	Vietnam Development Report
VND	Vietnam Dong
VNPT	Vietnam Post and Telecommunication
WTO	World Trade Organization

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Chapter 1

TRANSITION, TRANSFORMATION, AND TRIBULATIONS

CONTEXT AND KEY FINDINGS

1. Vietnam's transition to a market economy has transformed the country and the lives of its people. In 1986, Vietnam launched **Đổi Mới**—a homegrown, political and economic renewal campaign—that marked the beginning of its transition from a centrally planned economy to a socialist-oriented market economy. At that time, Vietnam was one of the poorest countries in the world, and with many problems: hyperinflation, famine, drastic cuts in Soviet aid, and a trade embargo by the west.[1] For most Vietnamese, life was harsh and the future looked bleak. When measured against this backdrop, the economic performance of the last 20 years has been impressive. Between 1990 and 2010, Vietnam's economy has grown at an annual average rate of 7.3 percent, and the per capita income almost quintupled. The rapid expansion of the economy has been accompanied by high levels of growth of international trade; large-scale inflows of foreign direct investment; a dramatic reduction in poverty; and almost universal access to primary education, health care, and life-sustaining infrastructure such as paved roads, electricity, piped water, and housing. Vietnam's transition from a centrally planned economy to a market economy and from an extremely poor country to a lower-middle-income country in less than 20 years—is now a case study in development textbooks.[2]

2. But Vietnam's other transition—to becoming an industrialized and modern economy—has barely begun. According to its recently approved Socio-Economic Development Strategy for 2011–2020, Vietnam aspires to achieve a per capita income level of US$3,000 (in current U.S. dollars) by 2020. This translates into a nearly 10 percent annual growth in per capita income over the next decade—requiring the country to replicate and sustain the economic success it achieved in the last 10 years. The Socio-Economic Development Strategy goes on to identify the country's key priorities to meet this ambitious target: stabilize the economy, build world-class infrastructure, create a skilled labor force, and strengthen market-based institutions.

3. Meeting these aspirations will not be easy. The country has experienced bouts of macroeconomic turbulence in recent years—double-digit inflation, depreciating currency, capital flight, and loss of international reserves—eroding investor confidence. Rapid growth has revealed new structural problems. The quality and sustainability of growth remain a source of concern, given the resource-intensive pattern of growth, high levels of pollution, lack of diversification and value addition in exports, and the declining contribution of productivity to growth. Vietnam's competitiveness is under threat because power generation has not kept pace with demand, logistical costs and real estate prices have climbed, and skill shortages are becoming more widespread (National Competitiveness Report 2010; SEDS 2011; VDR 2010). The country also faces many new social challenges: vulnerability is increasing, poverty is becoming concentrated among ethnic minorities, rural-urban disparity is growing, and the pace of job creation is slowing. These problems, taken together, pose a serious threat to Vietnam's medium-term socioeconomic aspirations.

4. Vietnam has a strong track record of formulating successful policy as a pragmatic response to national circumstances. Vietnam's success of the past 25 years, as discussed below, is due to a number of factors: (a) starting the transition from a low base and with fewer distortions, (b) pursuing a gradual and bottom-up reform process, (c) getting the broad policy reforms and incentive structure right, (d) embracing outward-oriented trade and investment policies, and (e) the enabling role of human capital, entrepreneurship, and the party-state system. With the low-hanging fruit already harvested, however, the issues that remain unaddressed—the "unfinished agenda" of transition—deal with the more complex issues of building market-based institutions and rebalancing

1 With a per capita gross domestic product of US$98 (in current U.S. dollars), Vietnam was indeed the poorest country in the world in 1990. The next two countries with the second- and third-lowest per capita income were Somalia (US$139) and Sierra Leone (US$163). In terms of per capita gross domestic product adjusted for purchasing power parity, Vietnam was among the 20 poorest countries in the world.

2 See, for example, Growth Commission (2009).

the equilibrium between the state and the market.[3] Can Vietnam face its next set of challenges?

5. As the country celebrates the Silver Jubilee of Đổi Mới, this *Vietnam Development Report* (VDR 2012) looks ahead at some of the pressing issues Vietnam needs to tackle to build a strong foundation for its quest to become an industrialized country by 2020. According to the recently approved five-year plan, three areas that need urgent attention are restructuring of the state-owned enterprises (SOEs), improving the effectiveness of public expenditure and stabilizing the financial sector. The analysis undertaken in this report focuses on first two of these priorities. First, it shows that the SOEs, which own fixed capital (land and credit) disproportionate to their size, are less efficient at using them than nonstate and foreign enterprises—requiring restructuring of the state-owned sector. Second, the analysis finds that Vietnam is allocating its public resources in a way that is creating a suboptimal and fragmented infrastructure at the local level that does not always contribute to building an effective infrastructure system at the national level, thus justifying changes to the allocation mechanism. The report then identifies the reasons for SOE inefficiencies and ineffectiveness in public investment and offers some broad policy options for discussion.[4]

6. Transition is a journey and not a destination. While it is easy to define Vietnam's initial point in its journey to becoming a market economy, there is unlikely to be a finish line. Even the most mature market economies must constantly change, update, and fine-tune their policies and institutions to keep up with the changing times. Therefore, VDR 2012 does not have answers to all the economic challenges facing Vietnam, nor does it contain an exhaustive list of policy suggestions for successful transition. Rather, it aims to contribute to the ongoing discussion on some of the most pressing and sensitive issues involving Vietnam's future.

7. The rest of the Report is organized as follows. The rest of Chapter 1 discusses the factors that have contributed to Vietnam's success and explores the emerging challenges. Chapter 2 explores the issue of restructuring SOEs. Chapter 3 examines the challenges of the public investment program and how to raise its effectiveness. Chapter 4 discusses the low level of transparency to support Vietnam's middle-income status—a critical issue that needs to be tackled if Vietnam is to achieve its socioeconomic aspirations.

II FACTORS UNDERPINNING THE INITIAL SUCCESS

8. Vietnam's transition to a market economy has been subject to much research. During the last two decades, numerous books and reports have been written documenting Vietnam's transition to a market economy. Many multilateral organizations have commissioned reports and several national and international scholars have written on the topic.[5] The discussion in this section draws lessons from past success to inform future debate, and is not meant to be an exhaustive exploration of factors explaining Vietnam's transitional success.[6]

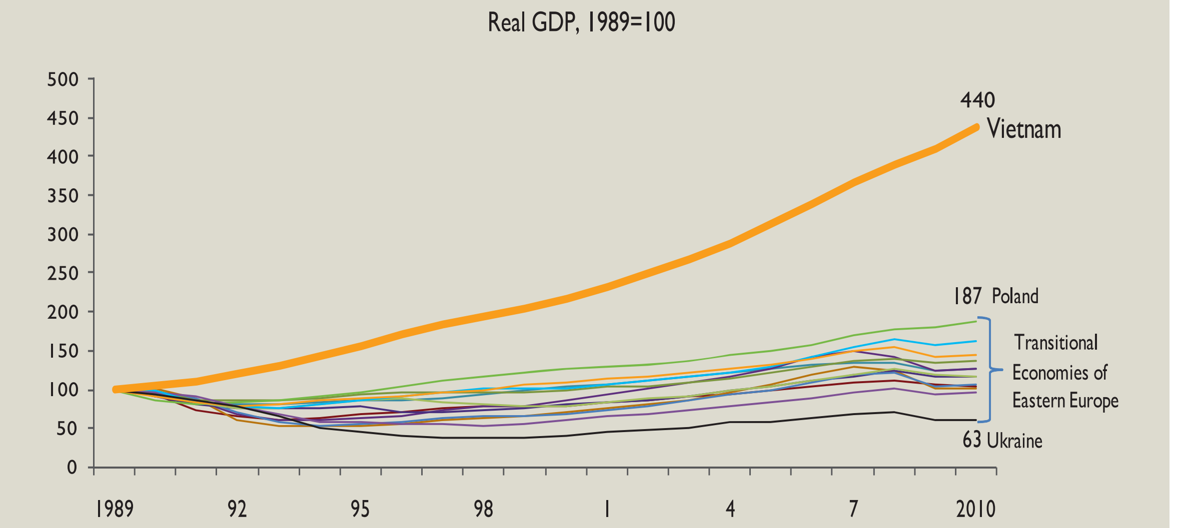
3 While in the post-global financial crisis of 2008–09 the pendulum has swung away from the market to the state in most advanced economies, in Vietnam the state has always played the leading role. However, the disappointing economic performance of the last few years has led many Vietnamese policy makers and national scholars to ask whether, in the case of their country, the pendulum needs to swing away from the state and toward the market. Interestingly, many International Financial Institutions in Vietnam have taken a more cautious stand on this issue (preferring gradual change) compared to national scholars, who seem to be calling for far-reaching changes, including some who have called for a second **Đổi Mới**.

4 The third area, consolidating the financial sector, is beyond the scope of this report. It will however be discussed by other ongoing work including soon to be launched joint World-Bank/IMF Financial Sector Assessment Program

5 See the list of references at the end of the report.

6 For more comprehensive discussion on transition, see Arkadie and Mallon (2003), IMF (1996) and ADB (2006).

Figure 1.1 Vietnam's Output Performance Relative to other Transitional Economies



Sources: WDI 2010; http://www.databasece.com/en/gdp-during-transition; WB estimates.

9. **Vietnam stands out as a clear success story among the transitional economies.** The transition in Eastern Europe proved to be a complex and problematic process, with recurrent economic crises, involving some combination of factors including falling output, declining average incomes, sharp increases in poverty, rising mortality and falling birthrates, and rapid inflation (figure 1.1) (World Bank 2002). However, Vietnam also experienced high rates of economic growth, rising investment, vigorous exports, and a sharp drop in inflation, with a program of limited and gradual reform. Moreover, the changes in Vietnam occurred in the context of the continuation of single-party rule, high levels of state intervention, and significant direct control of production through the SOEs. Why did Vietnam succeed while so many other countries failed?

II.A DIFFERENT INITIAL CONDITIONS

10. **At the start of its transition, Vietnam was the poorest and the least industrialized of all the transitional countries—which in hindsight seems to be an advantage.**[7] Its economy was never subjected to the same level of effective centralized control as in the Former Soviet Union and Eastern European transitional economies (Arkadie and Mallon 2003). For example, the list of commodities allocated under plans was always limited compared to the Soviet material balance system. Similarly, the SOE sector in Vietnam accounted for a small part of nonagricultural production, 29 percent, and an even smaller part of employment, 16 percent, unlike other transitional economies where the share of SOEs in total output was 75 to 95 percent (IMF 1996). While the transitional economies of Eastern Europe had achieved a higher level of industrialization under the central planning system with the development of heavy industry, much of the existing capital stock was found to be uncompetitive. Thus, while Vietnam could continue to use a large part of its pre-transition capital, other transitional countries often had to rebuild new capital stock, thereby experiencing a

7 Given our focus on Vietnam, there is much about other transition countries that may have been neglected here. For example, the former Yugoslavia broke into five (now seven) different countries and had a war. The Soviet Union broke into 15 countries, each of which had to establish new sets of political institutions and legal frameworks. Some borders remain in dispute to this day. There were wars in Caucuses and Tajikstan. Czechoslovakia broke into two separate countries. The need to establish new political institutions and legal frameworks, dealing with international and domestic security, and addressing the collapse of the socialist trading system and soviet aid must have posed massive challenges to transition countries in Eastern Eurpoe, much of which Vietnam was spared.

significant drop in output, primarily in the industrial sector, in the initial years.[8,9]

11. Another important feature was the relative importance of the rural sector and the dominant role of household units in Vietnam's agriculture production. Arkadie and Mallon (2003), Lin (2010), and others have argued that Vietnam, like China, was largely an agrarian economy at the time of transition, so its production structure was broadly consistent with its comparative advantage. Therefore, when Vietnam opened its economy to domestic and external competition, its agricultural sector responded vigorously to changes that incentivized agriculture—offsetting any contraction in the industrial sector. For example, Party Resolution No. 10, passed in 1988, provided farmers with property rights (albeit limited), which the Party Secretary-General, Do Muoi, argued was a turning point in agricultural development. The limited property rights, along with price and trade reforms, contributed to sustaining agricultural growth, generated the surplus necessary to diversify into nonagricultural sectors, and strengthened the resilience of the economy.[10]

II.B A BOTTOM-UP, GRADUALIST APPROACH

12. Reform in Vietnam, certainly in its early stages, was bottom-up and gradual, focusing heavily on productive units. The incremental process meant that at each step the effectiveness of new institutions and policies were tested and adjusted to Vietnamese conditions. This process was particularly evident in the agricultural sector, which was subject to a continuous crisis in the years prior to the adoption of **Đổi Mới**.

13. Agrarian collectivization was an important part of socialist strategy. This was particularly true in the North, where the cooperatives were developed both as productive units and as providers of social services. The experience of the South, and in particular the Mekong Delta, was somewhat different. There were two successive waves of collectivization in the Mekong, in 1979–80 and then in the early 1980s, although collectives never played as decisive a role in the southern rural economy as they had in the North.[11] As has been documented, many of the agricultural reforms were inspired by the resistance of farmers in the Mekong Delta to collectivization after reunification. In particular, it relates to farmers' refusal to grow rice beyond the need to satisfy their household requirements. Some senior policy makers witnessed the benefits of household farming and later formulated policies to encourage similar changes throughout the country (Dixon 2003; Rama 2009).[12] They decollectivized agriculture, established land-user rights, reduced the role of cooperatives, liberalized agricultural prices, and encouraged farmers to export—transforming the country from being chronically food deficient to the third-largest exporter of rice in two years.[13]

14. Another example of step-by-step reform can be seen in the development of market institutions. Unlike many other transitional countries, Vietnam did not entirely do away with its pre-reform economic institutions and structures, but rather adapted and reoriented them to changing times. Instead of complete destruction of old institutions as a prelude to the installation of new mechanisms, many reforms were directed at making existing institutions work better, while gradually introducing new market institutions. It is, therefore, not an accident that, among the economies closely linked to the

8 Critics have argued, however, that such an interpretation assumes that the problem was simply an overgrowth of the state sector and wrong investment in large capital-intensive projects. This ignores the deeper incentive problems associated with central planning and direct state involvement in production.

9 A possible variant of this hypothesis can be that it was sheer desperation—famine, hyperinflation, little or no aid—that pushed Vietnam's government to reform. In a humorous vein, some call this period reform by the PhDs—the poor, the hungry, and the driven.

10 Other initial conditions that helped Vietnam avoid a sharp decline in output include the timing of natural resource (mainly oil) exploration, and its location in one of the most dynamic and fastest growing regions in the world.

11 Even in Northern and Central Vietnam, farm households were an important element of the production system.

12 It has been reported that Mr. Do Muoi, the General Secretary responsible for unification, came from Hanoi to visit the farmers and told them that what they had done was correct (Howie 2011).

13 Others, however, have cautioned against bottom-up learning, arguing that "references to grass-roots communities are better translated as references to the base of an apparatus," see Fforde and Vylder (1996).

Former Soviet Union, Vietnam was unique for its swift adjustment with the least disruptions (Dollar 1999).[14]

II.C POLICY REFORMS AND INCENTIVE STRUCTURE

15. Perhaps the most fundamental change during the first few years of its transition is the slew of policy changes aimed at raising the efficiency of the enterprise sector, boosting production in agriculture, opening the economy to foreign trade and investment, and reforming the government. Several of the key policy changes in each of these areas include (ADB 2006; IMF 1996):

- *State-Owned Enterprises:* (a) Replacing central planning powers with substantial state enterprise autonomy; (b) giving enterprises the authority to set most prices, select appropriate mixes of inputs and outputs, and determine their own investment; (c) giving managers the right to lay off excess workers based on prescribed guidelines; (d) allowing enterprises the freedom to sell their excess production (beyond a centrally planned amount) at market prices for all outputs; and (e) imposing hard budget constraints on SOEs.
- *Private Business.* (a) Reducing restrictions on private enterprises; (b) allowing private sector enterprises equal access to credit and creating a legal framework more supportive of their operation; (c) subjecting all enterprises to uniform rules of taxation; (d) allowing all enterprises to establish direct trade links or to use trade companies of their own choice rather than a specific trade channel; (e) exposing all enterprises to foreign competition by liberalizing the import regime; and (f) decollectivizing agriculture and establishing land-use rights.
- *Price and trade liberalization:* (a) Liberalizing most industrial prices by the end of 1988, and the few remaining prices that were controlled for official (state) customers, such as those of cement, steel, and electricity, were generally set close to free-market values; (b) devaluing the official exchange rate and aligning it closely to the rate in the parallel market; (c) eliminating export subsidies; (d) allowing retention of foreign currency earnings; (e) liberalizing trade, in particular by allowing production enterprises to trade directly abroad, thereby dismantling the tight and bureaucratic grip of the trading companies; (f) creating export processing zones and industrial parks; and (g) abolishing internal customs checkpoints (ADB 2006; IMF 1996).
- *Labor market liberalization.* (a) reducing restrictions on the mobility of labor enabled underemployed people in rural areas to move to new jobs in urban and peri-urban areas; and (b) successive modifications to the labor code formalized labor hiring practices and eliminated obstacles to free labor mobility.

16. Many of these policies, aimed at boosting supply, provided the basis for a successful transition. Vietnam's physical and human capital was underused as a result of controlled prices and an incentive system that discouraged more production. By rapidly liberalizing prices and instituting an incentive system, the market economy succeeded where central planning had failed.

II.D USING EXTERNAL COMMITMENTS TO SHAPE DOMESTIC REFORMS[15]

17. The commitments undertaken by Vietnam in a number of regional and multilateral trade agreements—the Association of Southeast Asian Nations (ASEAN) Free Trade Area (FTA) in 1995 (including ASEAN FTAs with Australia, China, India, Japan, the Republic of Korea, and New

14 Critics of the gradualist approach to reforms have depicted it as a reflection of a limited understanding of the market, reinforced by inefficiency, corruption, internal opposition, lack of human resources, and the "trial and error" or "groping" approach followed by the government.

15 This section draws on a background note prepared by the EU-funded MUTRAP III project.

Zealand); Bilateral Trade Agreements with the United States in 2000 and with Japan in 2008; and becoming a member of the World Trade Organization (WTO) in 2007—have provided a considerable boost to domestic reforms during the transition period. Some of the benefits of trade liberalization include (a) a predictable and transparent regime for international trade, (b) a substantial reduction of tariffs for domestic manufacturers and exporters, (c) elimination of all export subsidies considered illegal by the WTO, and (d) liberalization of services such as banking, distribution, construction, health care, tourism, insurance, and business services (auditing, legal, information technology, and research and development).

18. **Trade liberalization has had a huge positive impact on Vietnam's economy.** Some of the visible benefits of trade liberalization include a significant boost to foreign direct investment, a resilient export sector, lower prices, and improved quality of goods and services. Bilateral trade agreements and WTO commitments have led Vietnam to introduce important modifications in its institutional and administrative systems. For example, as part of its WTO commitments, Vietnam publishes an official journal of all the laws, regulations, and administrative procedures of general application before enforcing them. Moreover, the full texts of the legal acts are posted on a government website at least 60 days prior to approval so agencies, organizations, and individuals can submit comments. A study conducted by the Multilateral Trade Assistance Project concluded that the impact of ASEAN, plus liberalization on almost all the main trade and economic indicators, has been largely positive.

II.E ROLE OF HUMAN CAPITAL, ENTREPRENEURSHIP, AND THE PARTY-STATE SYSTEM

19. **Vietnam's transition to a market economy reduced the barriers to the adoption of existing knowledge, which, along with improved incentives and increased competition, is crucial in explaining the rapid improvements in economic performance over the last two decades** (Arkadie and Mallon 2003). Vietnam's ability to rapidly exploit existing knowledge was aided by solid performance in promoting literacy, numeracy, and broader human development in the pre-reform period. In fact, at the beginning of the reform period, Vietnam had much higher literacy rates, life expectancy, and education than most other countries with similar levels of per capita income. The strong human capital base was complemented by the energy, liveliness, and entrepreneurial skills of the population and the quality of Vietnamese workforce.

20. **Some economic historians have argued that the Vietnamese party-state system played an important role in the country's smooth transition** (Dixon 2003). The pre-reform period party-state bureaucracy was a complex system that connected the central state to all elements of society, extending through many layers to the workplace and small community groupings. These systems enabled decrees, quotas, and policies to be transmitted through the systems and were extremely effective in mobilizing people and organizations at all levels. It is apparent that at all levels, considerable administrative and organizational capacity existed, which explains Vietnam's remarkable achievements in terms of such measures as literacy rates, life expectancy, and infant mortality rates even before the onset of the transition. Therefore, Vietnam entered the reform period with the ability to focus on long-term national goals, and with considerable administrative, managerial, and implementation capacity, which contributed to its initial success.[16] But as discussed later, with the expanding private sector, the party-state system has found it increasingly difficult to attract and retain talent—causing gradual erosion of its administrative and management capacity.

16 However, there are others—Fforde and Vylder (1996) and Pike 2000, for example—who have suggested that post-1990 growth in Vietnam owed little to the state.

III CHANGES, CHALLENGES, AND CONTRADICTIONS

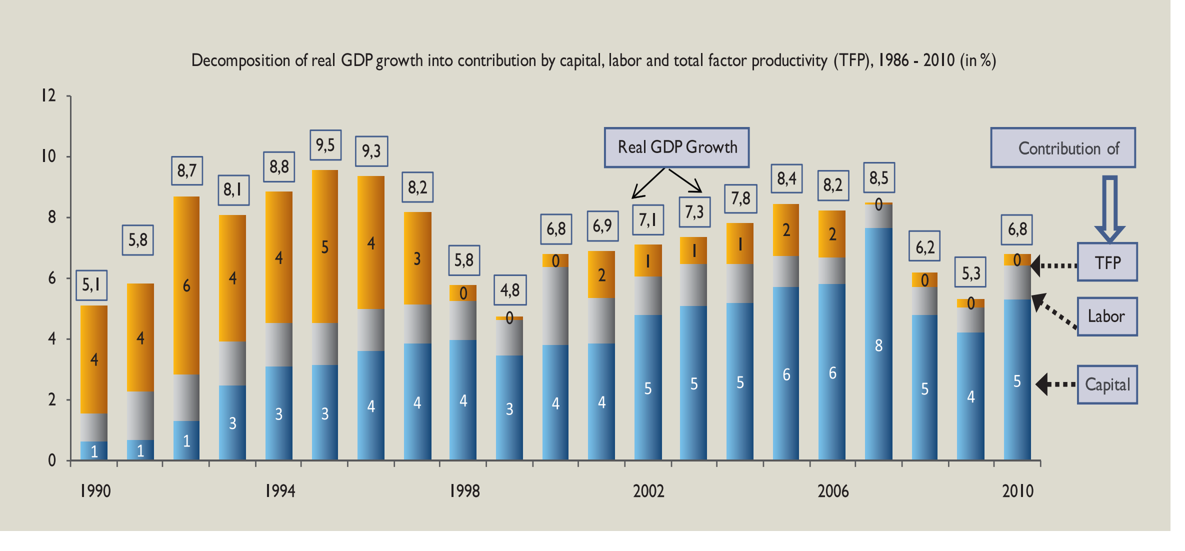
21. Vietnam's economy has grown so rapidly in recent years that it is easy to overlook some of its lingering challenges. In a span of five years, between 2003 and 2008, Vietnam's economy more than doubled from US$40 billion to US$90 billion, and its exports more than tripled from US$20 billion to US$63 billion. During this time, Vietnam also became a member of the WTO—triggering an unprecedented flow of private external capital, which reached its peak of 18 percent of GDP in 2007. Domestically, this period coincided with the establishment of State Economic Groups (SEGs)—a loose alliance of SOEs with similar business interests—and decentralization of investment decisions to the local governments. This period also saw booming investment, thriving stock market, escalating real estate prices and rising prosperity all around. It is therefore easy to overlook that this period also coincided with declining contribution of productivity to growth, increased macroeconomic instability, fragmented development and inability of public institutions to keep pace with a rapidly globalizing economy.

III.A DECLINING PRODUCTIVITY

22. If Vietnam's initial transition years were marked by "growth with limited resources," the last five years can be labeled as "abundant resources with limited growth." It is well documented that the sharp acceleration in growth in Vietnam during the 1990s is not explained by any sharp increase in capital formation. As shown in figure 1.2, nearly 40 to 60 percent of growth during the 1990s came through productivity growth and the rest through factor accumulation. The situation changed during the 2000s, a period when Vietnam received record flow of external capital. During this period, productivity accounted for only 15 percent of growth, with the remaining accounted by accumulation of physical and human capital. And in the last four years (2007-10) almost entire growth came from factor accumulation.

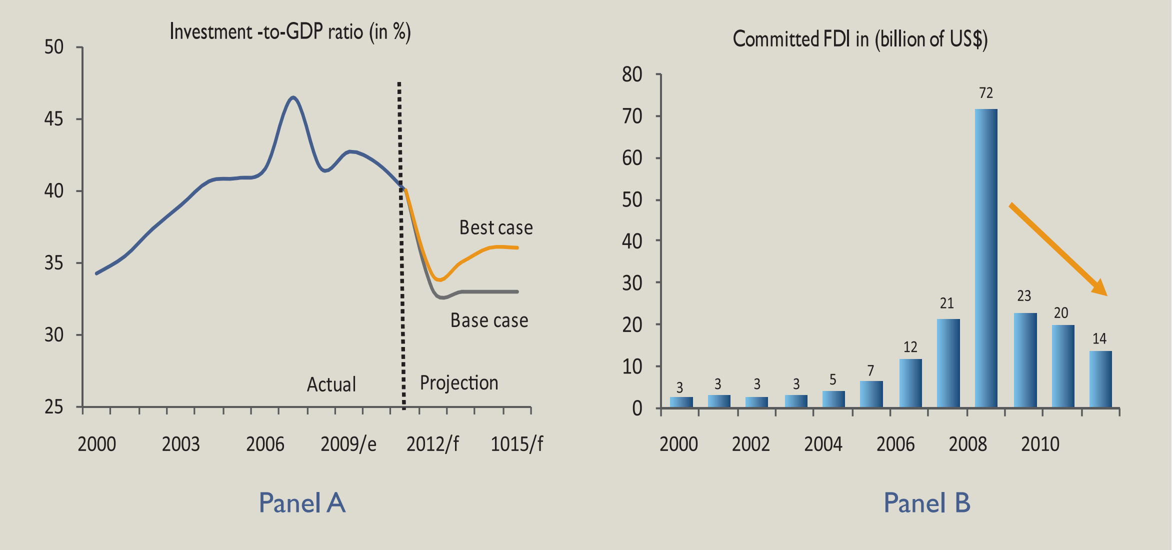
23. Excessive reliance on factor accumulation to support rapid growth is bound to be unsustainable. There is a limit to how fast factors can grow to support a rapidly growing economy. Though Vietnam has a large population, people with necessary education and skill to work in industry and services are getting increasingly scarce. This has led the SEDP to identify "skills and human capital" as one of the breakthroughs for the next five years. At the same time, rapid growth in credit, which is the basis for brisk growth in capital accumulation, has led to macroeconomic instability, forcing the government to pursue a tighter monetary policy in recent months.

Figure 1.2 Growth Has Been Increasingly Based on Factor Accumulation and Not Productivity



Sources: CIEM (2010).
Note: The estimates for 2009 and 2010 are done by the World Bank.

Figure 1.3 Vietnam Has Lower Investment Target and Is Receiving Less FDI



Sources: SEDP 2011–15; MPI, WB estimates.

24. The government's recent decision to slash the target investment rate for the next five years makes productivity increase an imperative. With no visible improvement in the external environment and continued macroeconomic turbulence at home, Vietnamese leaders reached a decision that the country has to do more with less, that is, it must maintain its high growth rate, but with a lower investment rate. Therefore, the government slashed the target investment rate for the next five years from the current 40 percent of GDP to 35 percent of GDP while maintaining the growth rate of the economy at 6 to 6.5 percent (panel A, figure 1.3). This is also consistent with the trend in committed foreign direct investment (FDI), which has been on a declining path for some time (panel B, figure 1.3). Raising productivity will require a paradigm shift in the way Vietnam's economy has operated in the recent past. Fundamental to this new approach will be the restructuring of SOEs, strengthening the effectiveness of public investment, and reforming the financial sector—the three priorities set out by the Party, Government and the National Assembly in their recent announcements. (The first two issues are the subjects of Chapters 2 and 3, respectively, in this Report). [17]

III.B MACROECONOMIC STABILITY

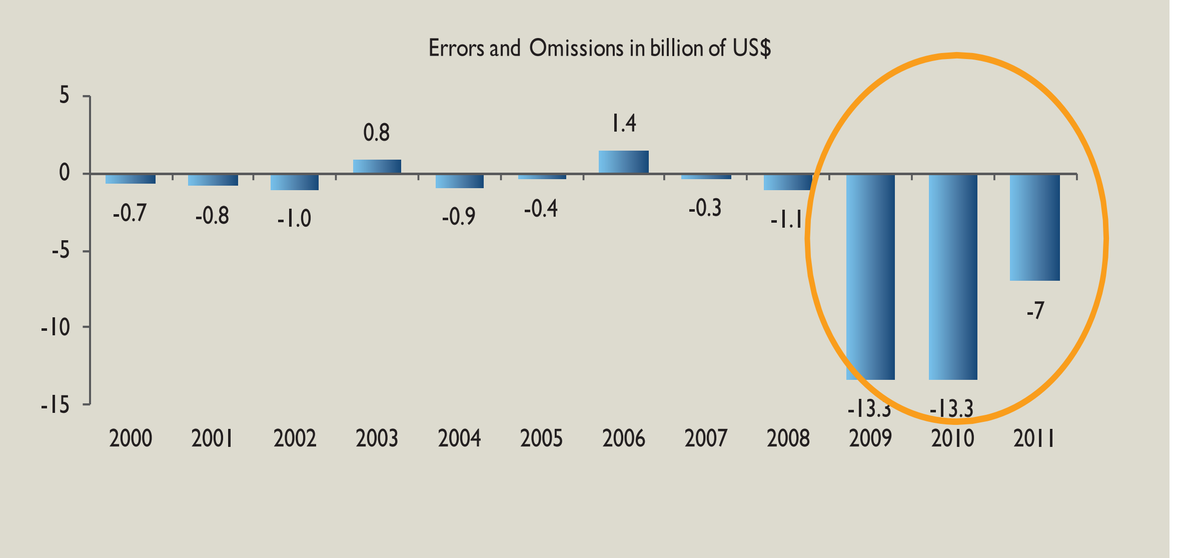
25. Another sign of weakness in Vietnam's economy is its persistent macroeconomic instability. For four years in a row, Vietnam has had one of the highest inflation rates in Asia, averaging nearly 16 percent a year between 2008 and 2011. Along with high inflation, Vietnam has also been coping with persistent pressure on its currency, falling levels of foreign exchange reserves, an underperforming stock market, high sovereign spreads and domestic capital flight. It has thus become an exception to the broader trend of the rest of the emerging markets in Asia, which are dealing with appreciating currencies, rising foreign exchange reserves, and increasing capital inflow.[18]

26. While Vietnam has addressed the symptoms of its macroeconomic problems, it has yet to tackle their root causes. In both 2009 and 2011, the government took bold measures to curb inflationary expectations and to stabilize the economy. But those measures have relied almost exclusively on tight monetary policy and widespread price and interest rate controls. Some

17 The third issue, reforming the financial sector, will be dealt with separately through the Joint World Bank-IMF Financial Sector Assessment Program, to be undertaken in 2012.

18 See various issues of *Taking Stock*, December 2010 and June 2011.

Figure 1.4 Vietnam Has Seen Sharp Increase in the Level of Capital Flight in Recent Years



Sources: WDI 2010; http://www.databasece.com/en/gdp-during-transition; WB estimates.

of the root causes of the problems—such as inefficiencies in the SOE sector, less effective public infrastructure programs, and the need for greater transparency and disclosure of information—have gone unaddressed. Consequently, investors' confidence in the ability of government's economic management has weakened, triggering considerable capital outflow—it is estimated that the cumulative errors and omissions (a proxy for capital flight) in the balance of payments in the last three years is equivalent to nearly 30 percent of GDP (figure 1.4) (IMF, 2011).

III. C FRAGMENTED DEVELOPMENT AND INSTITUTIONAL INERTIA

27. Vietnam has historically been a highly decentralized economy. It has a long tradition of relative autonomy of village and communities in managing their local economies. This practice was also consistent with the immediate requirement of war-time economy. And decentralization has had many virtues. It was the high degree of practical autonomy that led Vietnam to avoid the gigantism of Soviet-style industrialization. In recent years, decentralization has been responsible for more inclusive development and healthy inter-provincial competition.

28. While decentralized, Vietnam's development process has not been fragmented and localized, as it is now. Common purpose and strong leadership had meant the local and national governments each contributed in their own ways to common national goals. But overtime its new economy has developed under a degree of independence from the central system (Probert and Young 1995, 520), where the center's ability to direct activity toward national development goals and the means to establish the necessary institutional and regulatory framework for sustained growth has weakened. In combination, the reforms and the associated reduction in centralized control have promoted development within and closely connected to the SOEs, the local administrations, and subsectors of the centralized system. The resulting networks and localized "corporatism" have become major factors in economic change (Grabher and Stark 1998). Thus, lower echelons of the state have emerged as a form of new business elite (Forsyth 1997, 245, 257). While the majority of the new economic elite may neither wish for nor be in a position to demand political change, they have had a significant impact on decision making and policy (Dixon 2003). The localization of development and control in Vietnam contrasts sharply with the highly centralized systems that characterized such economies as Korea and Taiwan.[19]

19 Dapice (2008).

29. The scope and pace of reforms have been influenced by differing views within the party and the state and the proliferation of interests. The latter includes such broad sections as the military, police, trades unions, women, regional and local administrations, SOEs, and the various ministries and departments. There have also been significant shifts in the importance of these groupings, notably the increased representation and influence of local administrations and technocrats (Fforde and Goldstone 1995, 105). The major divisions are also variously reinforced and divided by the proliferation of the new economic interests. The result is that there are fewer fixed positions, with, for many individuals and groupings, the attitude to reform reflecting particular measures rather than the process as a whole (Dixon 2003; Koh 2001, 537–38). The proliferation of interest groups and the nature of the Vietnamese legal and regulatory systems—which operate on the basis of what is permitted rather than what is not—has resulted in the production of an enormous volume of decrees, regulations, and legislation. The operation of the system has been further hindered by lack of professionals and technocrats at higher levels, the ones who provide the cores of the bureaucracies in such Asian developmental states as Korea; Singapore; and Taiwan, China.

30. The fragmentation of development has also been associated with the weakening of the quality of the country's economic institutions. The legacy of central planning still weighs heavily on Vietnam's economic institutions. Although markets are now the main mechanism of resource allocation, they often function poorly because the underlying institutions are missing, poorly formed, or incomplete. Its public and private sector economic institutions are highly fragmented. Fragmentation is a problem because it increases the costs of coordination, which can result in a loss of efficiency. A fragmented regulatory system generates conflicting rules. Fragmentation of public investment results in duplication and waste.

31. The government's effectiveness has also deteriorated in recent years relative to its regional peers. The effectiveness of Vietnam's government—measured in terms of perception of the quality of public services, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies—is relatively low compared to some of the better-performing countries in Asia. And its effectiveness has taken a slight dip in recent years, while government effectiveness has risen in other countries (The Worldwide Governance Indicators, 2011).

IV ORGANIZATION OF THE VDR

32. One way to understand Vietnam's deeper structural problems is to begin with a simple analysis of ownership, allocation, and execution of capital. Is Vietnam's capital owned by those who are most efficient at using it? Are the owners of capital allocating it to the sectors where the social and economic returns are the highest? Once capital is deployed to a sector or a firm, is it being executed efficiently? These questions are examined in the next three chapters of *Vietnam Development Report 2012* (VDR 2012). Three of its key findings are:

- *Ownership.* Vietnam's state-owned enterprises (SOEs) are one of the least efficient users of capital, but they are its largest owner (Chapter 2).
- *Allocation.* The public investment program is becoming increasingly unaffordable and inefficient since allocation is based on administrative considerations rather than strategic needs and market-based mechanisms—creating excess supply in some areas and causing severe shortages in others (Chapter 3).
- *Efficiency.* Because of both the widespread use of administrative measures to control prices, and limited access to basic information, Vietnam's economy is being deprived of the "oxygen" that keeps a market economy functioning efficiently (Chapter 4).

33. It then explores the factors underpinning the inefficient ownership, allocation and efficiency of capital. Among the several explanations, it focuses on ones that are common to all, namely weak institutions, distorted incentives and inadequate information—**labeled as the three "I's" of a market economy.** Some of the key institutions that are found to be missing in Vietnam's economy include an agency to clearly specify property rights and a market in which to trade those rights, an autonomous agency to deal with the state management of SOEs, and impartial regulators for infrastructure sectors such as ports and industrial parks. Creating the right incentives includes valuing land at market prices for all transactions involving government and corporations, bringing an end to privileged access of SOEs to factor inputs, aligning local government interests with national priorities, providing public finance incentives for regional coordination, and making cash transfers to poor households directly rather than through subsidized prices. Measures also need to be taken to lower the cost and improve the availability of information, including a new disclosure policy for SOEs; improving budget transparency, especially with regard to large public infrastructure projects; and creating awareness among users of information to demand credible information from the government.

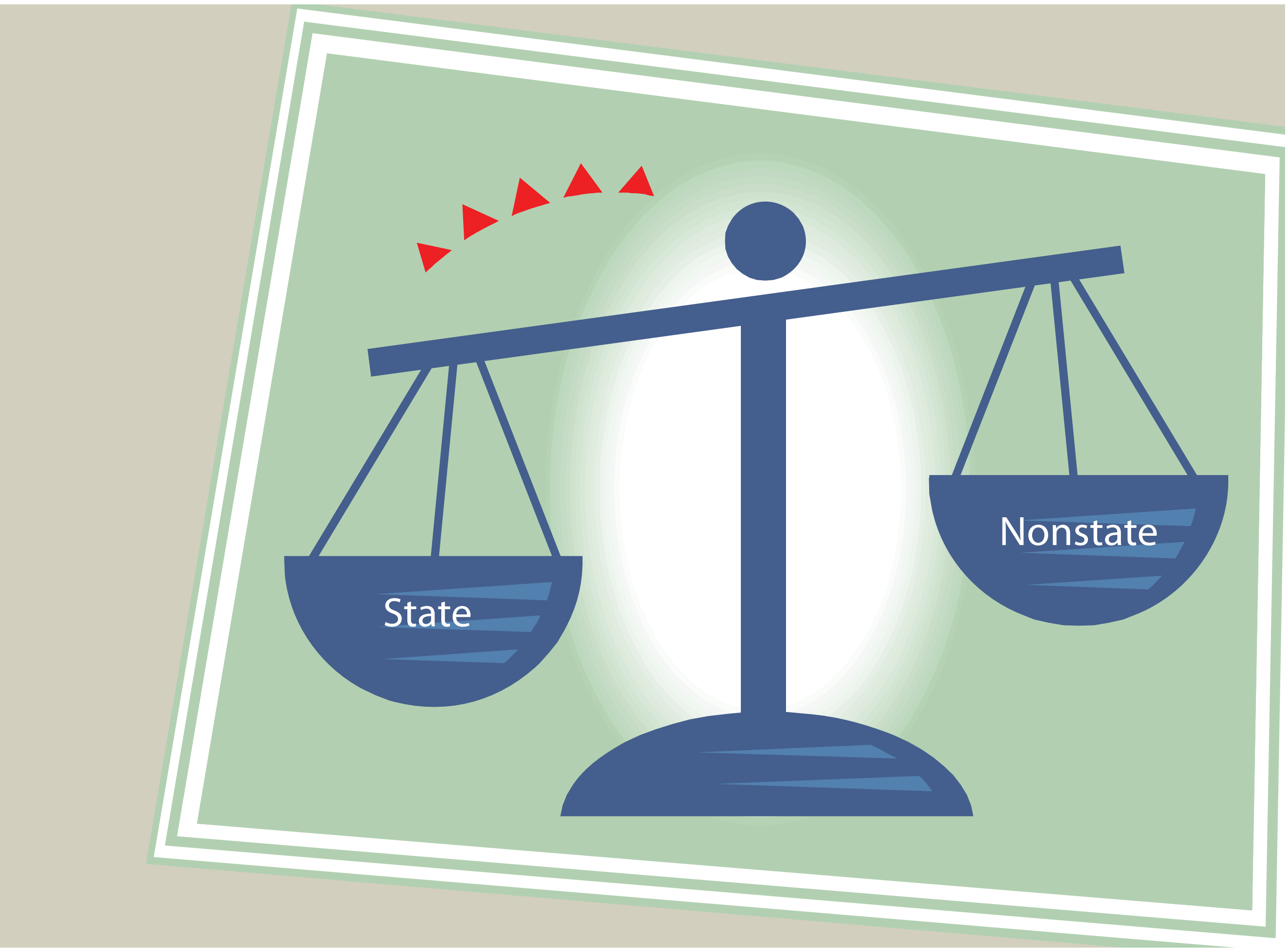
V EMBRACING MARKETS

34. Vietnam turned the crisis of the late-1980s into one of the greatest development successes of our time. The country has shown itself to be remarkably adaptable and has made impressive progress during the initial transition years under extremely difficult conditions. It was the decision to embrace market-based reforms and to change the incentive structures to conform to market principles that played a critical role in its success.

35. Vietnam can use the power of the market and the facilitating role of the state to chart a new course to create a more efficient economy and a more productive society. While Vietnam has embraced many policies of a market economy, it has so far neglected the difficult task of creating and strengthening market-supporting institutions. But the old forms of control are weakening and new activities are emerging that the system is not accustomed to or effective at regulating are rapidly emerging. These changes have to be matched by development of new institutions, new incentive structures and a more transparent and open society to support the strong and healthy market economy that has already evolved. With a new Congress, a new National Assembly and a new Administration in place, this is the ideal time for Vietnam to embark on its journey to developing a mature market economy that befits its status of a dynamic, emerging middle-income country in Asia. Such a journey is necessary, desirable and perhaps already underway.

Chapter 2

A LEVEL PLAYING FIELD: REFORMING THE STATE-OWNED SECTOR[20]



20 Ivailo V. Izvorski, Sunita Kikeri, and Chul Ju Kim provided written inputs for this chapter. The chapter also draws on two background studies prepared by CIEM and a third study prepared by Nexus Consulting. For details, see the list of references at the end of the report.

CONTEXT AND KEY FINDINGS

1. Few issues have evoked more passionate debate in Vietnam in recent years than the issue of state ownership. Twenty-five years into the transition to become a market economy, one would think the country would have reached closure on this issue. And for a while it seemed it had. During the 1990s and the early 2000s, Vietnam equitized thousands of small and medium-size state-owned enterprises (SOEs), and consolidated others into larger entities, called the General Corporations. But keen to emulate the experience of Japan's *Keiretsus* and the Republic of Korea's *Chaebols,* in 2005, Vietnam accelerated the process of creating State Economic Groups (SEGs)—a loose alliance of several SOEs with similar business interests[21]—before the country's accession to the World Trade Organization. The SEGs initially did well, but their weaknesses were revealed when one of their members, the state-owned shipbuilder Vinashin, failed to pay its international lenders and the state inspectorate found widespread financial irregularities and mismanagement in the company. It also brought to light Vinashin's hundreds of subsidiaries and affiliated companies that operated across a wide range of sectors—often far removed from the parent company's core business—with size and influence much bigger than ever imagined. This spurred a nationwide debate about the role of the state and the future of SOEs in Vietnam's economy.

2. This chapter tries to understand why, 25 years after Đổi Mới, state ownership remains a dominant feature of Vietnam's economy. Vietnam aspires to become a market economy with a socialist orientation. A reading of the various resolutions of the Party Congress and the Party Central Committee suggests that its leaders did not necessarily see a contradiction between the existence of a large state economic sector and a market-oriented economy. But in recent years, as the country apprears to have veered toward a model of state capitalism in which the SEGs have enjoyed privileged access to factor inputs and a high level of operational autonomy, more questions have been raised about their usefulness. The situation was exacerbated when a few SOEs, taking advantage of weak oversight and transparency in the system, expanded their operation into areas beyond their core competency, mismanaged their finances, and concealed information from the government—thereby tarnishing the reputation of the entire sector. As a result, the National Assembly in one of its resolutions indicated that restructuring the SOEs will be a top priority of the government in the next Socio-Economic Development Plan, spanning 2011 to 2015.

3. What will emerge from the current debate is unclear; possibilities range from cosmetic restructuring to radical equitization (including privatization). With sharp deterioration in the health of some SOEs, the status quo is no longer viable. Several options are being discussed by the government, although such discussions in the past have not always produced concrete actions. The key government agencies have been asked to devise a restructuring plan for the enterprise and banking sectors. This is an important initiative, but, since state ownership is not just an economic issue but also a political choice, major restructuring of SOEs is unlikely without strong political support. Any restructuring plan should be firmly based on a clear consensus on the role of the state in the economy and the desirable institutional arrangement to achieve that goal. It would have to involve a number of measures including what we call a "**DREAM**" framework—**D**isclose, **R**egulate, **E**quitize, **A**ccount(able), and **M**onitor—a description of which follows.

21 An SEG is held together through a pyramid ownership structure in which the parent company is at the top of the pyramid with a controlling stake in a number of subsidiaries (the second layer of the pyramid). The parent company and the subsidiaries together control the affiliated enterprises that form the bottom layer of the pyramid. In certain cases, the affiliated enterprises associate themselves with the SEG to take advantage of the latter's brand value, technology, market reach, and various intangible assets.

- **Disclose.** *A new information disclosure policy* that requires SOEs, starting with the SEGs, to report their financial stakes in all their subsidiaries and affiliated members and to timely and accurately disclose their annual reports, audit reports, and earning statements through print and electronic media or the internet.

- **Regulate.** *A modern corporate governance* system that separates state ownership rights from regulatory functions and implements an objective and transparent mechanism for the selection of Chief Executive Officers (CEOs) and board members. There is also a need to put an end to SOEs' privilege access to factor inputs and to value land at market price for all government and corporate transactions.

- **Equitize.** There is no more certain way to improve the internal functioning of SOEs than to subject them to the discipline of the market and oversight of the government. This would require *accelerating the equitization* of SOEs, including selling up to 49 percent of charter capital of the SEG parent company.

- **Accountable.** Holding the SOEs *accountable for their actions*, including a reward for greater transparency and timely reporting of data and information and a penalty for noncompliance.

- **Monitor.** Overhauling the *monitoring system* with a provision for mandatory, independent annual audits and timely submission of financial data to the relevant ministries and agencies.

4. **The rest of the chapter is organized as follows.** Section II begins with a discussion on the economic importance of SOEs and state-owned commercial banks (SOCBs) to the national economy and their relative performance vis-à-vis their domestic private and foreign counterparts. Section III presents the results of the survey "Changing Attitudes towards Market and State (CAMS 2011)." Section IV discusses the government's ambivalent approach toward SOE reform. Section V makes the case for launching a new policy to restructure SOEs. Section VI discusses policy options and suggests a way forward. (Box 2.1 provides a glossary of the terms used in this report.)

Box 2.1 The "Transition" Vocabulary

Following is a glossary of the terms used in this report, the definitions of which have evolved as Vietnam has gone through its economic transition process.

Equitization. A process of selling part of the equity of an SOE or SOCB to the public or a strategic investor. In recent years, equitization has mostly taken place through an Initial Public Offering (IPO) followed by listing of the company in the stock exchange.

Divestment. A process by which the government sells a part of or all of its equity to the public or to the private sector after the initial equitization. In Vietnam, most SOEs are first equitized and then gradually divested by the State Capital Investment Corporation (SCIC).

Joint Stock Company (JSC). A company with a diversified ownership structure and listed on the stock exchange. In theory, a JSC can be 100 percent privately owned or less than 99 percent government owned, though in practice state ownership in a JSC rarely exceeds 80 percent.

Joint Stock Bank (JSB). The banking sector counterpart of a JSC.

State Sector. The part of the economy that is owned by the state (the government). For the purpose of this report, the *state sector* comprises the following: (a) SOEs with 100 percent state ownership, (b) JSCs with more than 50 percent state ownership, (c) SOCBs with 100 percent state ownership, and (d) JSBs with at least 80 percent state ownership. In this report, we also use *state economic sector, state-owned sector,* and *state-owned entities* as synonymous with *state sector.*

Nonstate Sector. The part of the domestic economy in which the state is not the dominant owner. For the purpose of this report, the *nonstate sector* comprises domestic enterprises with 100 percent private ownership and JSCs with less than 50 percent state ownership.

II THE STATE SECTOR: SIZE, IMPORTANCE, AND EFFICIENCY

5. Vietnam's state sector has become smaller but is still relatively large and inefficient. The importance of the state sector in the economy has steadily declined as the domestic private and foreign sectors have rapidly grown over the last two decades.[23] However, the state sector still has a sizable presence in the economy. It is also highly inefficient in its use of factor inputs such as land and capital relative to its counterparts in the nonstate sector.

II.A LARGE BUT DECLINING IMPORTANCE

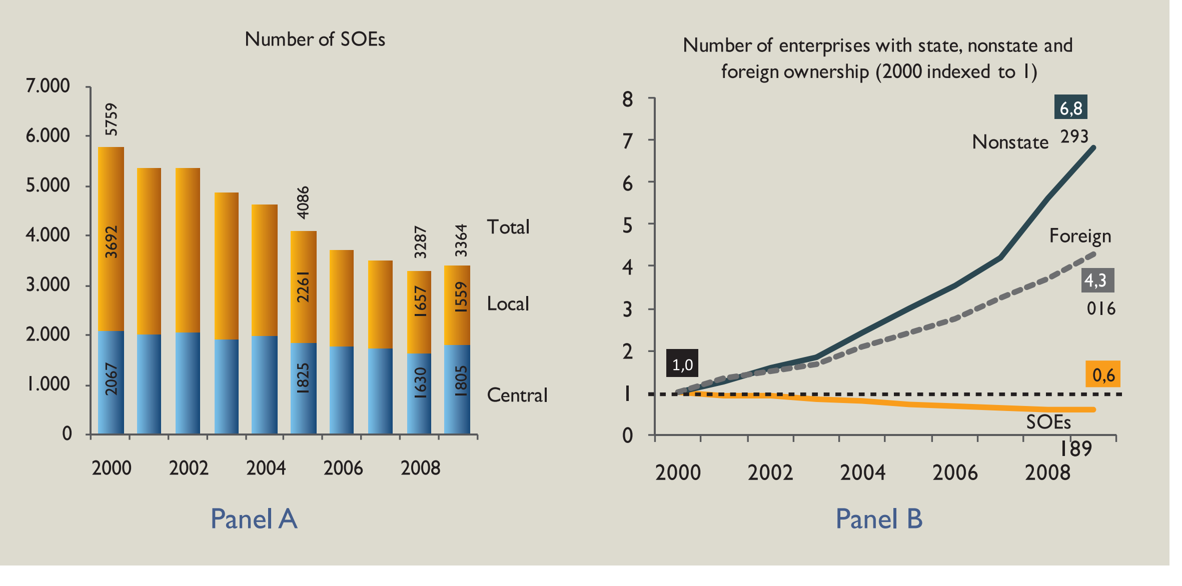
6. While the number of SOEs has steadily declined, their absolute number remains very high.[24] Between 1989 and 1992, thousands of small, loss-making and inefficient SOEs were closed or merged reducing their numbers from 12,084 to some 6000 (Griffen, 1998; World Bank, 1999, Dixon, 2003). The number of SOEs did not change much between 1992 and 1999—a period that was used to consolidate the sector by ending the system of direct subsidies, revising the incentive structures for workers and managers and increasing the level of autonomy. So in 2000, Vietnam had 5,759 SOEs of which 3,692 were owned by the local governments and 2,067 were owned by the central government (see panel A, figure 2.1). Through equitization, divestment, mergers, acquisitions, and liquidation, the number of SOEs rapidly declined between 2002 and 2005 and more slowly between 2006 and 2008.[25] In fact, in 2009, the trend was reversed and 175 new SOEs were added at the central level—a pattern that is likely to have persisted during 2010 and 2011.

23 See Fforde (2004) for an interesting account of the nature of property rights in SOEs in Vietnam. Fforde argues that Vietnamese SOEs are best viewed as "virtual share companies," with many SOEs being de facto privatized. His study is anecdotal; so when it comes to examining the importance of SOEs in the economy, there is no substitute for official statistics, even if the statistics may not fully capture the reality.

24 The government defines an SOE as an enterprise with 100 percent state ownership; the General Statistics Office, however, uses a broader (internationally accepted) definition to include any enterprise in which the government has a controlling stake, that is, 51 percent or more of the charter capital. At the end of 2010, according to the government, there were 1,200 SOEs in Vietnam. The General Statistics Office puts the number at 3,364. All the analysis involving the SOEs in this chapter is based on the broader definition.

25 Vietnam's experience is similar to that of China, where the number of SOEs also declined after the late 1990s, but many were reorganized as subsidiaries of large SOEs rather than "equitized" or "divested."

Figure 2.1 Number of SOEs Relative to Nonstate and Foreign Enterprises



Sources: GSO Enterprise Survey 2009; World Bank estimates.

7. The importance of SOEs in Vietnam's economy has steadily decreased due to the rapid expansion of privately owned enterprises. There has been a dramatic growth in the number new enterprises in the nonstate and foreign sectors in the country during the last decade. Between 2000 and 2009, there was a sevenfold increase in the number of nonstate enterprises and over a fourfold increase in foreign enterprises, while the number of SOEs declined by 40 percent during the same period (see panel B, figure 2.1). As can be seen in table 2.1, except for a few subsectors such as construction and insurance, the number of enterprises under state ownership is fairly small relative to the number of firms operating in the nonstate and foreign sectors. As shown later, however, it is not the number but the size that matters when it comes to competing in the marketplace.

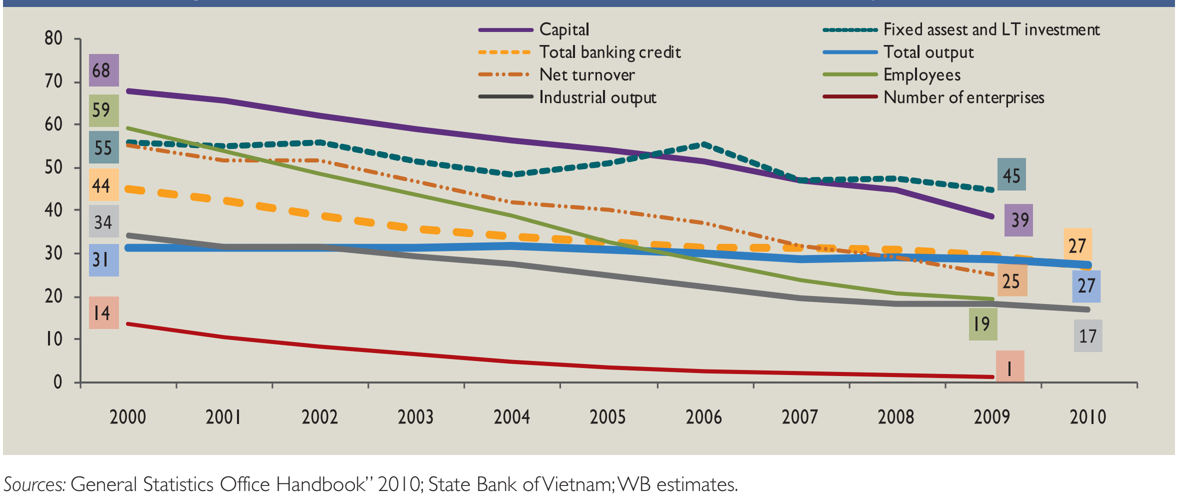
Table 2.1 Number of Enterprises at the Subsector Level (2009)

	Unit (Enterprise)			Share of Total (%)		
	SOEs	Nonstate	Foreign	SOEs	Nonstate	Foreign
Wearing Apparel	32	2,697	547	1.0	82.3	16.7
Chemicals	31	1,216	268	0.9	80.3	17.7
Rubber and Plastics	22	2,080	447	1.5	81.6	17.5
Electricity	80	1,919	5	3.1	95.8	0.2
Construction	388	24,022	129	19.4	97.9	0.5
Water transport	35	869	3	3.9	95.8	0.3
Telecommunication	30	776	10	3.7	95.1	1.2
Insurance	16	43	20	20.3	54.4	25.3
	634	**33,622**	**1,429**	**6.7**	**85.4**	**9.9**

Sources: GSO Enterprise Survey 2009; World Bank estimates.

8. The decline in the importance of SOEs can also be seen through their steadily diminishing share in factor inputs. In 2000, SOEs accounted for nearly 68 percent of capital, 55 percent of fixed assets (such as land), 45 percent of bank credit, and 59 percent of the jobs in the enterprise sector (figure 2.2). Since then, these numbers have steadily fallen, albeit at different speeds. The steepest decline has been in the employment share of SOEs—from 59 percent to 19 percent—as labor-intensive SOEs have been equitized and the domestic private and foreign enterprises have expanded their labor force rapidly. As shown in figure 2.2, by 2009, the share of SOEs in capital, fixed assets, bank credit, and the employment in the enterprise sector had fallen to 39, 45, 27, and 19 percent, respectively.

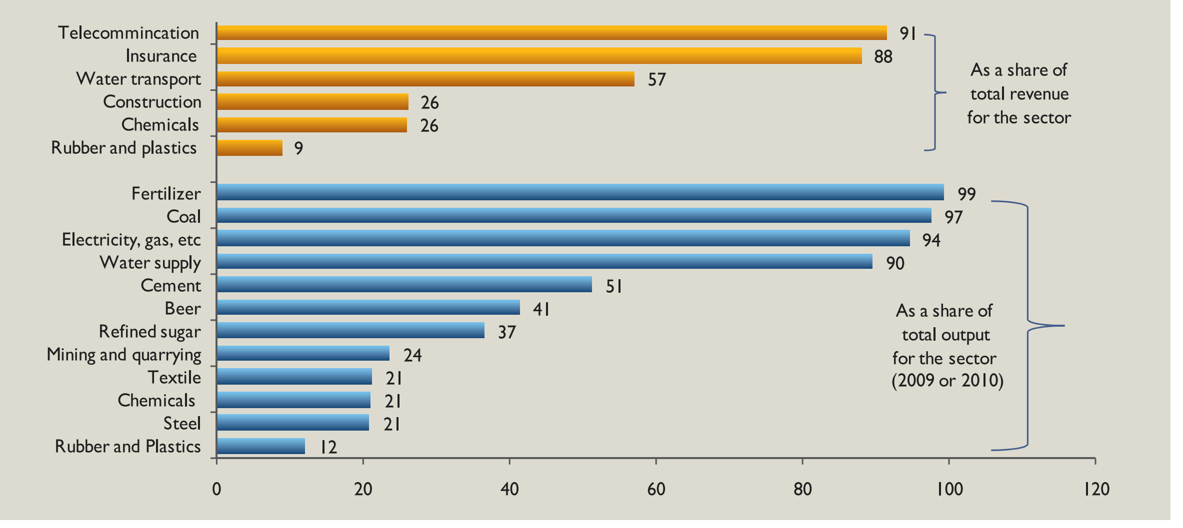
Figure 2.2 Share of SOEs in Selected Indicators for the Enterprise Sector



Sources: General Statistics Office Handbook" 2010; State Bank of Vietnam; WB estimates.
Note: LT = long term.

9. Notwithstanding shrinking state ownership, the state not only controls all the critical sectors, but also has considerable presence in various commercial activities. As shown in figure 2.3, the state sector enjoys near-monopoly status in the production of several goods and services including fertilizer (99 percent), coal (97 percent), electricity and gas (94 percent), telecommunications (91 percent), water supply (90 percent), and insurance (88 percent). Though some of these sectors can be considered as critical and this has been used as the basis to justify a large state presence, Vietnam is unusual in not allowing its own domestic private sector to invest in them. More surprisingly, the state has also maintained its presence in several consumer goods such as cement (51 percent), beer (41 percent), refined sugar (37 percent), textiles (21 percent), and chemicals (21 percent). Why does the state continue to invest in sectors where there are no market failures and the private sector has the resources and expertise to perform as well as the state sector? We look for the answers in section IV.

Figure 2.3 Share of SOEs in Output/Revenue for the Enterprise Sector (2009 or 2010)



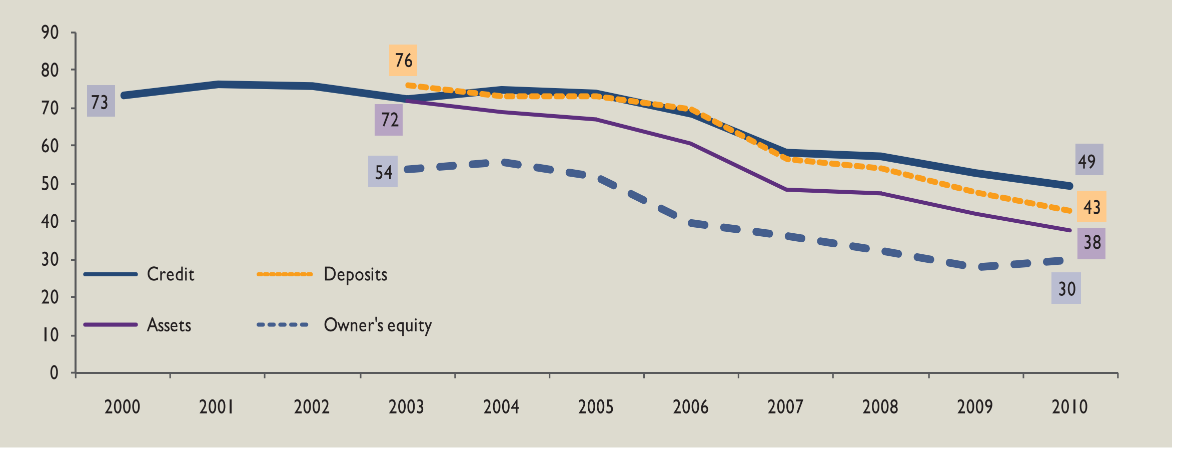
Sources: GSO Enterprise Survey 2009; World Bank estimates.

II.B IS STATE OWNERSHIP LARGER THAN WE THINK? A CASE STUDY OF THE BANKING SECTOR

10. The diminished role of the state in the enterprise sector is paralleled in the banking sector. The number of SOCBs has progressively declined and the number of JSBs has steadily increased. Currently, there are only two banks with 100 percent state ownership (Agribank and Bank for Investment and Development of Vietnam) and three banks with state ownership between 80 and 100 percent (Mekong Housing Bank, Vietcombank, and Vietinbank). The rest are JSBs.[26] The share of SOCBs in credit allocation and deposit mobilization was between 70 and 80 percent at the beginning of the last decade (figure 2.4). With increased equitization and growth of domestic private banks and foreign banks, these numbers decreased to 45 to 50 percent by 2010. At the level of individual banks, the SOCBs are actually doing quite well and their business is growing at a healthy pace. Collectively, however, their share is falling because their numbers are declining as more of them get converted into JSBs.

26 For the purpose of this study, we count the recently equitized banks, Mekong Housing Bank, Vietcombank, and Vietinbank, along with Agribank and BIDV, as the five SOCBs. The rest are counted as part of JSBs.

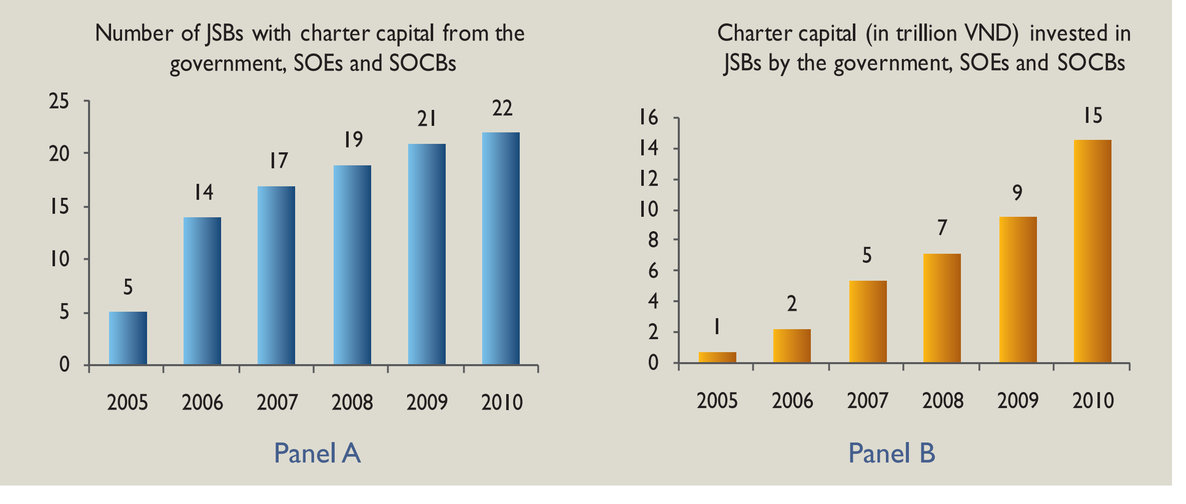
Figure 2.4 Share of SOCBs in Selected Indicators for the Banking Sector



Sources: "General Statistics Office Handbook" 2010; State Bank of Vietnam; World Bank estimates.

11. The number of JSBs with state ownership has steadily increased during the last five years. As shown in panel A of figure 2.5, in 2005, of the 14 banks for which ownership data are available, five had charter capital from the state. The number of JSBs with state capital progressively increased to 22 by 2010, implying that nearly 60 percent of JSBs had some charter capital from the state. As shown in panel B of figure 2.5, the amount of state capital in the JSBs has steadily increased from nearly VND 1 trillion in 2005 to VND 15 trillion by 2010. So both in terms of number of banks and the absolute amount of charter capital, the state sector's presence in the banking sector has increased.

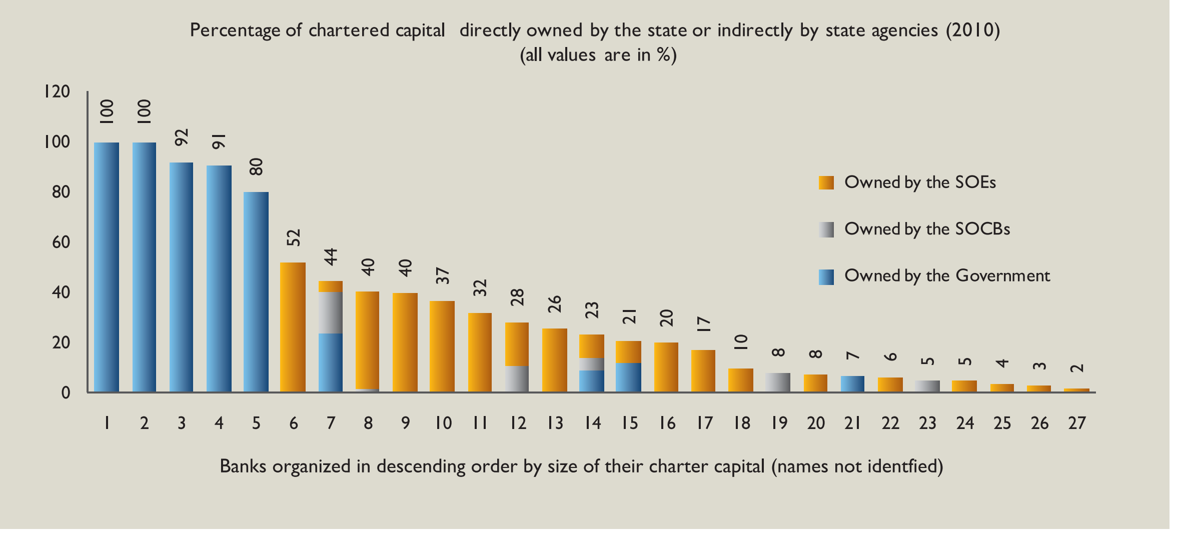
Figure 2.5 Number of JSBs with State Charter Capital and Amounts Involved (2005–10)



Sources: State Bank of Vietnam; Nexus Consulting; World Bank estimates.

12. The state continues to exercise considerable ownership over a large number of commercial banks. The size of state ownership in individual banks is reported in figure 2.6. It shows that the government has direct ownership in only nine banks—five SOCBs and four JSBs. Similarly, SOCBs have some ownership in six JSBs. The large majority of state ownership in the banking sector, however, comes through the SOEs, which hold charter capital in as many as 19 JSBs. This is partly the result of government policy to encourage SOEs and SOCBs to subscribe to the charter capital of the JSBs to make the equitization process successful. The state, however, has a controlling stake in only one JSB (that is, Bao Viet Bank). Thus, while the state presence is large in terms of number of banks, it is relatively small in terms of the share of the charter capital in individual banks.

Figure 2.6 Size of State Ownership in Joint Stock Banks (2010)

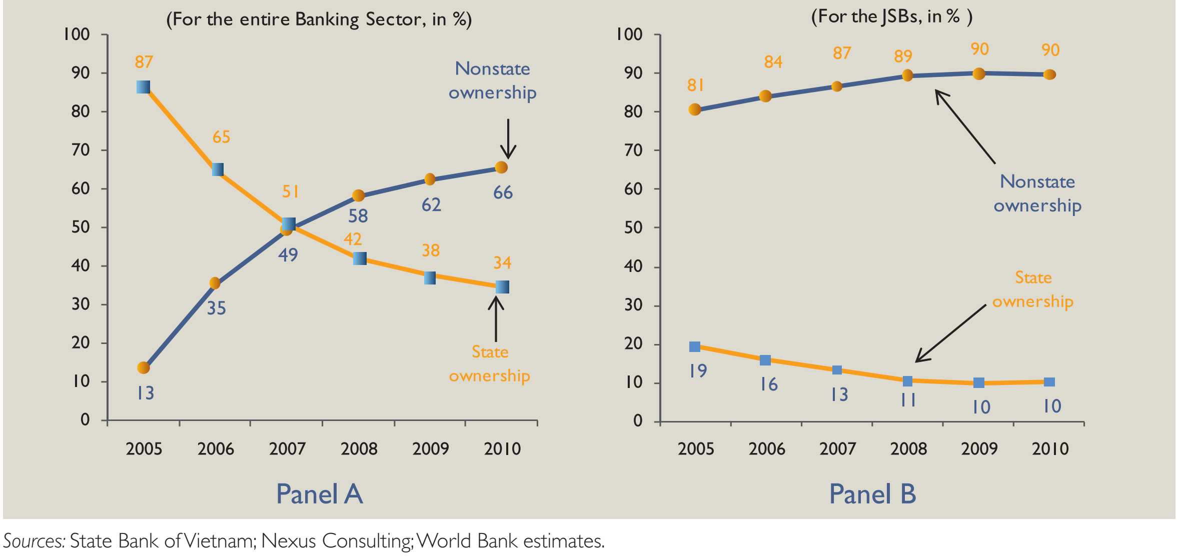


Sources: State Bank of Vietnam; Nexus Consulting; World Bank estimates.

13. But the share of state capital is relatively small and declining. State ownership in the banking sector—measured by share of state capital to total charter capital—has been progressively falling. As shown in panel A of figure 2.7, the share of state capital in the total banking system was 87 percent in 2005. It has rapidly declined since then and was 34 percent at the end of 2010. For the JSBs, the state share was much smaller to start with—only 19 percent in 2005. This number further declined to 10 percent by 2010, as shown in panel B of figure 2.7.

14. The dilution of state ownership, however, is not the result of an intentional policy; rather, it is largely due to the poor financial health of the SOEs. Following State Bank of Vietnam's regulation, many small JSBs have been forced to increase their equity capital in recent years. Some of the SOEs that hold equity in these JSBs have been unable to subscribe to additional equity because of their weak financial position, resulting in a gradual reduction in the state's share of total charter capital. Moreover, with the ongoing stock market slump, those who had invested in the equity of JSBs have earned negative returns, further discouraging SOEs from buying new equity in the JSBs. However, when the financial situation of SOEs improves, state ownership in the banking sector will start to increase again, underscoring the need to have a clear policy on state ownership that is independent of the whims of stock market performance or SOE balance sheets.

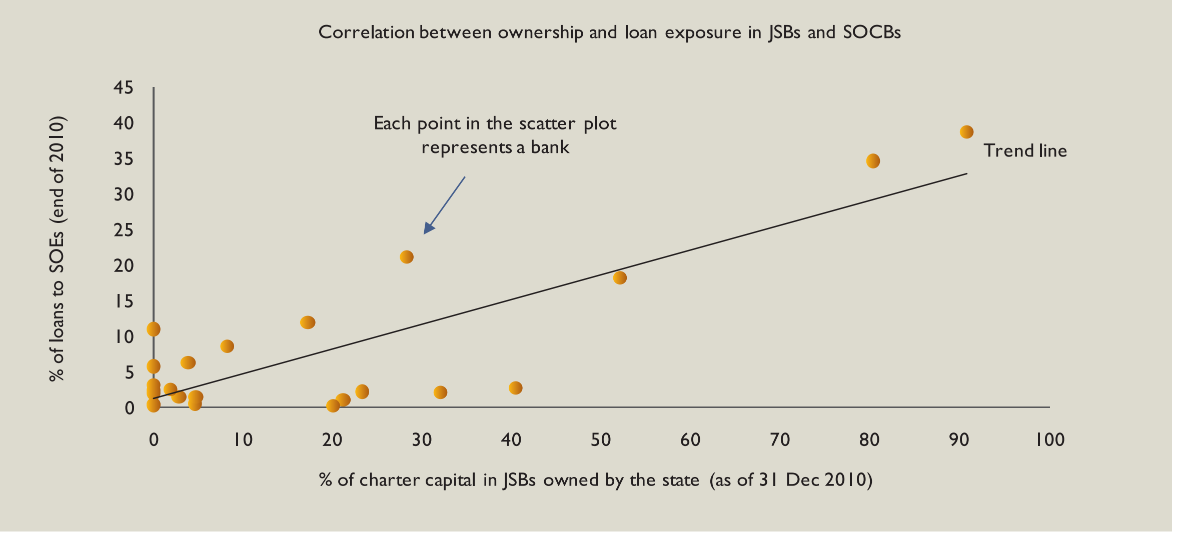
Figure 2.7 Share of Charter Capital Held by the State Compared to Nonstate Sectors (2010)



Sources: State Bank of Vietnam; Nexus Consulting; World Bank estimates.

15. If the overall share of state capital in JSBs is small and declining, why has the number of JSBs with state capital been increasing? In other words, why do SOEs prefer to spread their ownership capital so thin across so many JSBs? Because ownership seems to carry benefits, even when the SOEs do not have a controlling stake. As shown in figure 2.8, there is a positive correlation between the ownership structure of the banks and their loan exposure to the SOE sector, implying that SOEs do not always require a controlling stake (that is, charter capital exceeding 51 percent or more) in the JSB to influence lending activities in favor of their sector.[27] It is, however, important to reiterate that this is an average relationship and there are many exceptions. In fact, there are a large number of JSBs with 30 to 40 percent state ownership but with less than 2 percent exposure to the SOE sector.

Figure 2.8 Banks with Greater State Ownership also have Greater Exposure to SOEs (2010)



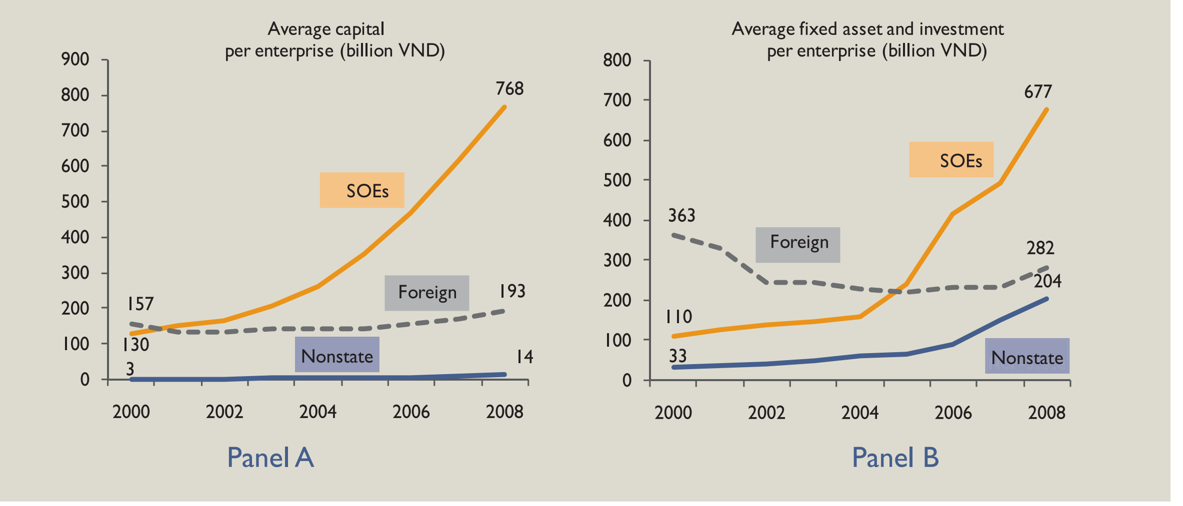
Sources: State Bank of Vietnam; Nexus Consulting; World Bank estimates.

II.C INTENSIVE BUT INEFFICIENT USER OF RESOURCES

16. SOEs use certain factors of production—especially capital and land—more intensively than their peers in the private sector. One of the most intriguing features of the last few years has been the dramatic acceleration in the capital and fixed asset base of SOEs. As shown in figure 2.9, the average capital per SOE increased from VND 130 billion to VND 768 billion in 2008—a number that must have increased to even higher level in 2009 and 2010 because of rapid credit growth during those years. During the same period, fixed assets (such as real estate and machinery) and investment in an average SOE increased six fold—from VND 110 billion to VND 677 billion. The corresponding numbers for foreign enterprises remained stable during this period. In the nonstate sector, average capital and fixed assets grew rapidly, albeit from a very low base. Since SOEs tend to operate in more capital-intensive sectors (such as petrochemicals, energy, and telecommunications), it is not surprising that their average capital and fixed asset usages are higher than their nonstate and foreign counterparts. As shown in panel A of figure 2.10, the capital-to-employee ratio of SOEs in 2000 was 0.4, which was not significantly different from the industry average of 0.3. However, by 2008, the capital intensity between the SOEs and the rest of the industry had widened considerably. What is surprising is that this rapid growth of factor accumulation has not been accompanied by a proportionate increase in output or higher labor productivity.

27 What are the channels through which SOEs owning JSBs could influence the latter's lending decision is a critical question, but goes well beyond the scope of our report.

Figure 2.9 Comparing Economic Performance of SOEs with the Rest of the Enterprise Sector



Sources: GSO Enterprise Survey 2009; World Bank estimates.

17. **SOEs use several times more capital to produce one unit of output than the industry average.** In 2000, the average ratio of turnover to capital (a proxy for the productivity of capital) in SOEs was 1.6 compared to 8.8 for the enterprise sector as a whole (panel A, figure 2.10). This implies that an average SOE required nearly nine units of capital to produce one unit of output (turnover) compared to the industry average. This is not entirely unexpected since SOEs specialize in more capital-intensive products. What is quite alarming, however, is that by 2009 the average ratio of turnover to capital for the SOEs fell to 1.1 while it increased to 21.0 for the industry. So while the enterprise sector as a whole was getting better at using capital more economically, the SOEs were using it more extravagantly.

18. **The growth of labor productivity in SOEs has not kept pace with the rest of the industry.** Since SOEs have higher capital intensity than the rest of the industry, and since this intensity has rapidly increased in recent years, one would expect SOEs to experience higher and rising labor productivity relative to the rest of the enterprise sector. The evidence, however, shows the opposite. As shown in panel C of figure 2.10, between 2000 and 2008, the turnover-to-employee ratio in SOEs increased from 0.6 to 1.7. During the same period, the turnover-to-employee ratio for the overall enterprise sector increased from 2.7 to 16.3, indicating that labor productivity between SOEs and the rest of the enterprise sector widened from 1:4 in 2000 to 1:10 in 2008!

Figure 2.10 Economic Performance of SOEs Compared with the Rest of the Enterprise Sector

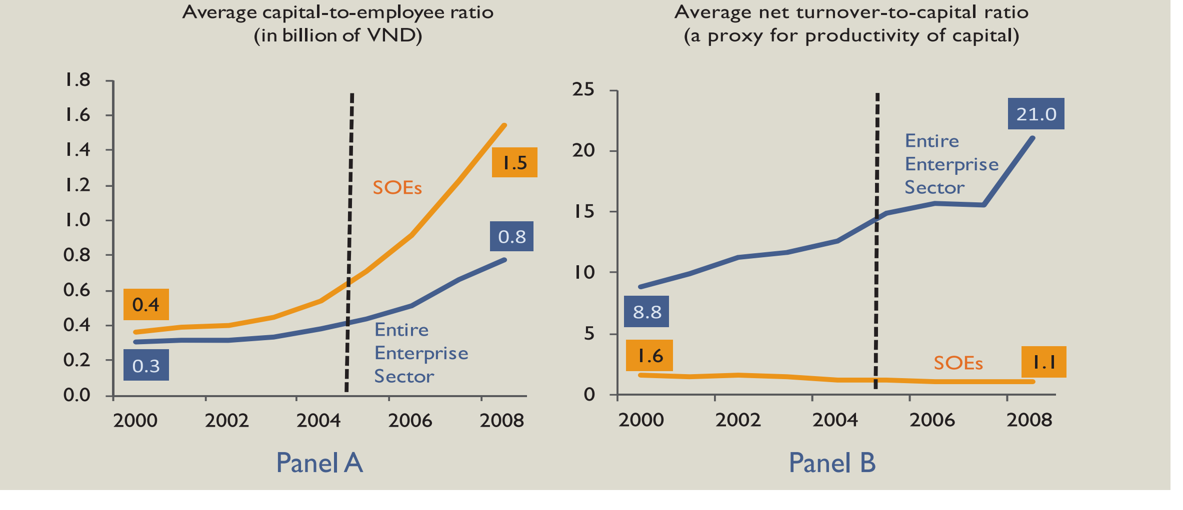
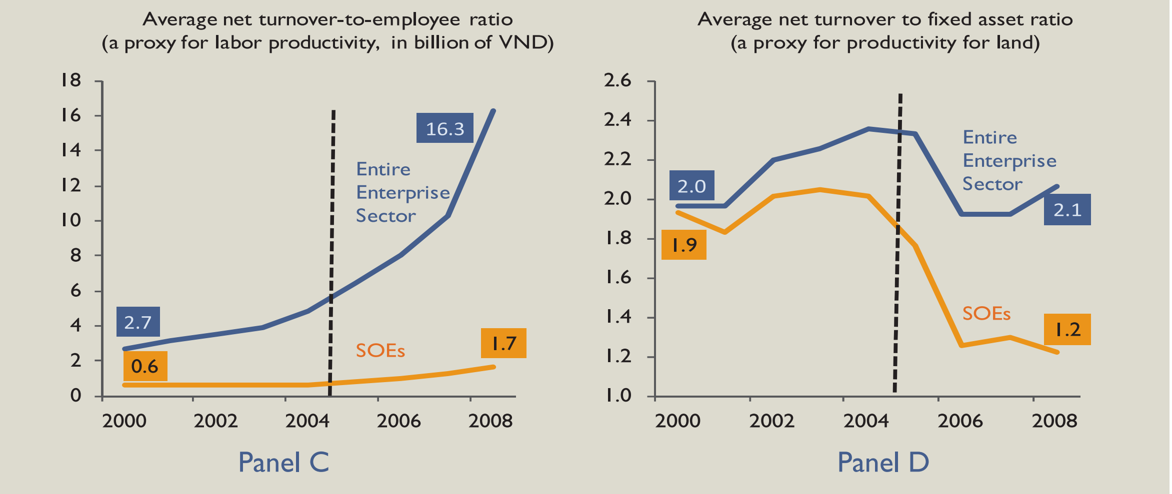


Figure 2.10 (contd.) Economic Performance of SOEs Compared with the Rest of the Enterprise Sector

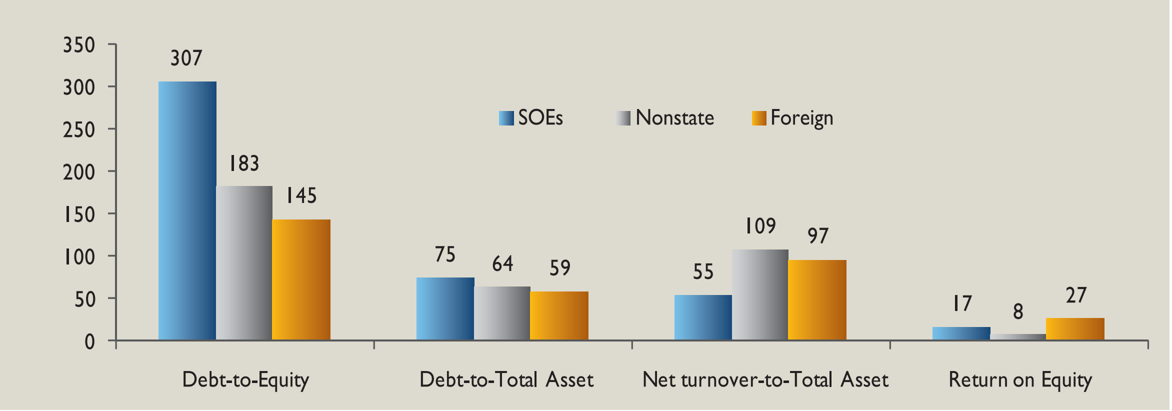


Sources: GSO Enterprise Survey (2009); World Bank estimates.

19. SOEs are also less efficient in their use of fixed assets such as land and machinery. As panel D of figure 2.10 shows, the turnover-to-fixed asset ratio—a proxy for the productivity of land and machinery—fell for SOEs between 2000 and 2008, while it remained unchanged for the enterprise sector during the same period. Thus, the SOEs have not only used factors inefficiently, but their level of inefficiency has greatly accelerated in recent years.

20. Along with being operationally less efficient, SOEs are also found to be financially less prudent. As shown in figure 2.11, between 2007 and 2009, the debt-to-equity ratio of SOEs averaged 307 percent relative to 183 percent for nonstate firms and 145 percent for foreign firms. The SOEs also had the highest debt-to-asset ratio among the three groups. Though the SOEs registered relatively healthy returns on their equity (17 percent), they were below the nominal growth rate of the economy (19 percent) and well below the return on equity of foreign firms (27 percent) achieved during 2007–09. Subsequently, the profitability of SOEs—which were more leveraged relative to the rest of the enterprise sector—has deteriorated significantly due to high interest rates.[28]

Figure 2.11 Financial Performance of SOEs Compared to the Rest of the Sector (2007–09; in %)



Sources: GSO Enterprise Survey (2009); WB estimates.

28 There are increasing signs of deterioration in the financial health of the SOEs. Vinashin has gone from defaulting on its external loans to restructuring its local currency debt. EVN has incurred losses for three consecutive years and has accumulated considerable arrears against a number of other SOEs. Recently, several SOEs in the cement sector failed to make payment on their bank loans, forcing the government to bail them out. A recent study by the Communist Party found that total SOE losses have been climbing rapidly in recent years and called for urgent attention.

III

PUBLIC ATTITUDE TOWARD STATE OWNERSHIP IN THE ENTERPRISE SECTOR

21. **The large state ownership in the Vietnamese economy seems to be at odds with the overwhelming majority of people who prefer greater private ownership in the enterprise sector.** In the World Bank-Vietnam Chamber of Commerce and Industry (VCCI) survey on "Changing Attitudes toward Market and State" (CAMS 2011), to which 967 people from a broad cross-section of society responded, an overwhelming majority—7 out of 10 respondents—preferred private ownership as the dominant ownership structure for the enterprise sector (see figure 2.12). Of the 967 respondents, 666—fully 69 percent—said "private ownership of enterprises is preferable to any other form of ownership," 120 (13 percent) said "state ownership of enterprises is preferable to any other form of ownership," and 181 (19 percent) said that the ownership structure did not matter to them.[29]

Figure 2.12 Overwhelmingly, Respondents Prefer Private over State Ownership of Enterprises

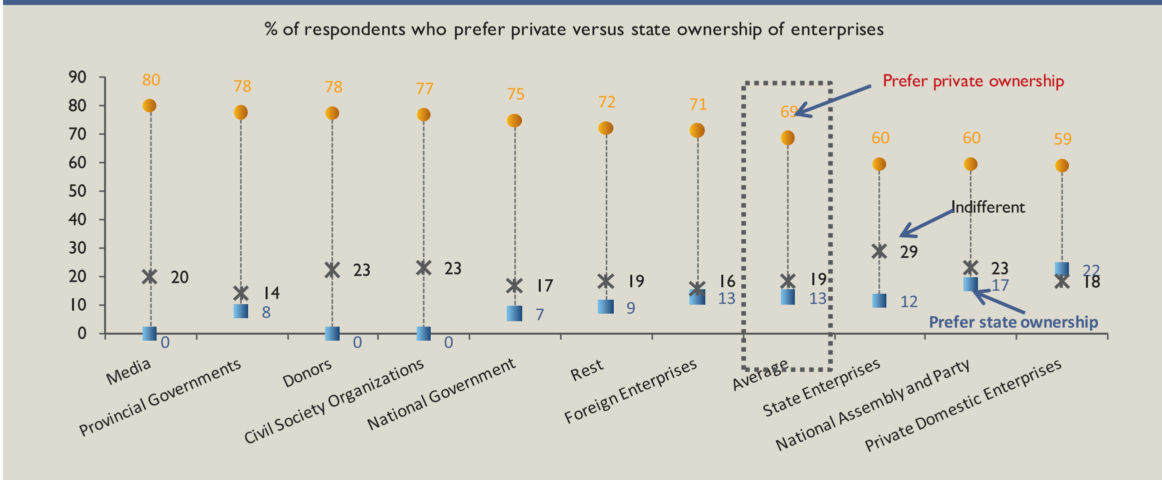
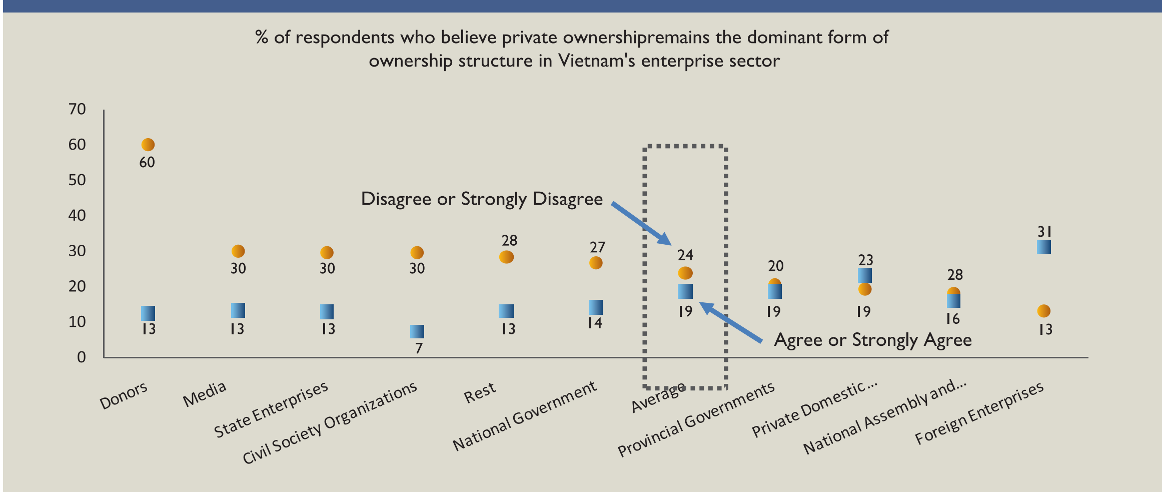


Figure 2.13 Many Respondents Believe that the State Remains the Dominant Owner of Enterprises



Sources: CAMS 2011.

29 It is ironic that the largest percentage of respondents who prefer state over private ownership of business work for private domestic firms. For an explanation and detailed results of the survey, see CAMS (2011).

22. Despite two decades of equitization, there is a strong perception among the people that state ownership remains the dominant ownership structure in the enterprise sector. In section II we have discussed the declining importance of SOEs in the enterprise sector. However, in our survey, nearly 24 percent disagreed or strongly disagreed that private ownership remains the dominant form of ownership structure in the enterprise sector, while 19 percent agreed or strongly agreed with the statement (figure 2.13). There is, however, considerable diversity in the views among the respondents on this issue; fewer respondents working in the National Assembly, the Communist Party of Vietnam (CPV), and the provincial governments agree that state ownership is the dominant ownership structure compared with the respondents from donors, civil society organizations, and the national government. It seems that those working for the state feel that the state has already relinquished considerable ownership power over time, while those working in nonstate sectors feel that is not enough and more ownership needs to be transferred to the private sector.

IV GOVERNMENT'S APPROACH TO SOE REFORM

23. SOE reform in Vietnam can best be characterized as one of simultaneous renovation and preservation. The renovation approach has been applied to the small and medium-size SOEs that were dissolved or merged with another "if they were inefficient or lacked capital or technology or did not have sufficient demand for their outputs" (Vu 2002, 7). As a result, the number of SOEs with 100 percent government ownership fell from 12,000 in 1991 to 1,200 in 2010 (and to 3,400 in which the government had 51 percent or more ownership). At the same time, however, preservation (and expansion) has been the preferred approach toward the large SOEs that form the core of the state economic sector—the leading force of the economy. In fact, a close reading of the various resolutions of the Party Congress and the Party Central Committee makes it clear that since the early 1990s, the Party has been unequivocal in its stance on the establishment of large economic groups.

24. Some may see a contradiction between the existence of a large state economic sector and a market economy, but in Vietnam the two goals were seen to be compatible.[30] Since the early 1990s, along with developing a multisectoral ownership structure and moving toward a market economy, the resolutions of the Party Congress have always emphasized the leading role of the state economic sector (see table 2.2). In 1991, the VII Party Congress asked to rearrange the enterprise unions and General Corporations (GCs) along a market-oriented economy and to build some big enterprise unions in order to attain sufficient prestige and competitiveness in foreign markets.[31] In 1996, the VIII Party Congress gave clear direction to concentrate state economic development resources on essential industries, such as social and economic infrastructure; the financial, banking, and insurance system; important business production and service units; and enterprises in the national defense and security sectors. In 2001, the resolutions of the XI Party Congress and the third plenum of the Party Central Committee issued instructions for the establishment SEGs, by selecting some of the general corporations that are strong enough to play a more catalytic role.

30 This view is perhaps best captured by a senior policymaker who once remarked that "we equitize SOEs to make the state sector stronger."

31 Enterprise union is a way of grouping SOEs with similar production profiles into a big one which had legal status (unlike SEGs) and completely controlled the union members.

Table 2.2 Timeline of Selected Critical Pronouncements and Decisions Involving SOEs	
1991: VII Party Congress	• *"... to rearrange enterprise groups in consistent manner with production and business requirements of the new market mechanism ... to build some big companies and enterprises with sufficient prestige and competitiveness to participate in international economic relations."*
1994: Decisions 91 and 94 of the Prime Minister	• *18 general corporations, so-called general corporations 91, were established* • *Aimed at reducing "the power of line agencies to interfere in business management and capture profits and rents of SOEs."*
1996: VIII Party Congress	• *"To make a summary on state general corporations model, thereby, to build measures for developing general corporations as strong economic groups with good performance, high competitiveness, and acting as the backbone of the national economy ..."*
2001: 3rd plenum of the Party Central Com. (IX Party Congress).	• *"... forming some strong economic groups consisting of state general corporations and others economic sectors, involving a multi-business model, in which a core business is defined for specialization, and the group plays dominating role in the national economy, holding large-scale capital, … establishing, on a pilot basis, some economic groups in some industries, which will have significant advantages, and are of development capacity for international competitiveness and integration…."*
2005-10: Establishment of pilot State Economic Groups	• *2005: Vietnam Post and Telecommunications, Vietnam National Coal-Mineral Industries, and Vietnam National Textile and Garment* • *2006: PetroVietnam, Vietnam Electricity, Vietnam Shipbuilding Industry, Vietnam Rubber* • *2007: Baoviet;* • *2009: Vietnam National Chemical p, Industrial Construction;* • *2010: Vietnam Housing and Urban Development.*

Sources: CIEM (2011a)

25. The government's decision to create SEGs seems to have been hastened by its desire to achieve competitiveness in an increasingly globalized world. When Vietnam was preparing to join the World Trade Organization, officials realized that most domestic companies, including the GCs, were too weak to withstand competition from foreign investors. The government, therefore, moved decisively to establish SEGs and provide them with privileged access and autonomy to enable them to compete with foreign firms on an even footing. This move was further strengthened by the idea that with a calibrated industrial policy in which the SEGs will play a catalytic role, Vietnam can transform itself into a modern and prosperous country. Like Korea; Singapore; and Taiwan, China, in order for Vietnam to catch up and be competitive, it was believed that Vietnam needs to develop strategic industries—cement, oil, power, steel, telecommunications, and so forth—and this can be done only by large business groups with enough resources, capital, and technical capacity under close state control, given the absence of a strong private sector.

26. The presence of SEGs has also been justified as a tool for macroeconomic adjustment and to perform social functions. During periods of high inflation, the government has controlled the price of commodities and services provided by SEGs—such as by EVN (electricity), Petro Vietnam (petroleum products), and VINACOMIN (coal)—and instructed the SEGs to reduce their investment in order to curb excessive demand.[32] The charter of all parent companies of the SEGs lists a number of welfare and social responsibilities that have been assigned to them by the state. For example, the Vietnam Post and Telecommunication Group is responsible for providing telephone and internet services to isolated and remote areas, thereby facilitating local and national socioeconomic development (VNPT 2010). Similarly, Decree 101/2009/ND-CP has set several developmental goals for SEGs, including introducing new and advanced technologies in the country and facilitating the development of other industries and sectors.

V TEN REASONS IN FAVOR OF RESTRUCTURING[33]

27. As shown, instead of being the driving force for the economy, SOEs have struggled to keep pace with domestic private and foreign enterprises. In recent months, the number of SOEs experiencing financial difficulties has increased.[34] There is a growing consensus that some restructuring is now necessary. Opinion is divided, however, about the nature and extent of restructuring.[35] There are some who believe that only minor restructuring (such as trimming capital expenditure) is enough to restore the health of SOEs and they can then go back to playing their leading role in the economy. There are others who think that a more radical restructuring, including equitization of SEGs, is in the country's long-term interest. If the problems that led to the fall of Vinashin reflect some of the generic issues affecting the state sector, then SOEs do face serious challenges that can be addressed only through a comprehensive reform program (see box 2.2). We present below 10 reasons why restructuring of SOEs is an imperative.

32 See Resolution No. 11/NQ-CP dated 24/02/2011 and Resolution No. 08/2008/NQ-CP dated 31/3/2008.

33 The term "restructuring" has a very specific connotation, which does not necessarily include equitization, divesture, and privatization. In Vietnam, however, during the ongoing debate, this term has been increasingly used more broadly to imply "state enterprise reforms." We too, therefore, use the word "restructuring" loosely to include all forms of SOE reform.

34 See footnote 8.

35 One of the reviewers of this report—a national scholar—said in his written comments that "currently, there is a consensus that restructuring of SOEs including SEGs and corporations is a must."

Box 2.2 The Rise and Fall of the Vinashin Shipbuilding Industry Group

Until recently, the Vietnam Shipbuilding Industry Group (Vinashin) was one of the largest SEGs in Vietnam, with over 160 subsidiaries, including 39 shipyards offering shipbuilding, ship repair, shipping, heavy industries, and other services. It accounted for approximately 70 to 80 percent of shipbuilding capacity in the country and had nearly 70,000 employees. According to a report by the Office of Government, the mother company of Vinashin had grown 35 to 40 percent annually during 1997–2007 and consistently posted high profits. Reports indicate that Vinashin's gross revenue was nearly US$1.5 billion in 2008.

From 2006 to 2010, Vinashin signed 85 contracts worth US$2.84 billion, but completed only 15 of them. It ran into financial difficulties in 2008 because several of its clients cancelled their orders following the global financial and economic crisis. Terminated contracts accounted for about half of the group's accumulated debt and interest, and fines further compounded the problem. It was only in mid-2010 that the extent of the problem became evident when more than 5,000 Vinashin workers lost their jobs and the company failed to pay US$12 million in salaries and social insurance. The total Vinashin debt was reported to be US$4.4 billion in July 2010–more than 300 percent of its annual sales and as much as 10 times its equity base.

According to a report by the Government Inspection Committee, which was submitted to the National Assembly in July 2010, Vinashin's problems can be traced to the following factors: (a) violating regulations on project formulation, approval, and bidding, and incurring huge debt; (b) falsifying financial reports; (c) establishing as many as 200 subsidiaries and expanding outside its core business operations (such as securities, real estate, and tourism); and (d) the Chairman committing serious violations and infringing regulations on the mobilization, management, and use of state capital. Key elements that led to the fall of Vinshin include weak corporate governance (including ineffective internal controls, limited transparency and disclosure, no independent external audits), lack of effective oversight and monitoring, and limited accountability and the excessive power of senior management to operate and expand the business without clear accountability.

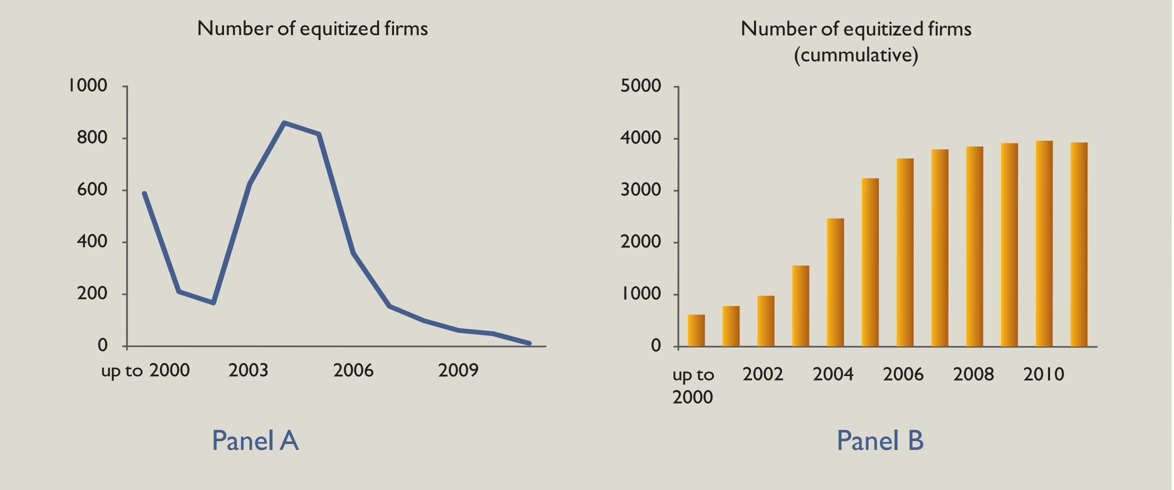
The day after the Government Inspection Committee report was submitted to the National Assembly, the Chairman of Vinashin was suspended and detained on mismanagement charges. Several other senior Vinashin officials were also subsequently arrested. A Steering Committee, chaired by the Deputy Prime Minister, was set up to restructure Vinashin. The Steering Committee has asked Vinashin to sell or transfer its stake in noncore businesses to other SOEs such as Petro Vietnam. The government said that it does not intend to make any debt repayments to the creditors on behalf of Vinashin, although it will help creditors recover and regain financially viability. Later, KPMG, Vinashin's auditor, was appointed as the restructuring adviser. Although more than 18 months have passed since Vinashin's problem first became public, Vinashin's restructuring plan remains tentative and its future uncertain.

Sources: Newspaper reports; meeting with Vinashin officials.

(i) **SOEs are less efficient than nonstate and foreign firms.** Evidence presented in section II.B shows that SOEs are inefficient users of inputs such as land, bank credit, labor, and other fixed assets relative to nonstate and foreign enterprises. This has a significant economic cost. For example, during the last decade, if capital usage by SOEs had grown at the same pace as that of foreign enterprises, all else being equal, the country's total outstanding bank credit at the end of 2010 would have been 102 percent of gross domestic product instead of 125 percent—which would have meant less rapid growth of credit in recent years. Similarly, more economical usage of land by SOEs could have significantly increased the availability of land and kept real estate prices more affordable for the rest of the economy. Vietnam, still being a poor country from a global perspective, needs to use its precious resources such as land and credit more efficiently.

(ii) **Equitization has been good for SOEs.** Studies have shown that SOE performance has changed positively after equitization. The pace of equitization was slow until 1997, with only 17 SOEs equitized, mostly through selling stakes at deeply discounted prices to workers and management in small SOEs. However, the equitization process gained speed after 2000, with a series of legislative and administrative measures including a five-year SOE reform plan adopted in 2001. As a result, the number of firms equitized increased significantly—to 856 in 2003 and 813 in 2004 (panel A, figure 2.14). Two studies show that indicators, such as turnover, profit, value added, and laborers' income increased rapidly after equitization (CIEM 2002, 2005). The 2002 study also inferred that "if the entire SOE sector was reformed and grew as the equitized enterprises did, Vietnam's growth rate could be 0.6–0.7 percentage points per year higher. And if this higher growth rate could be maintained for 11 years, the per capita income of the Vietnamese people would be doubled." Similarly, the disinvestment process after some initial problems has shown encouraging results (see box 2.3)

Figure 2.14 Equitization Has Slowed in Recent Years



Sources: Department of Enterprise Reform and Development, Office of the Government of Vietnam.

(iii) **Rethinking industrial policy.** While industrial policy can potentially be a powerful tool for developing an economy, carrying out an industrial policy does not necessarily mean using SEGs as a tool. Indeed, it will involve a different set of policies from simply aggregating companies under a single umbrella. The Japanese *Keiretsus* and the Korean *Chaebols* that Vietnam has tried to emulate were privately owned, were largely the result of business activities rather than administrative measures, were international market-oriented and, most important, functioned in different times. Furthermore, industrial policy loses relevance when SEGs are asked to accumulate an increasing number of unrelated affiliated enterprises and financial institutions.

Box 2.3 State Capital Investment Corporation (SCIC)

Officially established in August 2006 as a 100 percent state-owned, for-profit company, the SCIC is tasked with taking over the state capital in already equitized companies from line ministries and local governments, functioning as a government investor in charge of the state capital, and fully divesting nonstrategic SOEs. The SCIC also invests in projects outside its portfolio, purchases corporate equity and bonds, and manages a fund from the proceeds of divested enterprises under the instructions of the Prime Minister.

After five years in operation, the SCIC have taken over the state stake in 933 equitized enterprises with a book value of VND 7,400 billion, representing 30 percent of SOEs but only 1.2 percent of the value of state capital in the economy. Of these, 466 have been divested, and the SCIC current portfolio consists of 461 companies, most of which are expected to be sold in the next few years. The SCIC intends to keep only a small number of companies categorized as "strategic investments."

The effectiveness of the SCIC has been limited by the lack of explicit criteria for handing over state shares in large enterprises (for example, GCs), which is done on a case-by-case basis by the Prime Minister's Office, and an inadequate regulatory framework for financial management in the SCIC. To strengthen the SCIC, the Party Politburo apparently has decided that by 2015 the SCIC would take over the state shares of equitized GCs, and by 2020 of equitized SEGs. It is expected that by then, the management of equitized state capital will be done by only the SCIC.

Sources: Meeting with SCIC officials.

(iv) **Too big to fail, too big to save.** The ever increasing size of SEGs and the complex cross-holding of charter capital across and within enterprises makes it difficult for the state to assess inherent risks involved in their activities and the contingent liabilities arising from them.[36] The financial risks from the SOEs can easily spill over to the broader economy, given the strong links between them and some of the JSBs (see the discussion in section III.A). At the same time, the total liabilities of the SOEs exceed the government's own debt, thereby posing enormous fiscal risk for the government. Thus, on one hand, the SEGs have become too big to fail, while on the other hand, they are now too big to save. This poses both a considerable risk to the macroeconomic and financial stability of the country and a contingent burden on future taxpayers.

(v) **The changing role of the state in the economy.** The involvement of the state in the production of goods and services is generally justified on three grounds: (a) market failure, that is, the market fails to provide the goods or services because the private return is lower than the social return;[37] (b) the private sector is underdeveloped and lacks capital or skill to deliver certain goods or services;[38] and (c) during periods of unprecedented economic or financial crises, the government is sometimes forced to temporarily bail out insolvent or illiquid enterprises or banks in the national interest. In the case of Vietnam, as the discussion in section II shows, the SOEs are producing goods such as beer, milk, sugar, and textiles, and services such as

36 Currently, the total liabilities of SOEs far exceed the total debt of the Government of Vietnam.

37 Primary education, space research, and developing green technologies are some of the activities where the returns on private investment may be lower than social returns, justifying government involvement.

38 The private sector in Vietnam is rather new and has limited capacity and capital. Therefore, it may not be able to handle demanding infrastructure projects such as big hydropower dams or operating railways, providing the basis for government involvement in the early stages.

brokerage firms, hotels, and real estate companies, that are in direct competition with privately owned companies. There is little justification for the state to remain involved in these areas, especially given its inability to monitor SOE activities and improve their corporate governance.

(vi) **An uneven playing field.** The SOEs tend to get preferential access to banking credit, procurement contracts, and research and development compared to their peers in the private sector. For instance, the government on-lent nearly US$2 billion from an international bond issuance and overseas development assistance to SOEs during 2010. The research and analysis undertaken by more than 300 research institutes under the control of government ministries are exclusively used by the SOEs. Some even accuse the SEGs of influencing and interfering with important government policy decisions. Unlike the private sector, the SOEs face a soft budget constraint, meaning that the state bails them out when they are in financial stress. Under these circumstances, SOEs, despite their operational inefficiencies, can out-compete and crowd out the private sector (USAID 2010). Since no country has become a modern, industrialized country without the private sector playing a dominant role, Vietnam's long-term goal is best served by creating a level playing field for both state and privately owned enterprises.

(vii) **Slow to embrace modern corporate governance and transparency.** Vietnam's SOEs cannot become industry leaders if they do not adopt sound corporate governance practices. SEGs and SOEs are subject to the 2005 Law on Enterprises, but for many, the administrative re-registration of type of enterprise is yet to be accompanied by adherence to the provisions of the law, including those that mandate corporate governance (for example, a Control Board and a Board of Management), improved transparency (for example, disclosure of timely operational and financial information, including their ownership structure, financial statements, and audit reports), and protection of minority shareholders.

(viii) **Weak and incomplete corporate framework.** The initial legal framework for the establishment and operation of SEGs can be traced to Article 149 of the 2005 Law on Enterprises. Detailed instructions on implementing the law are described in Decree 139/2007/ND-CP, promulgated nearly two years after the first pilot SEG was established; and Decree 102/2010/ND-CP, promulgated nearly five years after the first pilot SEG was established. The legal framework provided by these three regulations, however, is inadequate. Decree 139 defines SEGs as being of "big scale" without defining "big." Similarly, Decree 102 says SEGs will have a "parent-subsidiary model," but by that definition, many more SOEs, and not just the 12 established so far, should have been characterized as SEGs. Starting July 1, 2010, all SEGs have been registered as one-member limited liability companies (except Bao Viet) and are supposed to operate under the 2005 Law on Enterprises. However, there is considerable confusion in interpreting various articles in the Law on Enterprises and their applicability to the SOEs.

(ix) **Lack of vision and clarity regarding their roles**. It is often said that SOEs have multiple objectives and missions as: (a) an instrument of industrial policy, (b) a tool for regulating and stabilizing the macro economy, (c) a tool for meeting the social objectives of the government, (d) a source of competition against foreign enterprises, and (e) the foundation of the economic mechanism of the socialist-oriented market economy. However, in reality, SEGs and GCs do not have a clear vision and do not identify how their mission is consistent with the development goals of the country. They are expected to perform social functions, yet they do not show their social responsibilities and values in their business strategy and operation. They are required to be a tool for stabilizing the macro economy, yet they are among the factors that have contributed to macroeconomic instability in recent years. They are required to concentrate on solving strategic problems of development, yet they tend to pursue short-term interests, seeking financial gains and rent, where available.

(x) **Leveraging SOE reform to develop the private sector.** If the government is committed to private sector growth, then the SOE portfolio can be used as a powerful tool to support this policy. SOE reform creates both market and investment opportunities for the private sector. When SOEs that compete with the private sector are divested, a more level competitive playing field is often the result. Where full privatization is not feasible or desirable, the contracting out of selected services by SOEs to the private sector can enable smaller local firms, either on their own or in a joint venture with offshore parties, to bid for the new services. Similarly, equitization and public-private partnerships can help accelerate commercialization and increase efficiency, provided there are robust governance arrangements, full transparency, and arms-length relationships with government shareholders.

28. There are, of course, a number of reasons against radical restructuring, one of them being the impact on employment. During the early 2000s, when Vietnam equitized a number of its SOEs, the economy was booming and the private sector could absorb the retrenched workers from the state sector easily. Given the current economic uncertainty and the weak safety net in Vietnam, there are reasons to pursue a restructuring policy that is pro-cyclical in nature (more restructuring when times are good and vice-versa) and one that does not result in mass layoffs.

VI REFORM OPTIONS

29. Successful restructuring of SOEs is predicated on finding appropriate technical solutions that can foster a political consensus. As discussed in Chapter 1, Vietnam has traditionally chosen a step-by-step, gradualist approach to reform rather than "big bang" solutions to address its economic problems. This approach is unlikely to change when it comes to reforming the SOEs, especially given the superior status granted to the state sector in the constitution. Therefore, reaching consensus on extreme positions such as equitizing all SOEs will be difficult. At the same time, trimming the capital spending of SOEs is not a solution, either. Below we present several ideas that try to balance the economic imperative of restructuring the SOEs with the social and political imperatives of maintaining a dominant role for the state sector.

30. The government has announced several initiatives in recent months. It has established a Steering Committee for restructuring SOEs, headed by the Finance Minister (November 21, 2011), improved the legal framework for equitization (Decree 59/2011/ND-CP, July 18, 2011), and is in the process of formulating a decree to separate the state regulation function from state ownership rights.[39] The recently approved Socio-Economic Development Plan and the annual plan have identified three main areas for SOE reform, including strengthening corporate governance, stepping up equitization, and developing the legal framework for SOEs.

39 Decree 59 overcomes several rigid provisions of its predecessor, Decree 109/2007, and introduces more flexibility in selection of strategic investors, in determining share prices, and in sequence of equitization and IPOs.

31. While such ad-hoc initiatives are welcome, agreement on the "broad principles" that will define the restructuring plan is needed. There are three major issues on which up-front agreement is necessary. First, should SEGs be included in the restructuring plan? In our view, they should be, given that SEGs have been the source of many of the problems described in section V, and the ongoing restructuring of Vinashin has not gone well. Second, should the state continue to run businesses in nonstrategic, commercial-oriented sectors? In our view, it should not, given that it is stifling the emergence of a strong private sector in the country (see box 2.4 on Korea's experience). Third, who should be given the responsibility for preparing the restructuring plan? There are two contenders for this job: line ministries and an autonomous agency. We believe that an autonomous agency with the right technical expertise and one with strong support from the government, Party, and National Assembly will be better placed to carry out such an exercise.

Box 2.4 Korean Experience of SOE Reform

Like in many other developing countries, SOEs were important in the Korean economy, especially in network industries and the banking sector. But even a country like Korea, whose approach to SOE reform could be characterized as "managerial efficiency first, privatization later," adopted a more aggressive approach to reform its SOE sector than Vietnam.

In the initial years, the government sought to improve the performance of public enterprises while retaining majority control. A major reform came in 1983 (when Korea was still a low income country) with passage of the Government-Owned Enterprise Act, which sharply reduced political appointments at SOEs, gave managers greater autonomy, and introduced incentives linked to a rigorous system of performance evaluation. With the line ministries involved in management to a limited extent, the Korean SOEs managed to achieve the highest level of operating efficiency in industries such as telecommunications, electricity, natural gas, constructing expressways, and steel.

With the increasing liberalization of the economy since the mid-1980s, Korea took the next step and began to draft a full-fledged privatization program. The financial crisis in 1997 further accelerated this process. Under the 1997 Act on the Managerial Structure Improvement and Privatization of SOEs, the government fully privatized large commercially run SOEs such as Korea Telecom, POSCO (an iron and steel company), Korea Tobacco & Ginseng, and many other SOEs. Studies show that in most of the privatized SOEs, managerial performance improved significantly after privatization.

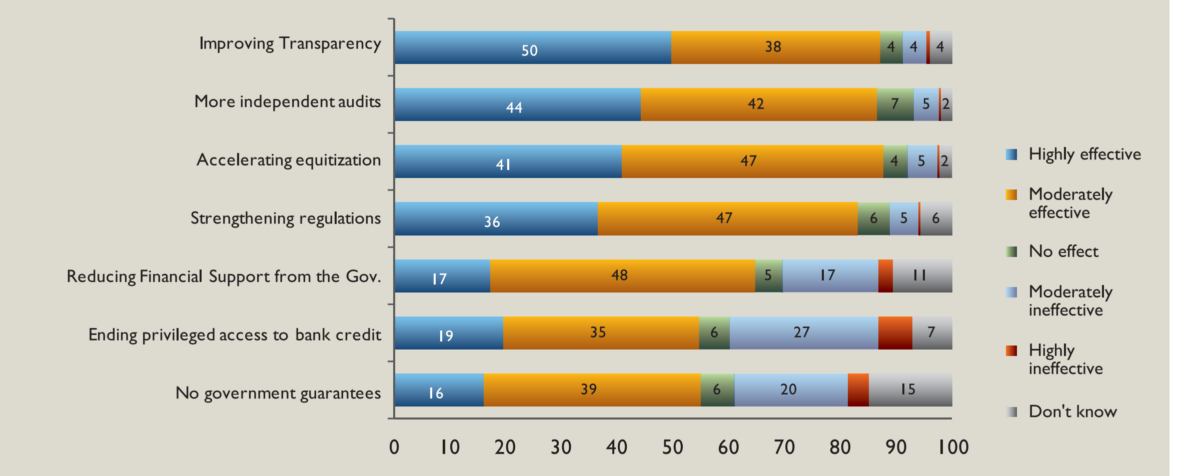
32. Constituting a commission with the mandate to prepare a roadmap for restructuring SOEs could be a useful starting point. Some have suggested appointing an autonomous body—to be named the National Economic Restructuring Commission (NERC)—composed of technical experts with the mandate to identify and classify SOEs into three groups (irrespective of the status of the SOE as a parent or subsidiary):[40] (a) those that need to be immediately equitized, with the government stake reduced to under 51 percent; (b) those that need to be restructured first and equitized later, with government ownership kept at 51 percent; and (c) those that will always remain under 100 percent state ownership but that still need to be restructured and their corporate governance strengthened. The commission could also be given the mandate to recommend a time-bound plan of equitization, divestment, privatization, mergers, acquisitions, liquidation, and restructuring of SOEs according to the above classifications.[41]

40 Such an idea was discussed at a conference organized by the National Financial Supervision Commission on October 17, 2011, where a National Assembly Delegate made this proposal and several national scholars and experts seconded the idea.

41 The National Steering Committee for Enterprise Reform and Development (NSCERD) comes closest to having a mandate similar to one being envisaged for NERC, but it does not enjoy the autonomy that NERC would need to be successful.

33. Restructuring SOEs is not only technically the correct thing to do, but also enjoys strong popular support. In our CAMS 2011 survey, we asked respondents to rate different measures that could improve the functioning and efficiency of SOEs on a scale that goes from being highly effective to being highly ineffective. The response of the 967 respondents is summarized in figure 2.15. It shows that 88 percent of respondents felt that improving the transparency of SOEs can be a highly or moderately effective tool, while 86 percent believed that a more independent audit of SOEs would be helpful. There seems to be equally strong support for accelerating the equitization program and for strengthening regulation of SOEs. Even measures such as reducing financial support from the government and ending privileged access to bank credit and guarantees to SOEs seem to enjoy the support of more than half the respondents. While economic policies should not always be based on popular sentiment, in this particular case, good economics and good politics seem to go hand in hand.

Figure 2.15 Strong Support from Respondents to Various Measures to Restructure the SOEs



Sources: CAMS 2011.

34. The SOE reform efforts, therefore, need to be more comprehensive. To date, the government has focused largely on equitization. Equitization is an important step in a successful transformation of SOEs and needs to be complemented, by a host of other steps, including strategic and business planning, corporate and financial restructuring, forming value-adding business partnerships or alliances, and implementing more transparent governance. Enhancing the market education of management and staff, modernizing management information systems and human resource development systems, and listing on the stock exchange are additional steps and challenges that need to be addressed for effective and comprehensive transformation.

35. We propose a framework, referred to as the "DREAM" framework—an acronym for Disclose, Regulate, Equitize, Accountable, and Monitor—that provides a broad range of ideas to address various weaknesses in the current regime governing SOEs. SOEs cannot become the leading sector of the economy by administrative fiat; they must earn it. And to earn such status they need to operate on a level playing field, which would involve the elements of the DREAM framework, discussed below.

VI.A MORE DISCLOSURE

36. Many of Vinashin's problems could have been nipped in the bud had more information about the company been publicly available (see box 2.2). The creditors would have been less generous in lending money to Vinashin, and the government could have taken preemptive measures to limit Vinashin's dizzy growth into noncore activities. The same story applies to many other SOEs in similarly difficult situations. Therefore, it is necessary to adopt a new information policy that makes it mandatory for SOEs (including SEGs) to provide the same level information that listed companies in Vietnam are required to disclose to the public. Below is a list of some of the information that should be published by economic groups in a timely manner:

- Audited half-yearly consolidated financial statements and annual financial statements, and annual reports of the parent company and of the overall group (if the SOE is an SEG)
- Decisions of ownership agencies; resolutions, decisions of Boards of Management, and minutes of these decision meetings,
- Investment portfolio and progress of current investment projects,
- Large-scale transactions, large loans or debts, and other contingent transactions,
- Long-term targets, detailed annual targets, and earning guidance
- Information about the members of Boards of Management and other core personnel of groups (personal information, professional qualification, experience, previous posts, management area, salary payment method, and other benefits; kin and their positions, curriculum vitae, their annual evaluation as business managers, and other relevant information),
- Market information, forecasts on product markets, and related market risks, and
- Information on related stakeholders, and transactions with involved stakeholders.

37. Some would argue that asking SOEs to disclose more information is easier said than done, since many of them do not have the necessary systems and practices in place to generate credible data that the market demands. Therefore, it is important to determine the requirements of SEG transparency; establish and issue detailed guidelines on SEG transparency; determine the organization and persons that have responsibility for SEG transparency, and establish and issue sanctions. These sanctions should not only be applied to SEGs and managerial positions, but also to the agencies, organizations, and persons in charge of managing and supervising SEGs, corporate governance in SEGs, SEG transparency, and SEG monopoly.

VI.B IMPROVED REGULATION AND CORPORATE GOVERNANCE

38. A more comprehensive approach to SOE reform is needed that accelerates the commercialization process through the development and implementation of sound legal and regulatory frameworks. This framework needs to provide SOEs with an operating environment and performance incentives similar to those of private sector firms, protect them from inappropriate political interference, and ensure that they are fully accountable for their financial results. Key elements of the process include (a) strengthening corporate governance—SOEs should be managed by skilled and experienced directors who make decisions that are clearly in the best commercial interests of the SOE, its owners, and key stakeholders; (b) implementing robust frameworks for "public service obligations"—these should be delivered only on a full cost-recovery basis, which requires that noncommercial services are identified, costed, contracted, monitored, and transparently financed. Where feasible the contract may be tendered to the private sector; and (c) imposing hard budget constraints—commercialized SOEs should operate under the same hard budget constraints as private sector firms. Strengthened governance practices and hard budget constraints will increase the transparency and independence of SOEs, allowing governments to better assess their contributions and hold them accountable for performance. Some of the key guiding principles of a corporate governance framework for SOEs are presented in box 2.5.

Box 2.5 OECD Guidelines on Corporate Governance of SOEs

Ensuring an Effective Legal and Regulatory Framework for State-Owned Enterprises: The legal and regulatory framework for SOEs should ensure a level playing field in markets where SOEs and private sector companies compete in order to avoid market distortions. This implies clear separation between the state's ownership function, simplified operational practices for SOEs, uniform application of general laws and regulations to all enterprises including SOEs, and no privileged access to SOEs for factor of production, including finance.

The State Acting as an Owner: The state should act as an informed and active owner and establish a clear and consistent ownership policy, ensuring that the governance of SOEs is carried out in a transparent and accountable manner, with the necessary degree of professionalism and effectiveness (for example, no involvement of government in the day-to-day management of SOEs; the state should let SOE boards exercise their responsibilities and respect their independence).

Equitable Treatment of Shareholders: The state and SOEs should recognize the rights of all shareholders and ensure their equitable treatment and equal access to corporate information (for example, SOEs should observe a high degree of transparency toward all shareholders, develop an active policy of communication and consultation with all shareholders, and protect the rights of minority shareholders).

Relations with Stakeholders: The state ownership policy should fully recognize the SOEs' responsibilities toward stakeholders and request that they report on their relations with stakeholders (for example, large SOEs, and SOEs pursuing important public policy objectives, should report on stakeholder relations).

T*ransparency and Disclosure:* SOEs should observe high standards of transparency such as developing consistent and aggregate reporting and an annual independent external audit based on international standards.

Responsibilities of SOE Boards: SOE boards should have the necessary authority, competencies, and objectivity to carry out their function of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions (for example, SOE boards should be assigned a clear mandate, responsibility for the company's performance, and be fully accountable to the owners; they should be constituted in such a way that they can exercise objective and independent judgment).

Sources: OECD Guidelines on Corporate Governance of State-Owned Enterprises 2005.

VI.C ACCELERATING EQUITIZATION

39. Most of the SOEs equitized to date are small; about 50 percent have capital of less than VND 5 billion. The challenge ahead is to equitize and transform the General Corporations and SEGs into efficient and profitable entities, in order to fully unleash the potential value of their assets, including their constituent companies.

40. There is no surer way to improve corporate governance of SOEs than to subject them to market discipline and government oversight. SOEs can generally be categorized into two groups:(a) purely commercial SOEs that are a poor use of public funds (they provide low rates of return while crowding out the private sector); and (b) infrastructure service SOEs that are inefficient and produce disappointing financial results, in part because "public service obligations" are not well managed. Purely commercial SOEs should be equitized, and infrastructure service SOEs should be carefully restructured so that commercial discipline can be introduced into their governance structures and management systems and incentive mechanisms can be established. This process may require further analysis of large, complex SOEs to prepare them for financial restructuring, and subsequent reforms to regulatory framework governing SOEs.

41. If the idea is to promote competition and create a truly level playing field, the government might consider a more aggressive option of equitizing many of the GCs and SEGs. Except for the BaoViet group, which has completed equitization, 100 percent of the charter capital of the other 11 SEGs is held by the state. Instead of equitizing only the member companies, equitizing the parent companies might also be considered. With some groups, like Vinatex; Housing and Urban Development and Investment; the Industrial Construction Group; and SOEs producing beer, sugar, and similar goods for commercial purpose, for instance, the state could reduce its share in these industries to below 50 percent in the near term and to zero in the long term. With other groups, the state may hold a dominating share of capital (51 percent) instead of 100 percent of capital in parent companies. Finally, only in SEGs involved in national defense and security should the state share remain at 100 percent.

VI.D STRENGTHENING MONITORING AND OVERSIGHT

42. Giving more operational autonomy to SOEs does not mean an end to monitoring and oversight on the part of the government, as some have interpreted it in the Vietnam context. Implementing sound performance monitoring systems (PMS) is in fact central to enhancing the transparency and accountability of SOEs. In general, a PMS includes (a) development of strategies and objectives for each company, (b) creation of key performance indicators (to measure the implementation of their strategy and objectives), and (c) preparation of a "performance agreement" that presents the high-level objectives and establishes the targets for each indicator (see box 2.6).

43. In Vietnam, efforts to develop a PMS for SOEs will face two immediate challenges. First, given the sheer number of SOEs (nearly 3,400 in 2010), developing such a system for each SOE will be time-consuming and laborious. Local governments, which own nearly 60 percent of the SOEs, may not have the manpower and capacity to undertake such an exercise. Second, this may require SOEs to invest in establishing management and supervision information systems consisting of information on finance, business performance, and related risks and changes, which can be both expensive and time-consuming. Vietnam, therefore, may not be able to develop a meaningful and effective PMS for SOEs unless the number of SOEs is drastically reduced. Therefore, in our view, developing PMS should begin with a pilot phase involving all 12 SEGs, which have better information systems, the necessary manpower, and account for more than half of the SOE sector (after taking into account their subsidiaries and affiliates), to undertake such an exercise.

Box 2.6 Developing SOE Performance Monitoring Systems

Developing monitoring systems involves several steps. A first step is to clearly define the **strategy and objectives** of the company. Often, SOEs have multiple and conflicting objectives, making it difficult to measure and monitor performance. For example, an SOE must operate in a commercial manner and be profitable, but at the same time it is often required, either formally or informally, to provide social services and maintain employment, usually without compensation from the government. Such noncommercial objectives may not be easy to eliminate, but a first step is to define and acknowledge such objectives explicitly so that they are transparent and more easily monitorable.

Once objectives are clearly defined, the next step is to **develop key performance indicators** to measure performance against expected results. Experience suggests several key principles in selecting and designing appropriate indicators: (a) indicators should be specific, measurable, and achievable; (b) they should not distort incentive structures; (c) they should facilitate benchmarking against other companies, including international companies, while recognizing country differences in accounting rules, taxation policies, and cost structures; and (d) they should be simple to begin with and improved over time with increased experience and capacity. Good indicators are both financial and nonfinancial. Financial indicators typically include profitability, efficiency, solvency, and budgetary support. Many countries are beginning to use the concept of "economic value added" to measure the true economic profit produced by a company by accounting for the cost of capital. Nonfinancial indicators include strategy development, corporate governance, innovation, and learning and development. One way to assess overall performance is to use a "balanced score card" approach, which is more comprehensive and aims to strike a better balance between financial and nonfinancial indicators.

Once objectives, indicators, and targets are agreed between owners and SOEs, they are typically **formalized in an agreement document** such as a Statement of Corporate Intent, a Performance Contract, a Memorandum of Understanding, or a Shareholders' Agreement. Developing such a document is usually a collaborative process between owners and SOEs. In most cases, a regulation or a protocol specifies the process and the roles and responsibilities of the various parties. Developing agreements can be a complex task that requires the right industry and financial skills on the part of both boards and owners. To be an informed owner, SOE ownership entities sometimes bring in external experts to help draft the agreement. In most cases, agreements are developed on a yearly basis, although they may also cover longer time periods.

Finally, SOE owners **review and evaluate performance** and take action based on any problems detected. This can be done through ongoing monitoring through information disclosure, an annual performance review, or both. A performance review includes an assessment of financial and nonfinancial results against the key performance indicators, and could also include a more general assessment of operating results, the company's commitment to good corporate governance, and the performance of the board. Auditing and disclosure of key performance indicators is gaining traction as a way to ensure the reliability of the process. The assessment would also identify steps to be taken by SOEs and owners and provide the basis for discussing objectives for the coming year. Increasingly, countries are linking an annual review to performance-based compensation systems for SOE management.

Sources: "Toolkit on State Enterprise Corporate Governance," Finance and Private Sector Development, World Bank, forthcoming.

VI.E HOLDING SOEs ACCOUNTABLE

44. Establishing clear accountability requires owners and boards to benchmark performance against clear objectives. Therefore establishing a monitoring system is key to holding SOEs accountable. As discussed in box 2.7, some countries have developed performance management systems and use it to reward SOEs with good performance and penalize SOEs that function poorly. This creates competition among the SOEs and helps them produce better results.

45. Accountability needs to be developed at both the organizational and individual level. In addition, the process through which performance is evaluated and accountability determined should be transparent and objective. Therefore, along with proper monitoring, transparency is key to holding SOEs accountable (as discussed in section VI.A).

Box 2.7 Using PMS to Hold SOEs Accountable—An Example from India

In India, Central Public Sector Enterprises (CPSEs) are monitored and evaluated through the Memorandum of Understanding (MOU) process, a performance agreement negotiated and signed between a CPSE and its administrative ministry. Established in 1986, the main goal was to improve CPSE performance by providing greater autonomy to the enterprises while holding them accountable for results through the MOU, which set out objectives, targets, and incentive-based rewards. The MOU system has steadily evolved and improved over the past 20-plus years, and has become a key tool for ensuring accountability of CPSEs and their directors.

The MOU's contents are set by government guidelines and include (a) a mission statement, (b) CPSE objectives, (c) areas where power has been delegated to the CPSE, (d) performance targets, and (e) commitments from the government to the CPSE.

In practice, the primary focus of each MOU is the performance targets. Department of Public Enterprises guidelines specify particular financial and nonfinancial or dynamic targets, with different weights assigned to each, based on the broad sector the CPSE operates in (loss-making companies and those under construction have their own formats). A balanced scorecard approach is used, with 50 percent of the weight given to financial targets and 50 percent to nonfinancial targets.

MOU negotiations are arranged by the Department of Public Enterprises and facilitated by 11 "Task Force Syndicates," organized by sector. Each CPSE is assigned to a particular Task Force, which approves the MOU and evaluates how well the enterprise did in meeting the targets. Each Task Force consists of the convener, six members, and the Task Force members. The six members consist of retired civil servants, public sector executives, management professionals, and independent members with relevant experience. Task Forces were formed to bring technical expertise that was considered lacking in the government and the CPSE, and to bring independence to the process (no current government member can serve on the Task Force). Final MOUs must be approved by the High Powered Committee, which also assesses the performance of both CPSEs and administrative ministries in meeting their commitments.

Performance is evaluated based on a comparison between actual achievements and the agreed annual targets. It is measured on a five-point scale, ranging from excellent (1) to poor (5) for each target area. Typically, a majority of CPSEs receive scores between 1 and 2, indicating that they are top performers. Performance incentives are monetary and nonmonetary. Monetary payments are based on MOU scores. Nonmonetary incentives include Excellence Awards for the best-performing CPSEs, and Excellence Certificates for CPSEs with a final rank of 1.5 or better. The score is also taken into account in the evaluation of and bonuses for managing directors and other senior officers. (Companies are rated by their score, with high-scoring companies accorded the status of *Navratna* [royal jewel] and *Miniratna* [mini-jewel]). If high-status companies do not show consistent performance for three consecutive years, they can lose their status.

The World Bank (2009) identified room for further improvement, including improving the capability of the task forces, including corporate governance, social objectives, and service delivery targets in the MOU, clarifying ownership obligations, and providing more disclosure.

Sources: India: "Corporate Governance of Central Public Sector Enterprises," World Bank, June 2010.

VI.F PACE AND SEQUENCE OF THE REFORM PROGRAM

46. For effective results, the pace and sequence of the SOE reform program should be calibrated to the urgency of the situation and the capacity of the implementing agencies. In the case of Vietnam, many of the ideas mentioned above have been under discussion for a long time and their implications are well understood. Nevertheless, it is important that adequate thought be given to the implementation arrangements. One possibility is to adopt a two-pronged approach of kick-starting the equitization process of enterprises operating in noncritical sectors (irrespective of size) and restructuring the ones operating in the critical sector. For those operating in the critical sector, the key is to start with a pilot exercise to develop a performance monitoring system for each of the 12 SEGs, facilitate more disclosure about their operational activities, hold them accountable to the mutually agreed performance goals, and work on a modern corporate governance code. If a more aggressive equitization and restructuring policy is pursued, it should be complemented with adequate investment in social safety net programs to avoid a sharp displacement of workers. There is little doubt that once the political consensus on the nature and extent of restructuring of SOEs has been reached, the government will move quickly to implement arrangements that will define the appropriate pace and sequencing of the reform program.

Chapter 3

DOING MORE FOR LESS: IMPROVING THE EFFECTIVENESS OF PUBLIC INVESTMENT[42]

42 This chapter draws on a number of background studies commissioned as part of the *Vietnam Development Report 2012*, including CIEM (2011), Thanh and Pincus (2011), and Tuyen (2011). For details, see the list of references at the end of the report.

CONTEXT AND KEY FINDINGS

1. Vietnam has been highly successful in mobilizing huge investment to support its rapid growth. During the past two decades, its economy has grown at an annual average rate of around 7.5 percent, making Vietnam one of the fastest growing countries in the world. This successful growth story has been driven primarily by rapid factor accumulation—physical and human capital—with productivity growth playing a secondary role.[43,44] Its track record in mobilizing investment—both at home and abroad and from private and official sources—has been impressive. As shown in panel A of figure 3.1, Vietnam has the highest investment rate after China among the select group of large emerging markets in the world. It is also one of the highest recipients of foreign direct investment, which averaged over 7 percent of gross domestic product (GDP) during 2005–10 (panel B of figure 3.1). At the same time, Vietnam remains the highest recipient of net Official Development Assistance (panel C of figure 3.1) outside the group of low-income countries. Undoubtedly, the country's ability to attract considerable capital from diverse sources has been a key part of its development success.

2. Equally important has been Vietnam's ability to translate the high level of investment into basic infrastructure services, making the development process extraordinarily inclusive. Consider the following facts. The ratio of rural households connected to electricity grids increased from 14 percent in 1993 to almost universal access by 2010. From a mere 8.8 billion kilowatt hours of electricity production in 1990, output soared to 80 billion kilowatt hours in 2009—a remarkable annual average growth rate of 13 percent. Between 2000 and 2010, the total length of paved roads in Vietnam quadrupled from 30,000 kilometers (km) to almost 120,000 km, connecting farms and firms with the market and lowering transaction costs. The number of households with access to a piped water network rose from 12 percent in 2002 to 76 percent in 2009. Similarly, container throughput (a measure of volume of international trade) grew by more than 20 percent per year on average between 2000 and 2009—the fastest container volume growth rate in Asia during the period. It is these successes that partly underpin Vietnam's ability to simultaneously achieve impressive growth and extraordinary poverty reduction.

3. But Vietnam's investment regime, especially its public investment component, is being increasingly viewed in the last few years as unaffordable, inefficient and, therefore, unsustainable. There are three commonly cited concerns against the current investment regime:[45]

- **Affordability.** Because the strategy has relied almost exclusively on raising the "level" of investment rather than improving its "efficiency," the amount of financial resources required to meet Vietnam's future infrastructure needs has reached an unaffordable level. For example, according to the Ministry of Planning and Investment (MPI), Vietnam needs around US$25 billion a year to invest in infrastructure (more than 20 percent of GDP), while the annual funds available from both the public and private sectors are less than US$16 billion—creating an annual shortfall of US$9 billion (Thanh and Dapice 2008). With government debt at 57 percent of GDP and domestic credit at 120 percent of GDP, there are concerns that continuing the current trend in public investment, often using borrowed funds from expensive sources, will be fiscally unsustainable and add to macroeconomic vulnerability.[46]

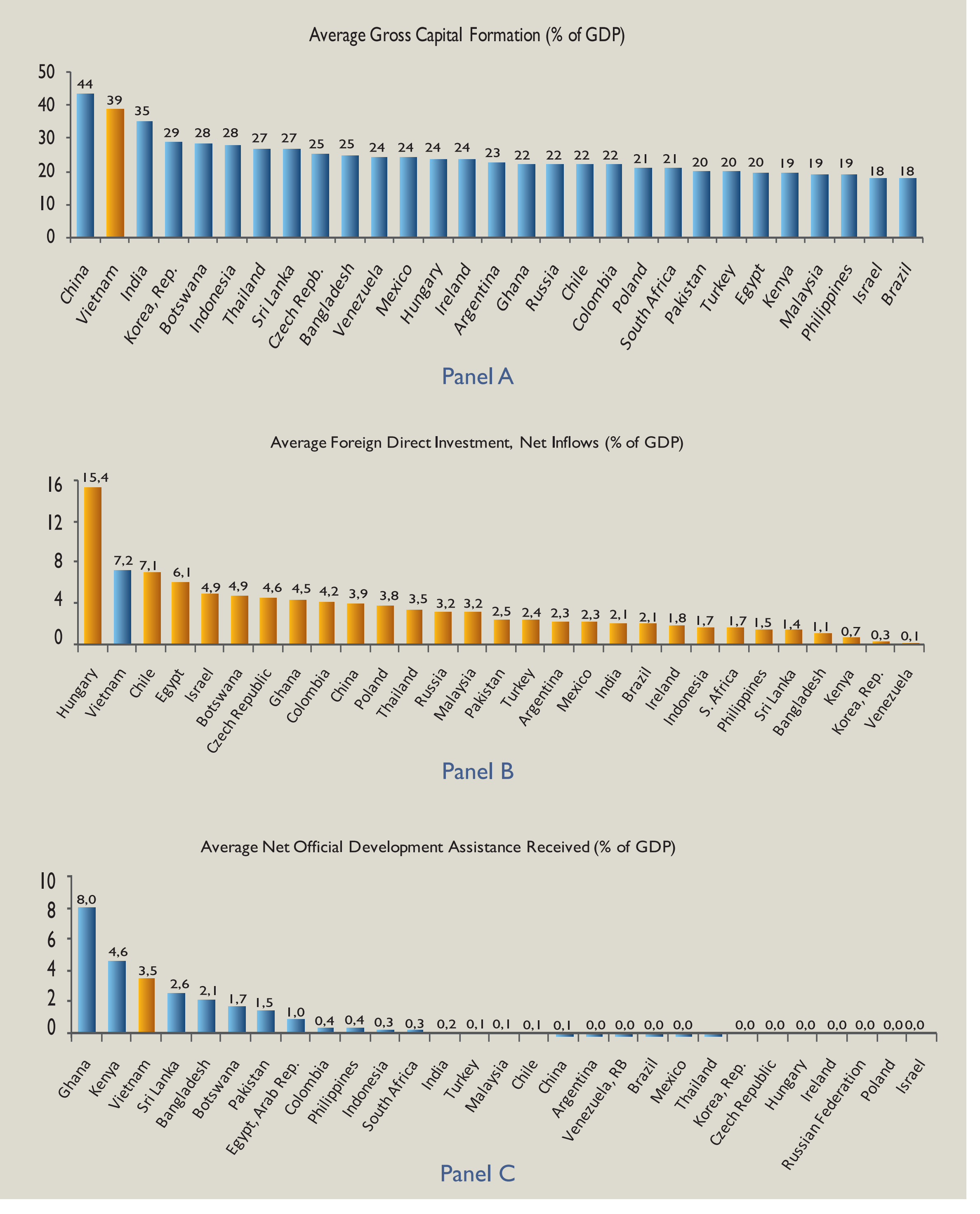
43 Vietnam's growth experience mirrors the experience of other countries in the region that have achieved similar growth records in the past. See Young (1995), who described the sources of growth for East Asia's then Newly Industrialized Countries—Hong Kong SAR, China; the Republic of Korea; Singapore; and Taiwan—as "99 percent perspiration (factor accumulation) and 1 percent inspiration (total factor productivity)." Also see World Bank (1993) and World Bank (2006).

44 See CIEM (2010) and Porter (2011) on the calculation of total factor productivity for Vietnam.

45 A fourth concern is its environmental sustainability, which was discussed in Vietnam Development Report 2011.

46 There are affordability issues at the micro level, as well. First, the debt-to-equity ratio of most enterprises, especially the SOEs, has increased rapidly in recent years, and a further increase in their debt level is not advisable. Second, following Vinashin's default, the cost of borrowing for Vietnamese firms has risen considerably, making it prohibitively expensive for them to borrow in the international markets. Third, the user fees associated with many infrastructure projects are below cost, making them financially unsustainable without government support.

Figure 3.1 Vietnam's Success in Mobilizing Investment from Various Sources (2005–10)



Sources: World Development Indicators, World Bank (2011).

- **Impact.** Despite huge investment, Vietnam's infrastructure bottleneck remains a significant constraint to future growth. Along with macroeconomic stability, other factors cited by investors as some of the main constraints to operating in Vietnam are lack of adequate and reliable electricity, congestion on the roads and at seaports and airports, and poor quality of infrastructure in industrial areas.[47] While critics concede that the infrastructure problem could have become worse without the higher investment, they also point to the high cost and time delay in building infrastructure as

47 See Japanese External Trade Organization, 2007 Survey of Japanese-Affiliated Firms.

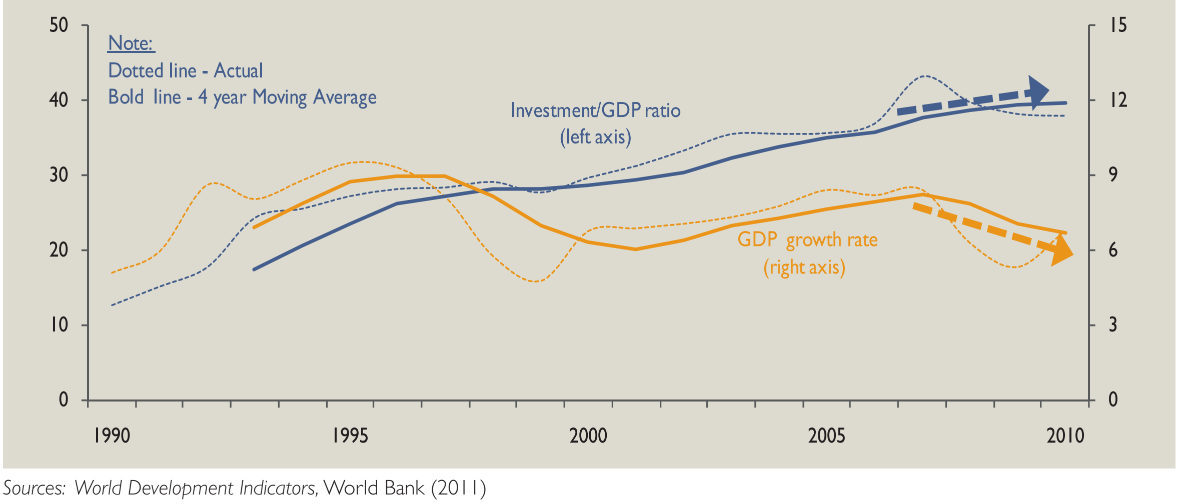
more binding constraints than availability of financial resources.

- **Link to growth.** A strong positive correlation between investment rate and growth over a sustained period is one of the well-known stylized facts in the literature on growth (Levine and Renelt, 1992). This relationship appears to have weakened in Vietnam in recent years. Figure 3.2 shows the actual and four-year moving average of the ratio of investment to GDP and the real GDP growth rate.[48] It shows that during the last five years, there has been a steady increase in the investment rate, initially fueled by a sharp increase in foreign direct investment (a dividend from joining the World Trade Organization) and later by the stimulus spending (in the wake of the global economic crisis). But this is also the period when growth started to decelerate. A significant part of the growth deceleration, at least initially, was due to a sharp drop in exports and a slowdown in global demand. Since then, exports have rebounded, but not growth. In fact, even under optimistic assumptions, Vietnam's growth is expected to remain at around 6 percent in the foreseeable future. The fact that growth is becoming less responsive to investment, especially to public investment—which accounts for as much as 30-40 percent of total investment—has, therefore, emerged as a key concern for policy makers.

4. While the unsustainability of the investment regime has long been recognized, it is only recently that the government seems determined to make the effectiveness of public investment its top priority. With no visible improvement in the external environment and continued macroeconomic turbulence at home, the realization has dawned that Vietnam must do more with less, that is, it must maintain its high growth rate, but with a lower investment rate. Therefore, the government has shifted the paradigm: it has slashed the target investment rate for the next five years from the current 40 percent of GDP to 35 percent of GDP while maintaining the growth rate of the economy at 6 to 6.5 percent—signaling that a larger part of growth will now have to come from higher efficiency. This sentiment was echoed by the Central Party Committee, which in one of its recent communications said:

"To renew the thinking on investment, gradually adjust the public investment structure in the direction of reducing the proportion of public investment and improving the efficiency; resolutely overcoming the widespread investment and promoting the capital mobilization for development. In 2012, to strictly implement the conclusion of the third Central Conference and the instruction of Prime Minister on

Figure 3.2 Recent Investment Boom Has Not Delivered Proportionate Growth(variables are in %))



Sources: World Development Indicators, World Bank (2011)

48 Given the lag between investment and growth and the annual fluctuations in data, the comparison using the four-year moving average is perhaps more meaningful.

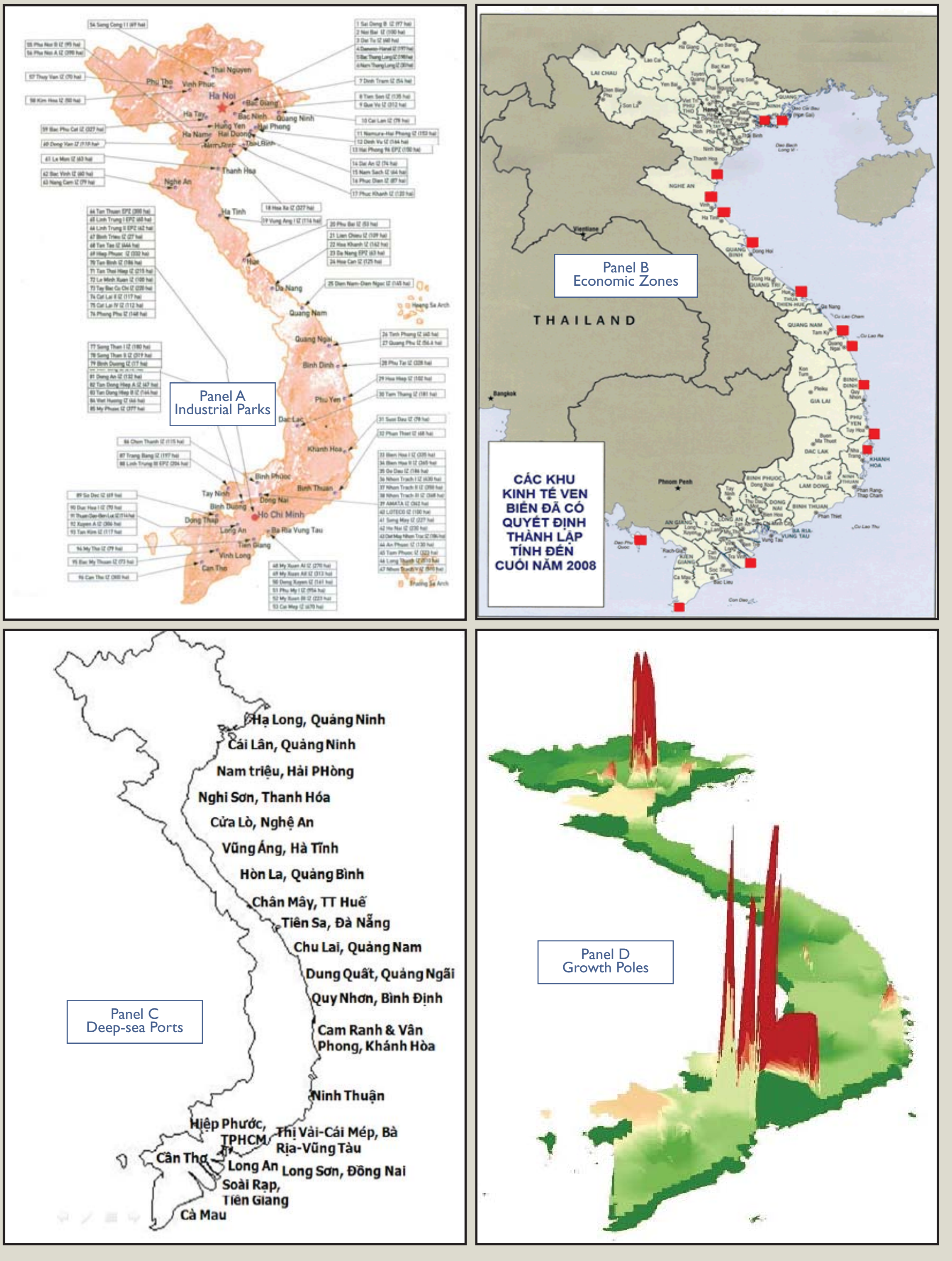
strengthening the management of investment from the state budget, public bond, strictly controlling investment of state enterprises. To renew the mechanism of investment allocation; focus capital on urgent projects to finish soon, quickly putting into use to promote the efficiency. Put priority on funding the project already completed and put into use, the projects planned to be completed in 2012 and reciprocal capital for ODA [Official Development Assistance] projects. The new projects and construction must be strictly controlled; the capital resources must be clearly identified, ensuring efficiency and investment procedures."

5. **Vietnam's existing public investment regime can be best described as one in which the parts do not add up to the whole.** In Vietnam's highly decentralized administrative structure, developing infrastructure is the responsibility of local governments. By putting its 62 provincial governments and two city administrations in charge of screening, appraising, selecting, and executing their own infrastructure projects, Vietnam has unleashed tremendous energy and competition among its local governments—certainly a positive move. But as discussed later in this chapter, this has been done without connecting the infrastructure to the strategic priorities of the country (such as improving competitiveness) or using the market as a means of allocating resources. Consequently, each province has worked in isolation to create fragmented, suboptimal infrastructure projects, many of which have become idle.

6. **If all the approved projects in Vietnam were built, the country would have one of the highest numbers of deep-sea ports, international airports and industrial parks in the world relative to the size of its economy.** Building more infrastructure is often a virtue, especially in an interdependent, globalized world, where a country like Vietnam can use its low-cost advantages to transact goods and (tradable) services many times higher than its GDP—a strategy that has been deployed in the past by smaller economies in the region such as Hong Kong SAR (China) and Singapore. But Vietnam's problem is that, while it is thinking "big," it is building "small." Consider the following facts.

- There are nearly 260 **industrial parks** (IPs) that have been built or are under construction in Vietnam and 239 more have been approved to be built in the next 10 years (panel A, figure 3.3). Of these 260 IPs, nearly 50 have a zero occupancy rate, accounting for 20 percent of the total land area occupied by IPs. The average nationwide IP occupancy rate is only 46 percent.
- There are 18 **economic zones** (EZs) in Vietnam, occupying about 765,000 hectares (ha). In contrast, all 260 IPs occupy less than 72,000 ha (panel B, figure 3.3). While the EZs have a slightly higher occupancy rate than the IPs, many EZs are finding it difficult to attract enough investors to be financially sustainable.
- Vietnam has 24 **deep-sea ports** and many more are planned (panel B, figure 3.3). Some of the new ports being built are actually clusters of ports such as the Cai Mep–Thi Vai Port complex, which consists of nine ports with a combined realized capacity of 8.1 million twenty-foot equivalent units (TEU). However, the current utilization rate in the Cai Mep–Thi Vai port is less than 30 percent.

Figure 3.3 Location of Existing and Under-Development Infrastructure in Vietnam



Sources: Authors' compilation from Vietnam government development plans for port location, the *Vietnam Economic Times*, and Thanh and Pincus (2011)

- There are 20 airports operating in Vietnam and a few more on the drawing boards. The median capacity of these airports is around 1 million to 1.5 million passengers. Ensuring adequate air traffic to these airports and keeping them operational will be much more expensive in the long-run than building and maintaining a few large airports in strategic locations.

7. While the decision to build life-sustaining infrastructure throughout the country—electricity, roads, drinking water supply—was a brilliant move, the logic behind building growth-sustaining infrastructure in every province—airports, seaports, IPs, EZs, and so forth—appears less persuasive. Experience of countries shows that "economic growth is unbalanced, but development can still be inclusive" (*World Development Report* 2009). Vietnam, knowingly or unknowingly, pursued this approach during the 1990s and early 2000s when it invested heavily in building basic infrastructure for its population, making development inclusive. But in recent years, especially after approval of Law on Investment (2005), which devolved all investment-related decisions to local governments, the logic of building life-sustaining infrastructure was extended to build growth-enhancing infrastructure. But such a move had two limitations. First, as shown in panel D of figure 3.3, nearly 70 percent of Vietnam's output is generated around two growth poles—the Red River Delta region and the area surrounding the Mekong Delta, including Ho Chi Minh City (HCMC). Second, with an average size of 200,000 households and a GDP of less than US$1 billion per province, most provinces have neither the financial capacity to build globally competitive infrastructure nor enough internal demand to ensure their full utilization. There is no doubt that as Vietnam becomes more prosperous and a bigger economy, all of its infrastructure will be fully utilized,[49] but in the medium term it will suffer from the opportunity cost of building infrastructure that the market currently does not need.

8. We use three case studies—one on industrial parks and two from the port sector—to identify the problems that have contributed to an inefficient public investment regime and what can be done to address them. These case studies were chosen because they illustrate the generic nature of the problem facing many infrastructure projects in Vietnam, namely (a) use of nonmarket means to allocate resources, especially land; (b) poorly specified and enforced property rights; (c) weak coordination among governments, line agencies, and state-owned enterprises (SOEs); (d) lack of impartial regulating agencies; and (e) weak implementation of existing laws. These case studies also reflect the problems associated at different stages of the public investment cycle—strategic planning, screening, appraisal, selection, implementation, and evaluation—and discusses potential ways to address them.[50]

II INDUSTRIAL PARKS: BOON OR BANE?

9. IPs have played a critical role in Vietnam's transformation from an agriculture-based economy to a low-cost exporter of manufactured products. Political stability, a young and educated labor force, the relatively low cost of doing business, and strategic location are some of the factors that have made Vietnam a magnet for foreign direct investment.[51] Many of these foreign investors, and a large number of domestic investors, have found a home in the ubiquitous IPs that dot the length and breadth of the country. At the end of 2010, Vietnam's 261 IPs (see table 3.1) occupied 71,394 ha in 57 of its 62 provinces. Of these, 173 IPs are fully operational and 88 are at various stages of construction. In recent years, these IPs have attracted nearly 8,350 projects with a registered capital of US$74 billion, of which US$24 billion has been disbursed. In 2010, the enterprises operating in the IPs produced nearly US$34 billion worth of products, of which US$19 billion was exported (40 percent of total manufacturing exports from Vietnam). There are more than 1.6 million workers employed in these IPs. By most criteria, the IPs in Vietnam should be considered a huge success.

49 The current flooding in Thailand has forced some investors to look for alternative sites, and Vietnam, with its underutilized IPs and EZs, may be an attractive alternative. However, Vietnam's infrastructure policy should not be driven by providence, but by market forces.

50 Also see MPI (2009).

51 The net foreign direct investment in Vietnam during 2006–10 exceeded the cumulative net foreign direct investment in Indonesia, Malaysia, the Philippines, and Thailand combined (*World Development Indicators 2011*).

Table 3.1 Selected Statistics on Vietnam's IPs (at the end of 2010)			
Indicator	Foreign Invested	Domestic Invested	Total
Number of IPs	40	221	261
IPs currently operational	23	150	173
Number of projects (enterprises)	3,962	4,377	8,339
Amount of registered capital	US$53.6 billion	VND 336,078 billion	US$74 billion
Amount of disbursed capital	US$17.1 billion	VND 135,950 billion	US$24 billion
Production turnover	US$30.5 billion	VND 57,251 billion	US$34 billion
Exports	n.a.	n.a.	US$19 billion
Imports	n.a.	n.a.	US$18.5 billion
Number of employees	n.a.	n.a.	1.6 million

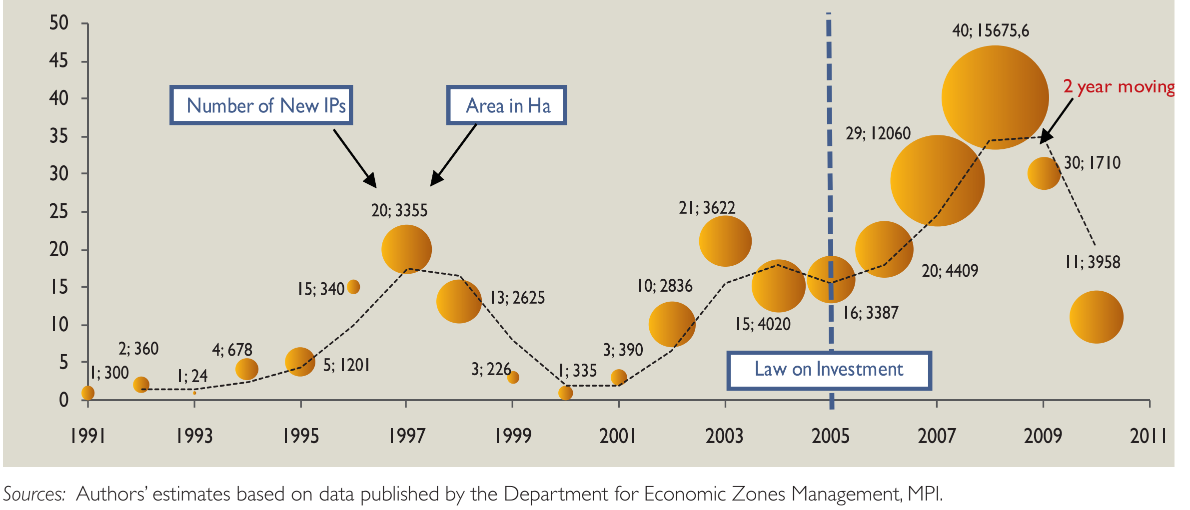
Sources: Department for Economic Zones Management, MPI.
Note: n.a. = not applicable.

10. Yet, instead of being a source of pride, the IPs are increasingly viewed as a symptom of a problem, namely, excessive investment that is not yielding commensurate growth. As discussed in section I, the country is now scattered with fragmented, suboptimal-size infrastructure projects with low utilization rates. This problem is most acute with the IPs where the average occupancy rate is only 46 percent. To add to the problem, nearly 239 new IPs have been approved for construction during the next 10 years! What led Vietnam to build so many IPs that it cannot afford or does not need in the foreseeable future?

II.A BUILD IT AND THEY WILL COME

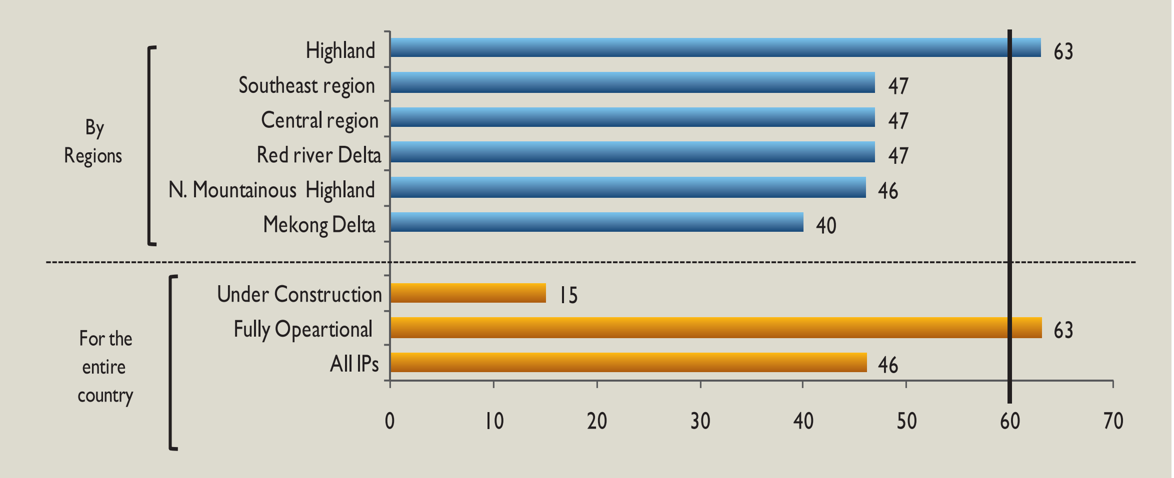
11. Encouraged by the initial success, Vietnam went into overdrive to build IPs during the mid-2000s. On January 25, 1991, the Prime Minister issued a permit to establish the Tan Thuan Processing and Export Zone, which is considered to be the first modern IP in Vietnam, following which more IPs were built, though the pace of expansion was interrupted by the East Asian Crisis in the late 1990s. As figure 3.4 shows, the rate of approval and construction of IPs increased in 2002 and went into overdrive after the approval of the Law on Investment in 2005. In 2008 alone, the amount of land approved for IPs exceeded the cumulative land allocated for IPs between 1991 and 2003. Even at the height of the global economic crisis in 2009, 30 new IPs were approved. The deluge of foreign investment, signing of various trade agreements, and incentives provided by the government created a feeling that if you build an IP, the investors are sure to come.

Figure 3.4 Approval of New Industrial Parks in Vietnam (1991–2010)



Sources: Authors' estimates based on data published by the Department for Economic Zones Management, MPI.

Figure 3.5 Utilization Rate of Existing IPs (at the end of 2010)



Sources: Authors' estimates based on data published by the Department for Economic Zones Management, MPI.

12. The speed at which industrial parks are being built exceeds any reasonable demand for them, with the global economic crisis in 2009 exacerbating the problem. According to the Ministry of Planning and Investment (MPI), at the end of 2010, the nationwide vacancy rate in existing IPs was less than 50 percent. Data available from the Department for Economic Zones Management in MPI show that the fully operational IPs have an occupancy rate of 63 percent, while for those under construction, the occupancy rate is 15 percent. The overall nationwide occupancy rate is estimated to be 46 percent (figure 3.5). International experience shows that a 75 percent occupancy rate is required for an IP to be economically sustainable in the long run.

13. The occupancy rate is not only low, it has steadily declined. For example, nationwide utilization rate peaked at 62 percent in 2007 but then fell rapidly to 46 percent by 2010. The overall low occupancy rate has been adversely affected by the large number of non-performing IPs. Among 260 IPs, about 50 IPs have zero occupancy rate, accounting for 20 percent of the total IP land areas. The decline in the occupancy rate has been uniform across most provinces. For example, between 2007 and 2010, the utilization rate in Hai Duong fell from 66 to 35 percent, in Hung Yen from 60 to 25 percent, in Long An from 53 to 31 percent, and in Tien Giang from 34 percent (in 2006) to 31 percent. A large part of this decline can be attributed to a boom in the approval of IPs between 2006 and 2009, the construction of which has since slowed due to weaker demand.

14. But some IPs are doing much better than others, especially ones closer to the growth poles. Location of the IPs appears to be a significant factor behind their performance. IPs in the two economic hubs of the country (Hanoi and HCMC) and some of the surrounding provinces (Hai Phong, Hai Duong and Hung Yen in the North and Dong Nai, Binh Duong and Ba Ria Vung Tau in the South) outperform their counterparts in the other locations in terms of turnover and export revenues (table 3.2). While these 8 cities and provinces accounting for less than half the number of IPs, they contribute 84 percent of export turnover in 2010.

15. The problem of underutilized IPs will certainly worsen if all the IPs included in the master plan are built. Despite the low utilization rate of current IPs, nearly 239 more, amounting to 54,882 ha of land, have been approved for implementation during 2011–20. In addition, the approved master plans of national and local governments include construction of 3 national economic zones with the combined area of 265,000 ha and 1,643 provincial-level industrial clusters with a land area of 73,000 ha. It is estimated by MPI that the country would require nearly US$40 billion in investment in the next 10 years just to construct the infrastructure for these approved IPs and economic zones.[52]

52 MPI estimates that the investment rate for IP infrastructure is US$300,000 per hectare.

Table 3.2 Successful IPs in terms of export turnover (2010)							
Provinces	Number of IPs	Export turnover in leasable industrial land		Rate of occupancy		Export turnover	
		Export turnover (USD mil./ha)	Ranking	Rate (%)	Ranking	(USD mil.)	Ranking
Hanoi	11	1.83	1	64.6	16	2,118	3
HCMC	18	1.24	2	48.4	30	3,100	2
Hai Phong	5	1.13	3	39.2	38	717	7
Dong Nai	30	0.86	4	58.6	22	5,476	1
Can Tho	6	0.85	5	50.1	27	515	9
Hai Duong	10	0.78	6	35.0	44	980	5
Phu Tho	2	0.69	7	73.7	11	211	11
Hung Yen	9	0.61	8	25.3	50	757	6
Dong Thap	3	0.60	9	73.0	12	119	19
Binh Duong	25	0.38	10	58.7	21	2,020	4

Sources: Department for Economic Zones Management, MPI

II.B WHAT IS DRIVING THE IP BOOM?

16. **While the proliferation of IPs has had many influences, institutional factors and the incentives they generate have contributed to it.** In particular, the system of intergovernmental fiscal relations provides incentives for provinces to prefer industrial production, and the system of land management provides a further (invisible) subsidy to the cost of IPs (see Box 3.1). In the current decentralized environment, the MPI, which is responsible for approving IPs, does not have enough political capital to reject proposals made by the provinces. And even if the central government promulgates regulations to slow new IP development, those regulations have been creatively sidestepped.

(A) Incentives for the Provinces

17. **Vietnam's system of taxation provides that virtually all land related tax revenue accrue to the local governments, including 100 percent of land and housing taxes, tax on the transfer of land use rights, tax on the use of agricultural land, land rent and the fees from the use of land** (see box 3.1). Since agricultural land is valued, rented, and taxed at lower rates than industrial land, converting the land to industrial use can bring added revenues to the province. In addition, corporate income tax and VAT (for goods bound for the domestic market) are shared taxes, meaning the province gets to keep some of the tax revenue collected from firms. Indeed, regardless of where the good are sold in Vietnam, the province where the firm is headquartered collects the VAT and all of the shared revenues associated with those collections accrue to that province. [PER 2005, p. 89] In Long An province, with 24 industrial zones, 48 percent of revenues come from the shared revenues and those that are designated for local governments, including the land-related revenues. In contrast, only 22 percent of revenues from are from such sources in Bac Lieu, a province with only a single IP.[53] While many of the fiscal benefits from industrializing accrue to the provinces, many of the costs of building associated infrastructure are subsidized by an allocation from the central government. Taken together, it is clear to see why IPs are attractive from the perspective of the provinces.

53 While there has been little research conducted into the relationship between land/property taxation and government finances in Vietnam, studies have shown that local governments are operating in an unsustainable manner by converting and selling valuable agricultural land to underpin their operation budget needs (WB study, 2008).

Box 3.1 Inter-Governmental Fiscal Transfers in Vietnam

The level of fiscal decentralization in Vietnam, which has been historically high, has continued to increase in recent years. In 2000, nearly 40 percent of investment from the state budget was executed by the local government; by 2010 this number has increased to 51 percent.

Revenue assignment between central and local governments is currently stipulated by the Budget Law 2002. According to the Law, all revenues collected from taxes and fees related to international trade must be transferred to the central budget. On the other hand, local governments retain 100 percent of the revenues they collected from land (e.g., renting, tax on land use transfers, land use tax), from natural resource tax, registration fees and from lottery. Specific land price brackets will be determined by provincial People's Committee.

Another source of revenue for provinces is part of the revenues collected from VAT, corporate income tax, personal income tax, and gasoline fee. There exists a sharing mechanism between central and provincial government for these revenues, but the majority of provinces can retain 100 percent for their own budget. Richer provinces (HCMC, Hanoi, Quang Ninh etc) have to transfer a part of these revenues to the central budget. The sharing mechanism is kept stable for 3-5 years.

Overall, the central government keeps about 60 percent of total revenues collected from fees and taxes, and provinces received about 40 percent of these revenues. However, the central government transfers about half of its tax revenues to provinces. So the final share of central-provincial tax and fee revenues after the transfers is around 30:70.

Sources: Budget Law and The State Budget Budget Accounts for 2010 (MOF Website).

(B) Land-Use Planning and Property Rights

18. The system for land management indirectly provides incentives favoring industrial parks. As IPs are large projects, they qualify for compulsory land acquisition, meaning that the state acquires the land, with compensation, from those with existing land use rights, and then converts the land to industrial use for the IP, renting it to the new users. The level of compensation for those who lose their land is in general based on the market price of the land's former use (usually agriculture), rather than being based on the value of industrial land. Moreover, the level of compensation does not reflect the loss of livelihoods experienced by farmers whose primary skill is farming. All this for projects those are essentially private in nature. As the land is taken in a compulsory way, it is likely that the value of the land to those who lose it is higher than the value of the land to those who acquire it, generating an economic efficiency. It also means that a key input for the creation of IPs, land, is implicitly subsized by those who lose the land, usually farmers.

(C) Strategic Guidance for Investment

19. The current IP policy lacks credible strategic guidance that anchors government decisions and guides sector-level and province-level decision makers. While Vietnam has Five Year Plans and separate Master Plan for IPs and for Economic Zones, that establish economywide broad development priorities and action plans to implement those priorities, there seems to be limited connection between them (see box 3.2). A simple, back-of-the envelope calculation shows that the IP approval process has little bearing on the rest of the economy. For example, with 140,000 ha planned for industrial parks, the state will be required to invest approximately US$40 billion to build supporting infrastructure such as wastewater treatment plants, hazardous waste disposal systems, emission treatment facilities, and roads connecting the IPs to the nearest highways or ports. In addition, the IPs will need to attract around US$300 billion in investment projects and

Box 3.2 China's Experience with Industrial Zones

China has more than 1,000 industrial zones (IZs) following a central government policy encouraging the development of such zones. Most cities and counties have followed the models set by the large zones developed by the central and provincial governments. The local governments are motivated to develop industrial zones to get tax revenues and revenues from selling land, as well as nice records of administrative performance. These industrial zones have played a critical role in facilitating the growth of Chinese SMEs from family operations catering to the local market to global powerhouses. These zones not only provided Chinese SMEs with good basic infrastructure (e.g. roads, energy, water and sewage), security, streamlined government regulations (e.g. government service centers) and affordable industrial land, they also provided technical training, low cost standardized factory shells allowing Chinese entrepreneurs to "Plug and Play" as well as Chinese workers with free and decent housing accommodations.

But not all Chinese industrial zones have been successful. The better ones were built on existing or potential industrial strengths, in other words, local comparative advantages. Most of these zones specialize in particular industries, letting market forces drive the organic development of specialized clusters. China's success also relied a great deal on intense competition (domestic producers as well as export markets), its decentralized implementation and ensuing competition between local governments as well as with the key role devoted to the banks and private sector developers.

By contrast, most of Vietnam's IPs are not specialized clusters. There are limited linkages between IPs and the vast majority of small, informal SMEs which focus on the domestic market and remain small. Export growth in Vietnam does not bring about as much value addition as one finds in China (20 percent vs 33 percent in China from manufacturing value added) as the large firms also suffer from not being plugged into local clusters and value chains—they import most of their inputs.

Sources: http://blogs.worldbank.org/developmenttalk/blogs/vandana-chandra.

hire 9 million industrial workers to be financially sustainable in the long term. Even less thought has gone into issues such as accommodations for the workers; equipping the labor force with basic training; or developing supporting infrastructure, such as wastewater treatment plants, emission treatment systems, hazardous waste and solid waste disposal systems, and connectivity with the nearest urban center or port. There is a need to link the IP approval process with the annual budget preparation process so that the planning and financing part of IPs are jointly determined.

(D) Inconsistent Laws, Weak Implementation

20. The authority to develop and manage IPs has undergone several changes in recent years. A selection of the key regulations involving establishment and management of IPs between 1997 and 2010 are presented in table 3.3. In 1997, management of IPs was the responsibility of the Vietnam Management Board, which reported directly to the Prime Minister. In 2000, the Vietnam Management Board came under the authority of the MPI. In 2003, the MPI was given a greater mandate to oversee the state management functions of IPs. But such a centralized arrangement appeared infeasible, forcing MPI to gradually assign greater state management functions to the IP Provincial Management Boards (PMBs). Following approval of the Law on Investment (2005), which dramatically accelerated the decentralization of investment to local governments, PMBs became almost entirely responsible for the management of IPs and for Export Processing Zones and Hi-tech Zones. Decree No. 29/2008/ND-CP introduced further decentralization and the one-stop shop, and outlined procedures for handling issues such as environmental and labor standards.

Table 3.3 Selected Key Regulations Involving Establishment and Management of IPs, 1997–2010		
Name of the Regulating Instrument	Issuing Authority and Year Issued	Key Provisions
Decree No. 36/ND-CP/1997	Central Government, 1997	Development and management of IPs rested with the Vietnam Management Board, which reported to the Prime Minister
Decision No. 99/QD-TTg	Central Govern-ment, Sept. 2000	Vietnam Management Board for IPs came under the authorization of MPI
Decree No. 61/ND-CP/2003	Government June 6, 2003	MPI was put in charge of strict management of IPs, but by applying the decentralization mechanism, it gradually assigned most of its function to the Provincial Management Boards
Law on Investment 2005 Decision	National Assembly, 2005 Prime Minister,	Dramatically accelerated decentralization of investment
No. 1107/ 2006/QD-TTg Decree	August 21, 2006 Government	Plan for IP development in Vietnam to 2015 and 2020 vision
No.29/2008/ ND-CP	March 14, 2008	Establishment, operation, regulation, and state management of IPs and Export Zones consistent with World Trade Organization regulations

Sources: MPI; MOF; various sources.

21. While regulations have been constantly revised, their implementation has been uneven and weak. For example, although Decree 29/2008/ND-CP was approved in 2008, many authorized ministries had not provided detailed instructions to the local governments as late as mid-2011. Thus, some PPCs have hesitated to delegate certain tasks to PMBs, causing an uneven mandate for PMBs across provinces.

22. Regulations concerning the setting up of IPs are not always consistent with each other. Take for example Decree No. 29/2008/ND-CP, which states that one of the conditions for establishing new or expanding existing IPs is that the average occupancy rate of IPs in a province reaches 60 percent.[54] This is a sensible regulation intended to maintain an appropriate balance between demand and supply of IPs within a province. But there are other regulations that help provinces sidestep this restriction. If the occupancy rate of existing IPs is less than 60 percent, provinces need to "find a niche" to overcome such regulation. PPCs can also ask for "special approval" to allow them to establish new IPs even when the occupancy rate of existing IPs is lower than 60 percent, or they can phase land transfer to existing IPs into different periods, and calculate the occupancy rate based on the transferred area rather than the total area of the IPs.

23. The legal document guiding the master planning process for spatial development lacks enforcement power. The main strategic document for the nation-wide development of IPs is the Master Plan for IPs development, which is supposed to be reviewed by a National Appraisal Committee and then approved by the PM. There is another master plan for economic zones and a number of other related master plans such as Land Use Master Plan, Urban Development Plan, Transport Master Plan and Power Master Plan. The inter-linkages between them are vague and the current consultation process for achieving coherence remains a formality rather than a strategic tool. The only legal document guiding the master planning process for spatial development is Decree 92/2006,[55] which clearly lacks enforcement power

54 This provision applies to all provinces and top-tier cities under central management in the country.

55 Some of the articles of Decree 92 were amended by Decree 04/2008.

to deal with other closely related laws such as Construction Law or Land Law. As a result, the current spatial planning has largely been driven by infrastructure development plans with inadequate attention given to the overall efficiency.[56]

III THE RELOCATION OF THE HCMC PORT SYSTEM: WHY THE GRIDLOCK?

24. The HCMC port system shares many of the characteristics of a typical infrastructure project that are unique to Vietnam: multiple owners, large presence of state enterprises, and suboptimal scale. The HCMC port is not a single port but a cluster of numerous port terminals operated by different companies. As shown in table 3.4, there are nine port operators, each operated by a state agency (a total of four SOEs, the People's Committee of HCMC, the People's Navy, and the Ministry of Defense), and in two cases there are joint ventures with foreign companies. While there are 37 berths spanning over 6,000 meters, they are scattered across nine operators, with four berths and less than 500 meters berth length per operator—quite modest by global standards.

25. Relocating the HCMC port system to a new location makes perfect sense. All the ports in HCMC are river ports, occupying riverfront land in the central business district and nearby areas. The rapid growth of exports and imports and the shift toward containerization in ocean shipping in the early 2000s have created critical challenges for HCMC ports. Draft and length limits prevent

Table 3.4 Ho Chi Minh City Ports

Port Terminal	Port Operators	Number of Berths	Total Berth Length (m)	Area (ha)	Vessel Size (DWT)
Sai Gon Port (Nha Rong and Khanh Hoi terminal)	Vinalines (SOE)	10	1,750	32.2	10,000–30,000
Sai Gon Port (Tan Thuan terminal)	Vinalines (SOE)	5	995	13.6	10,000–30,000
Ben Nghe port	People's Committee of HCMC	4	816	32.0	10,000–30,000
Vietnam International Container Terminal	Southern Waterborne Transport Co (SOE), NOL Group (Singapore) and Mitsui & Co (Japan)	4	678	28.3	15,000–20,000
Sai Gon New Port	People's Navy	4	733	31.9	5,000
Ba Son Shipyard (ship building facility)	Ministry of Defense's General Department of Military Industry	6	754	26.4	6,000–10,000
Tan Thuan Dong Port	Sai Gon Transport Services (SOE)	1	149	2.9	15,000
Vegeport (Rau Qua)		1	222	7.2	20,000
Lotus Port	Viettrans (SOE), Vosa, and (Blassco) Ukraine	2	275	6.0	30,000

Sources: Thanh and Pincus 2011; Note: DWT = pennyweight.

56 The on-going formulation of a Spatial Planning Law is expected to reduce the inconsistency among different laws for spatial development and improve the coherence and efficiency.

large vessels from calling at these ports. As a result, export and import goods have to be transshipped on feeder ships via ports in Singapore and other Asian countries, raising the cost of shipping to and from Vietnam in terms of time and money. Furthermore, the location of the ports deep inside the city center causes major traffic problems since trucks have to traverse busy urban districts to get to the ports. The city is also undertaking large urban development projects on the eastern side of the Saigon River at Thu Thiem. When bridges are built across the river, it will be effectively impossible for large vessels to pass under them. Perhaps most important, the land under the existing ports has risen in value over the last decade. The failure to redevelop this land for commercial and residential use represents a missed opportunity for the city in terms of revenue generation and positive externalities in the form of demand for complementary investment and services.

26. The relocation of the port system was first proposed in the late 1990s, with the consent of key stakeholders. With container handling facilities operating close to full capacity and little room for expansion at existing sites, it had become increasingly clear that sustaining rapid growth in trade required the development of a new port complex with modern facilities, and that the new ports would be located outside of the city center (APL 2007, 49).[57] In 2005, a decision was taken by the central government to identify Ba Son Shipyard and four ports—Saigon New Port, Sai Gon Port (Nha Rong and Khanh Hoi terminals), Tan Thuan Dong Port, and Vegeport—as the specific facilities that were to be moved out of the city by 2010 at the latest. At the same time, the Cai Mep–Thi Vai River in Ba Ria–Vung Tau (BRVT) was identified as the preferred site for Vietnam's main international gateway port. The HCMC port relocation policy had the strong support of both the business community and all the state agencies involved.

27. But one year after the deadline, all but one port in HCMC remain at their original location. Why? Sai Gon New Port is the only facility that moved further downstream from the city center when the relocation deadline passed. Reasons cited by other port operators for not relocating include the need to receive assurances that new sites are economically viable, and financial constraints on new investments. As the discussion below shows, the absence of coordination among agencies, clear lines of authority and accountability, and well-defined property rights have resulted in a situation in which firms and government agencies act in accordance with short-term interests that often generate socially suboptimal outcomes.

(A) Land Use Planning and Property Rights

28. Lack of well-defined property rights and the inability to transfer land-use rights are major causes for the current stalemate. Port operators hold land-use rights that give them authorization to use state land for the specific purpose of operating a port. They do not own the land in the sense of having the right to sell, lease, or mortgage it, or to develop the land for other purposes, such as commercial and residential use. The current operators, therefore, have an incentive to maintain some nominal maritime activities at their existing locations in order to control the land. Sai Gon Port already has a "land-conversion" plan to redevelop its port area so that revenue generated can be used to finance its new port in Hiep Phuoc. Similarly, the HCMC People's Committee in 2009 decided to develop the cruise ship terminal further downstream in the Phu Thuan Park Project. But getting approval of the land conversion plan has been complicated.

29. The HCMC People's Committee is both one of the port operators and the agency that approves the land-use plan—mixing its interest as a player and its responsibility as a regulator.

57 Globally, ports have been moving out of cities because of the need to accommodate larger vessels, the rising opportunity cost of inner-city land, and traffic congestion caused by port operations. Recent examples of port relocation and new port developments in Asia include Busan Port to Busan New Port in Korea; Waigaoqiao to Yangshan Port in Shanghai, China; Bangkok to Laem Chabang Port in Thailand; and Mumbai to Nhava Sheva Port in India.

In order for Sai Gon Port to proceed with its project, a detailed land-use plan must be in place.[58] As of mid-2011, the HCMC People's Committee had not approved the plan. Only in 2009 did the City's Department of Planning and Architecture start the land-use planning process covering the port area in the city center. Like many government efforts to implement policies, a steering committee involving all relevant agencies was set up in April 2008 to "direct and coordinate the activities of central and local agencies in carrying out the implementation of the port relocation plan."[59] The land-use planning issue was raised in every meeting of the steering committee during 2008–11. Table 3.5 shows the series of deputy prime ministerial/prime ministerial directives setting deadlines for HCMC to finalize its land-use planning of the city center. However, as each deadline was missed, a new directive was announced setting a new one.

(B) Distorted Incentives for Local Governments

30. The relocation of the HCMC port system poses two major concerns for HCMC authorities. First, logistics firms and other port-supporting businesses will move out of HCMC to be nearer to the new container terminals. Having declared that its future development will rely more heavily on services than on manufacturing, HCMC is keen to maintain its status as the country's center of logistics services.[60] Second, the large revenues from trade taxes generated by imports through HCMC's ports are at risk. In 2010, HCMC collected VND 57 trillion (US$2.8 billion) in export and import duties, accounting for 40 percent of its total budget revenue. And, since 2005, this ratio has been around 40 to 46 percent.[61,62] While it is true that a substantial portion of the trade taxes goes to Ha Noi, HCMC People's Committee relies on using its large trade tax base to keep more tax revenues in the city.

31. The case study shows that most stakeholders are acting in their own self-interest, while the national interest is compromised. Facing the prospect of not being able to control the land after relocation, Sai Gon Port's best strategy is to stay put. At the same time, HCMC has every incentive to proceed

Table 3.5 Timeline of Central Government Directives to HCMC Involving Land-Use Planning

Date	Specific Directive
28 Apr 2008	Port Relocation Steering Committee was established
12 May 2008	First Steering Committee Meeting with the Transport Minister stressed the importance of land-use planning for future inner-city ports
01 Apr 2009	Transport Minister officially requested that the Prime Minister order HCMC People's Committee to approve inner-city port land-use plans *soon*
18 Jun 2009	DPM directive set the land-use planning deadline for *Sept. 2009*
13 Jan 2010	DPM directive set the land-use planning deadline for *Feb. 2010*
10 Aug 2010	DPM directive set the land-use planning deadline for *Q4 2010*
29 Mar 2011	DPM directive set the land-use planning deadline for *June 2011*
29 Mar 2011	PM directive reiterated the land-use planning deadline as *Jun 2011*

Sources: Official documents 219/TB-BCĐ dated 27 May 2008, 1949/BGTVT-KHĐT dated 1 September 2009, 178/TB-VPCP dated 18 June 2009, 11/TB-VPCP dated 13 January 2010, 217/TB-VPCP dated 10 August 2010, 70/TB-VPCP dated 29 March 2011, and 132/TB-VPCP dated 2 June 2011.

58 By law, local government authorities are responsible for preparing, ratifying, and enforcing detailed land-use plans at the 1:2,000 scale. Only with the completion of these land-use plans can investors prepare detailed land-use plans at the 1:500 scale and make investment proposals.

59 Prime Minister's Decision 458/QD-Ttg dated 28 April 2008 establishing the HCMC port relocation steering committee.

60 HCMC People's Committee, Five-year Socio-economic Development Plan 2011–2015.

61 HCMC Statistics Office, HCMC Statistical Yearbook 2010.

62 The total revenue does not include nontax sources such as revenue of crude oil export or transfers.

slowly and cautiously with its detailed land-use planning. The city does not have an alternative revenue stream to replace the loss in trade taxes and fees that would result from relocation of the ports. Their decision, however, is not only delaying the much-needed relocation of the port system from the central business district, but is also resulting in poor utilization of the new port being built in the vicinity, which we discuss next.

IV UNDERUTILIZED PORT! THE CASE OF THE CAI MEP–THI VAI PORT COMPLEX

32. Located in the vicinity of HCMC, the Cai Mep–Thi Vai River in Ba Ria–Vung Tau (BRVT) has been identified as the preferred site for Vietnam's main international gateway port. With a depth of 14 meters and the absence of significant sedimentation, the site could accommodate dedicated deep-sea container terminals to handle post-Panamax vessels[63] for direct shipment to North America and Europe.[64] However, it needs supporting infrastructure, particularly connecting roads, from HCMC.

33. The number of ports planned in the BRVT port complex has gradually increased. In the late 1980s, the Ministry of Transport (MOT) started to look for new port locations in the greater HCMC area. In 1991, Tedi South consultants[65] produced the first study of the Thi Vai–Vung Tau Deepwater Port System, which led to the first master plan of the port complex in 1992.[66] In early 1998, the port master plan was adjusted, regrouping the complex into four port areas and identifying sites for several general cargo and container terminals.[67] In 2001 and 2002, the Japan International Cooperation Agency conducted its Port Development Study in the South, which proposed a plan of general cargo and container ports with moderate capacities in Cai Mep–Thi Vai. Six general cargo berths with 3.3 million to 6 million tons throughput were planned for the Thi Vai section. The 2005 master plan for port development in the Southeast, covering HCMC, Dong Nai, and BRVT, significantly increased the number of ports in the complex. There are now 19 ports in the plan, of which four are dedicated container terminals with 18 berths. As shown in table 3.6, the port has managed to attract some of the best-known port operators in the world, and in all but one, the port terminals' Vietnamese partner is an SOE. In short, the fragmented port ownership structure in the HCMC port group appears to have been replicated in the BRVT port complex.

34. Despite significant investment, the container volume in the port has fallen well short of expectations. The Official Development Assistance project proved to be pivotal in attracting private investors to the location. Within a very short time span—from October 2006 to February 2007—five investment licenses were issued for the development of dedicated container terminals. Domestic port operators in HCMC, under pressure to relocate, were also quick to secure land in the port area. As soon as the terminals were opened, 16 post-Panamax vessels started direct service to the ports. But the container volume has remained abysmally low. As reported by the port operators, actual container throughput was 28 percent of total capacity in 2010 and only 12.9 percent in the first eight months of 2011 (see table 3.6).[68] In May and June 2011, four shipping line services (out of the original 16) were cancelled due to insufficient demand.[69]

63 Panamax is the term used to describe the size limits for ships traveling through the Panama Canal. The term post-Panamax is the term used to describe ships that do not fall within the Panamax sizes.

64 Container terminals in the area can be constructed to receive "mother ships" capable of carrying 8,000 TEU to 10,000 TEU (100,000 DWT to 120,000 DWT).

65 The port unit within Tedi South, which undertook the study, later became the independent Portcoast Consultant Corporation.

66 Decision 55/Ttg of the Prime Minister on the approval of the Master Plan of the Thi Vai–Vung Tau Deepwater Port System, 5 November 1992.

67 Decision 50/Ttg/1998/QD-Ttg of the Prime Minister on the approval of the adjustment and addition to the Master Plan of the Thi Vai–Vung Tau Deepwater Port System, 28 February 1998.

68 Data reported by the ports to the Vietnam Port Association.

69 Cosco, Kline, Yangming, and Hanjin announced the Cai Mep suspension for their Asia-Europe route in May 2011, and CSAV withdrew from its Cai Mep–U.S. West Coast direct route in June 2011.

Table 3.6 Dedicated Container Terminals at BRVT Port Complex						
Terminal	Opening Year	Vietnamese Partner	International Partner	Capacity (mil TEU)		
				Planned	2010	Aug 2011
SP-PSA International Port (SP-PSA)	May 09	Sai Gon Port (Vinalines)	PSA International Port (Singapore)	1.1	0.182	0.114
SP-SSA International Terminal (SSIT)	2012	Sai Gon Port (Vinalines)	SSA Holdings International (U.S.)	1.2	—	—
Cai Mep International Terminal (CMIT)	March 11	Sai Gon Port (Vinalines)	APM Terminals (Denmark)	1.1	—	0.032
Tan Cang–Cai Mep Container Terminal (TCCT)	Jun 09	Sai Gon New Port (People's Navy)	—	0.6	0.295	0.204
Tan Cang–Cai Mep International Terminal (TCIT)	Jan 11	Sai Gon New Port (People's Navy)	Wanhai Lines, MOL and Hanjin Shipping	1.2	—	0.084
Sai Gon International Terminals Vietnam (SITV)	Aug. 10	Sai Gon Investment Construction and Commerce (JSC)	Hutchison Port Holdings (Hong Kong)	1.2	0.025	0.045
Cai Mep International Container Terminal	2013	PMU 85 (MOT)	JBIC (Japanese ODA)	0.75	—	—
Terminal Link Cai Mep (Gemalink)	—	Gemadept	CMA-CGM	1.2	—	—

Sources: Thanh and Pincus 2011.
Note: According to the latest plan, six more container-dedicated and multipurpose terminals will be built.
— = not available

IV.A WHAT EXPLAINS THE UNDERUTILIZATION OF PORT CAPACITY?

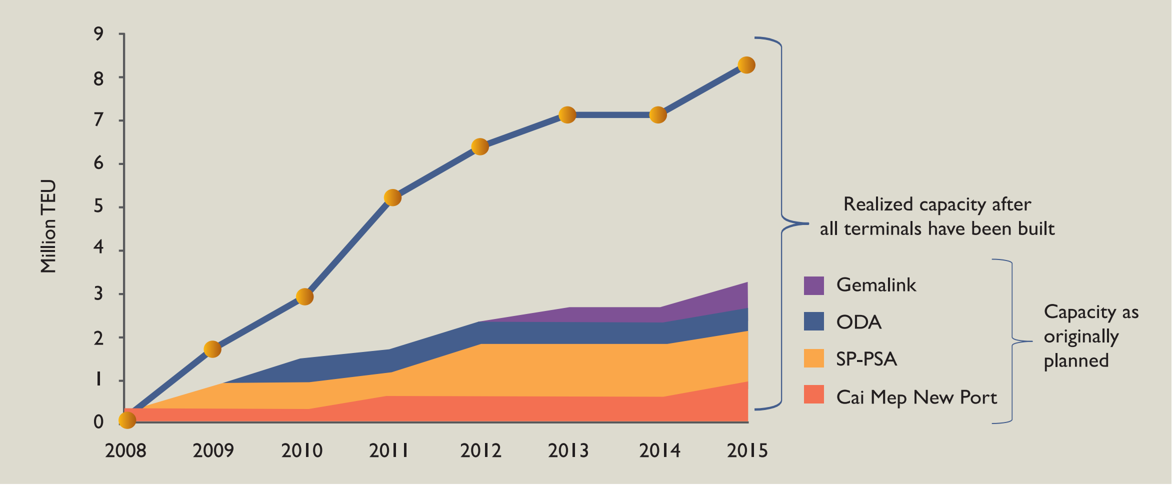
(A) Lack of a Market Mechanism to Foster Competition

35. Critical decisions like total port capacity were continuously altered with little regard to market supply and demand. As the Cai Mep–Thi Vai detailed plan was repeatedly updated, more ports were added and almost all of the harbor-front land was allocated. As illustrated in figure 3.6, the original plan called for four container terminals with a total capacity of only 3.3 million TEU by 2015.[70] Over time, the number of investment licenses granted exceeded the initial plan. By early 2011, the four container terminals under operation (CMIT, SITC, and SP–PSA, TCCT–TCIT) had a combined capacity of 5.2 million TEU (see table 3.5). The construction of SSIT is due to be finished in early 2012, increasing the total capacity of the complex to 6.4 million TEU. The two Official Development Assistance terminals are expected to be completed in 2013. Another joint-venture container terminal between Gemadept and France-based CMA–CGM, which currently has the largest land area and longest berth length, is still under construction.[71]

70 In the final report on the detailed plan made by Portcoast in April 2011, there was only one reserve area left in the entire complex, and this was designated as a maritime services base. In August 2011, when the plan was approved, even this reserve area had been turned into another general cargo port. Therefore, according to the detailed plan of 2011, the Cai Mep–Thi Vai Complex now has 34 ports in total, of which 14 are already under operation, including container terminals, multipurpose terminals, general cargo ports, and specialized ports.

71 A comparison of port capacity at BRVT with Thailand and India illustrates the extent of excess capacity that has been planned in the former. When Thailand started developing its new deep-sea seaport in Laem Chabang to replace the Klong Toey Port in Bangkok in the late 1980s, only one container terminal was built, with a capacity of 0.6 million TEU. Over time, more terminals were added, and the port complex now has seven container terminals and one multipurpose port. It is now ranked 22nd among the world top container ports, and handled 5.2 million TEU in 2010. Nhava Sheva Port, developed to relieve pressure on Mumbai Port in 1989, currently has only three terminals with five berths. It handled 4.3 million TEU in 2010.

Figure 3.4 Development of Container Terminals: Original Planned Capacity Compared to Realized Capacity



Sources: The original plan's capacity is from the Vietnam Maritime Administration (Vinamarine); realized capacity is from table 3.6.

36. The license to develop multiple container terminals was allocated on administrative grounds, divorced from market principles. The government's decision to segment the port into several terminals, and then award development and operation rights to different investors, was justified on both theoretical and practical grounds. The existence of multiple operators would foster competition, which would ensure good services and low costs (World Bank 2007, 24). The problem in this case was not one of not using the market to promote competition. Rather, it is the ability of numerous state agencies and state-owned companies to extract favors from the government, and the absence of coordination among these entities. Unable to achieve greater efficiency, the ports are forced to engage in destructive pricing to survive, particularly in a context of slow growth in world and regional trade. As reported by the Vietnam Port Association, the operators are pricing their services so low that they are unable to cover costs.[72] To generate revenue, some of the container terminals even used their underutilized container terminals for general cargo handling and cruise ship docking (Thanh and Pincus 2011).

72 At the Annual General Meeting of the Vietnam Port Association in September 2011, it was revealed to the media that the service fee charged by the container terminal operators in Cai Mep–Thi Vai to shipping lines was only US$32 per TEU, while the terminals needed to collect US$88 per TEU to break even (*Tuoi Tre Newspaper*, "**Cảng biển lỗ nặng**" (Sea ports suffering heavy losses), 21 September 2011.

(B) Provision for Supporting Infrastructure

37. The problem of capacity underutilization has been exacerbated by the government's failure to complete the necessary supporting infrastructure. The BVRT port complex is 50 km from Bien Hoa, Dong Nai, and 80 km from HCMC. Although the construction of container terminals in BVRT began in early 2007, it was not until late 2009 that the project improving National Highway (NH) 51 was launched. Even when completed, widened NH51 will still be inadequate. The HCMC–Long Thanh–Dau Giay Expressway, which promises to cut travel distances and increase speed, was scheduled to be completed at the end of 2012. However, this will likely be pushed back to late 2013 or early 2014. The Bien Hoa–Vung Tau Expressway also must be started soon to complete the road network. Not only the expressways are behind schedule; so is the connecting infrastructure. Nothing could be more obvious than the need to finish a connecting road between the Cai Mep Port complex and NH51 (so-called Road 965) in time for the operation of the container terminals. As of October 2011, this 8.5-km road was still several months from completion. The existence of many terminals in the complex points to the need to build a high-capacity interport road. This was also recognized by the government and financed by government bonds, but construction has been delayed. A freight rail line between Bien Hoa and Cai Mep–Thi Vai has been proposed, but the economic and financial viability of the project is open to question because of its short distance (less than 80 km).

38. The relocation of the HCMC port group and underutilization of the BVRT port complex are part of the same problem. While only a fraction of the new container terminals boasting state-of-the-art facilities at the BVRT port complex is being used, most of the container cargo remains with existing HCMC ports operated by the same domestic investors. The decision to continue operating ports in HCMC is rational from the perspective of the individual investors, since these ports were profitable even during the slow growth years of 2009–10.[73] However, this is costly from a societal perspective due to negative externalities such as traffic congestion and pollution, which is the opportunity cost of using prime urban land for ports rather than commercial and residential development. If some of the 4 million TEU currently transported through HCMC ports were to be moved to Cai Mep–Thi Vai, the undercapacity problem would be reduced.[74]

V POLICY OPTIONS

39. Vietnam has overstretched its public investment budget by starting too many fragmented, suboptimal infrastructure projects that lack market demand. Fortunately, the government and National Assembly have already started taking several corrective actions in recent months: (i) initiating the process of formulating a new law to improve the legal framework for public investment and public procurement; (ii) tightening the oversight and supervision procedures for existing projects, giving MPI a larger role in screening the projects, especially on the availability of resources (Directive 1792/2011 issued in October 2011); (iii) substantially reducing the level of public investment in SEDP 2011-15; (iv) issuing a Resolution on Land Use Master Plan to 2020 and Land Use Plan to 2015, which aims to tighten the land use for sustainable development, including fix area for rice growing (3.8 million ha now), and list of eight major tasks and solutions that the central and provincial governments have to implement, including: their land use master plans must follow National Assembly's one, clearly identifying the borders of land reserved for different purposes, and publicly releasing the information;[75] and (v) recently putting a ban on approval of new IPs.

40. These steps constitute a good beginning, but more needs to be done, especially putting in place institutions, incentives and information that will ensure repeat of the past problem. In this section we propose four such ideas to strengthen the effectiveness of public investment: (a) clarifying and strengthening property rights to force competition for land into the market and out of the political arena, (b) creating impartial agencies in key sectors to regulate infrastructure development, (c) creating a mechanism to share revenues among local authorities to encourage development of regional and national infrastructure, and (d).strengthening the public investment management cycle.

(A) Clarifying and strengthening property rights

41. Land is the most important asset in Vietnam. Studies in Vietnam have shown that state agencies and SOEs enjoy an advantage over private companies and individuals in gaining control over land. However, even these state entities do not have clearly specified property rights to the land. Land-use rights generally allow use of the land for a specific purpose, such as for residential use, manufacturing, mining, or agriculture. Maintaining control over the land while transferring the right of use from one sector to another is an important means of creating and transferring wealth in Vietnam.

73 After-tax profits of Sai Gon Port and Cat Lai New Port in 2010 were VND 64 billion and VND 73 billion, respectively. (Source: 2010 financial statements of the port companies.)

74 Laem Chabang Port in Thailand took off only when Thai authorities imposed a cap of 1 million TEU on the Klong Toey Port in 1996, so that shipping lines were forced to switch to the new container terminals (ADB 2009, 17).

75 Any adjustment of land use must be reported and get approved by the National Assembly, and the government must report to the National Assembly every year about the implementation of the Land Use Master Plan.

42. Because land-use rights are administrative in nature, the solution to the problem is sought by the government through administrative means rather than through market mechanisms. One way to address the problem is to create an agency that will be responsible for specifying and awarding property rights to businesses and enterprises, starting with the ones involving disputes between state agencies. This needs to be accompanied by (a) allowing more flexibility with land-use planning and letting buyers covert land use after paying an appropriate fee to the state, and (b) creating a market for trading land-use rights among the existing users.[76] This would transform the competition for land from a zero-sum political contest into a market transaction in which the various parties would be compensated for surrendering their control over land. Such a policy will increase the supply of land in the market, resulting in lower prices, and ultimately lower the cost of creating new infrastructure in the country.

(B) Creating impartial regulators for key infrastructure sectors

43. A second cause of institutional fragmentation is the absence of clear boundaries between regulators and market participants, central government ministries and local authorities, and even among units of one agency. Under these conditions, the rules of the game are unclear and unenforceable. The imposition of simple, enforceable rules would go a long way toward reducing fragmentation. This problem could be addressed through the creation of a national or regional Infrastructure Regulatory Authority for key sectors such as the Port Authority of the Southeast, with responsibility for regulating the port system in the region. Many countries have established governmental or quasi-governmental authorities for airports, seaports, and Economic Zones to administer and regulate infrastructure systems that serve more than one province or region (see box 3.3 for the experience of Singapore with the corporatization of its port and creation of the Port Authority). In Vietnam, such regulatory agencies exist, but they often are part of a line ministry, blurring the line between ownership and regulation. Such agencies need to be upgraded to the status of authority, with powers equivalent to those of a central ministry and given sufficient financial resources and operational autonomy. Their main responsibilities would be to approve new projects, set industry standards, create a level playing field to ensure fair competition among operators, protect citizens' interest, and set user fees.

Box 3.3 Maritime and Port Authority of Singapore

The Port of Singapore is a very successful container port and, since 1986, the busiest port in the world in terms of shipping tonnage, most of it containerized transshipment cargo. Singapore was a service port, combining land ownership, statutory functions and cargo operations within one organization, and one of the few successful public service ports in the world. In 1996, however, the Government of Singapore decided to fundamentally change the management structure of the port.

The Government changed the port's structure by creating a corporatized entity (PSA Corporation) whose structure would be sufficiently flexible to permit it to operate and invest in the region, especially in container terminals located on major shipping lanes. Corporatization of part of the Port Authority's business meant increased financial autonomy and generated greater cash flows. It also enhanced Singapore's position as a hub port and was expected to contribute to the economic development of Singapore and the surrounding region.

76 Selling land use certificates is permissible as long as land is used for the same purpose. But such transactions are less frequent and often take place in private. A market along the lines of carbon trading, if created, would lower the transaction cost considerably for the buyers and sellers of land use certificates.

Since the PSA Corporation has a monopoly position in Singapore, it is regulated. The Maritime and Port Authority of Singapore was established by an Act of Parliament (The Maritime and Port Authority of Singapore Act 1996) to provide that oversight. The main tasks of the new Authority are to promote the use, improvement and development of the port, to control vessel movements and ensure navigational safety, to license and regulate marine services and facilities including conventional cargo terminals, and to regulate the port industry's economic behavior. The Act states that no person shall provide marine or port facilities without a public license or exemption from MPA. The Authority may control and fix the tariffs charged by licensees for handling and storage of origin-destination cargo (i.e., non-transshipment cargo).

Sources: World Bank (2009) "Port Reform Tool Kit."

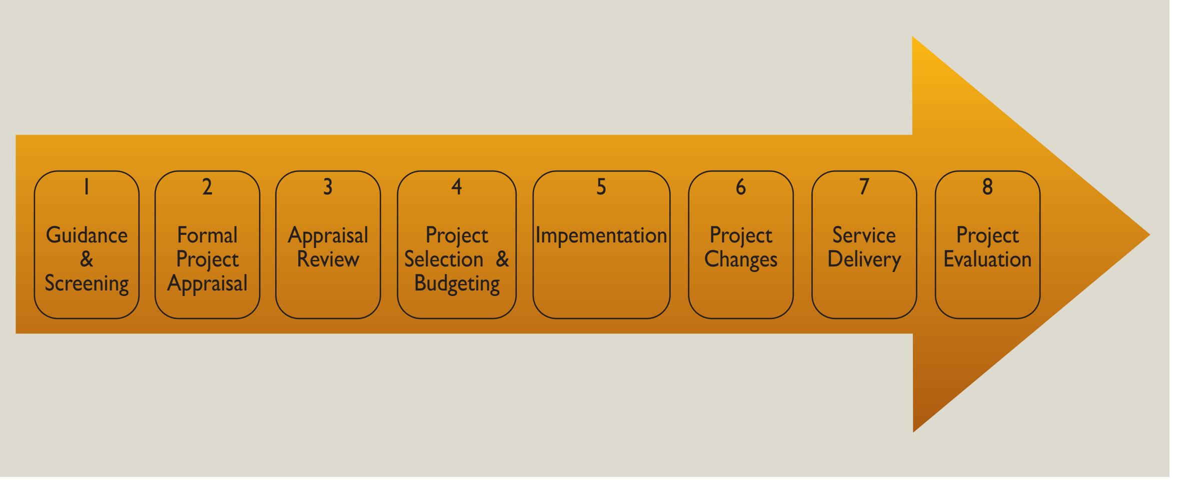
(C) Public finance incentives for regional coordination

44. Many local governments are keen to build infrastructure since it becomes a source of a future revenue stream. The absence of a regional revenue sharing mechanism creates competition among local authorities to attract infrastructure projects to their locality, sometimes at a cost to the national or regional economy. A regional or national Infrastructure Regulatory Authority, if established, would collect relevant taxes from the infrastructure projects and reinvest them in supporting infrastructure to overcome the coordination failure within the government. All revenue not invested in supporting infrastructure would be distributed among the provinces in such a way that it strikes a balance between preserving the provinces' incentive to create infrastructure and reducing unhealthy inter-provincial competition. Similarly, the national government's investment budget allocation should give priority to national projects, followed by those that involve multiple provinces and city administrations, and only then to single-province projects, as a way to encourage local authorities to work together to build infrastructure that enables Vietnam to be globally competitive.

(D) Strengthening the Public Investment Management Cycle

45. A more rigorous public investment management (PIM) cycle, synchronized with the budget process, will help Vietnam avoid approving inefficient and cost-ineffective public investment projects. A typical PIM cycle involves eight stages: (a) strategic guidance and screening, (b) formal project appraisal, (c) appraisal review, (d) project selection and budgeting, (e) implementation, (f) project changes, (g) service delivery, and (h) project evaluation (see figure 3.7).

Figure 3.7 The Eight "Must-Have" Core Public Investment Management Features



Sources: Rajaram et al (2010)

46. In Vietnam, the stages that need strengthening seem to be the initial stages of the PIM cycle, namely, strategic guidance and screening, formal project appraisal, appraisal review, and project selection and budgeting. Local governments and line ministries initiating projects for public investment should prepare a project profile with basic project information, including relevant strategic priority and sub-program or program, specific problem to be addressed, project objective, main activities, expected results, and estimated budget. In addition, it is important at this stage that options for addressing the problem with and without a project are considered, and demand, supply, and gap analysis is undertaken. First-level screening of project proposals should be undertaken to ensure that they meet both the minimum criteria of consistency with the strategic goals of government, and the budget classification tests for inclusion as a project rather than as a recurrent spending item. An appropriate institutional arrangement to ensure that all major project proposals (exceeding, say, VND 1,000 billion, or US$50 million) are screened so that resources are not wasted on more detailed project appraisal. For this function, on occasion, the responsibilities can be delegated to line ministries and local governments.

47. Projects or programs that meet the first screening test should be subject to appraisal of their viability, which requires a feasibility analysis. This requires a regulated set of project preparation steps, such as a pre-feasibility study and a feasibility study, including preliminary design and environmental and social impact assessments that must be completed before a project can be approved for funding. It is always sound practice to subject project appraisals to an independent review. This can be performed by the Ministry of Finance, a planning ministry, or another specialized agency. Finally, it is essential that the process of appraising and selecting public investment projects is linked in an appropriate way to the budget cycle, even though the project evaluation cycle may run on a different timetable. Without adequate skill and manpower in the government, implementing the above steps can be onerous, so its application should be tailored to Vietnam's context and can start with a pilot in one of the key sectors, such as ports.

Chapter 4

FEEDING A MARKET ECONOMY: THE ROLE OF INFORMATION AND TRANSPARENCY[77]

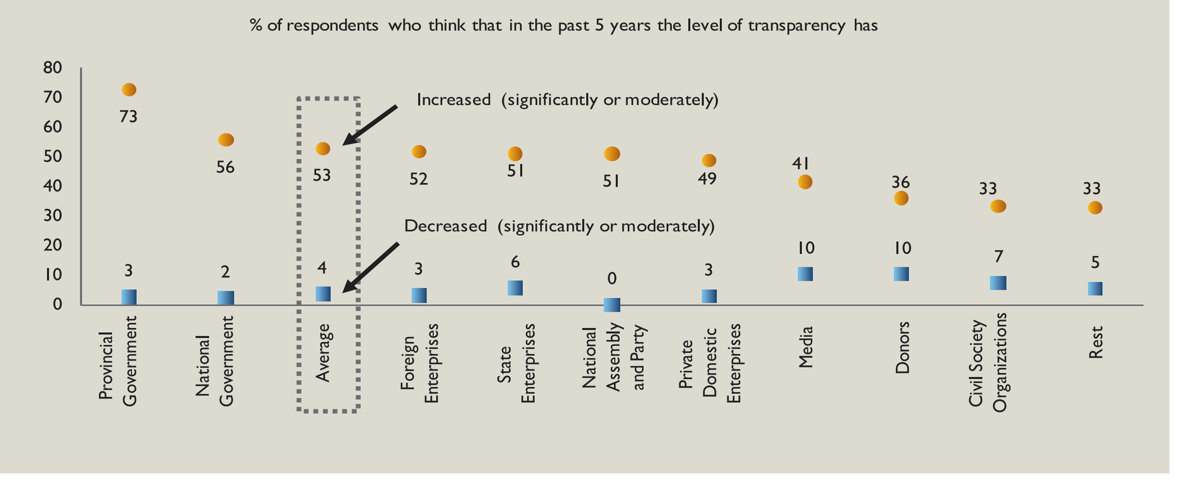
77 This chapter draws on background policy notes prepared by Bill Allan, Nga Nguyet Nguyen and Habib Rab.

I THE CONTEXT

1. **Vietnam has come a long way in the last 15 years in promoting the public availability of economic data and information.** The preparation and release of macroeconomic data in Vietnam has gradually become more systematic. Information available on the State Budget in the public domain has also improved. Increasing numbers of government agencies are using their websites to communicate information.[78] As figure 4.1 shows, most respondents to the World Bank-Vietnam Chamber of Commerce and Industry (VCCI) 2011 survey on "*Changing Attitudes toward Market and State*" (CAMS 2011) agree with such an assessment. Of the 967 respondents, 53 percent felt that the level of transparency has increased in the past five years compared to 4 percent who thought it has decreased. While those affiliated with the provincial and national governments seem to hold a more positive view than those who work in media, the donor community, and civil society organizations, there is little doubt that Vietnam is making progress toward becoming a more open and transparent nation.

2. **However, progress has been slower than expected due to the absence of a generalized law on access to information.** *Vietnam Development Report 2010 – Modern Institutions* catalogued some 30 laws, decrees, and other legal normative documents that call for certain kinds of information to be made public. Yet, many of those provisions have not been implemented. A 2010 study on land transparency found that for some pieces of land-related information, as few as 9 percent of provinces had made the information available, as mandated by law (Nguyen et al. 2010). There were several reasons for the poor implementation of transparency provisions, ranging from organizational culture and poor record keeping, to the simple fact that many officials did not know that the law required that they make the information available. Without a generalized access to information law, which would make access to information the default rather than the rule and would establish monitoring and enforcement mechanisms, there

Figure 4.1 Level of Transparency Has Increased in Vietnam in Recent Years



Sources: CAMS 2011.

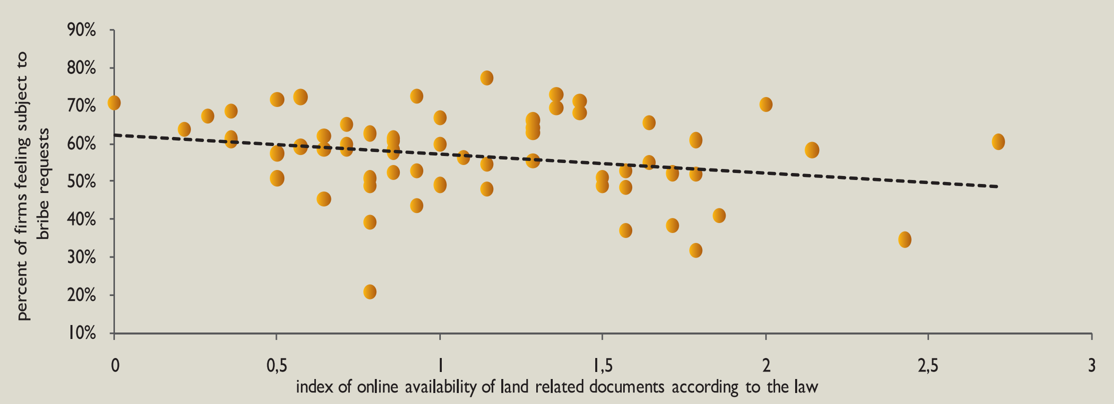
78 See 2010 *Vietnam Development Report* for an in-depth discussion of some of the achievements in promoting transparency across a wide range of public policy areas.

is insufficient motivation for offices and officials to freely provide that information. Indeed, Vietnam's low score (zero) for access to information according to the Global Integrity Index stems directly from the fact that there is no generalized law on access to information in Vietnam.

3. The impact of weak transparency has been costly for Vietnam's development. A 2011 study of corruption in land management (Embassy of Denmark, World Bank, and the Embassy of Sweden 2011) identified lack of transparency as one of the core drivers of corruption in Vietnam, a finding that is borne out by the data. While corruption has many causes, it is clear that provinces with lower levels of transparency when it comes to a range of land-related documents also have, on average, higher levels of corruption (figure 4.2.) The value of information can also be seen from the results of a survey of land officers carried out by the Government Inspectorate: 76 percent of land officers said that a key reason they like their job is that they have early access to information on land (GIRI and T&C Consulting 2010). The same study found that citizens often use intermediaries in dealing with land-related issues, and half of the time the intermediaries are land officials themselves. While the public would gain from freer access to information, there are private benefits to keeping information closely held.

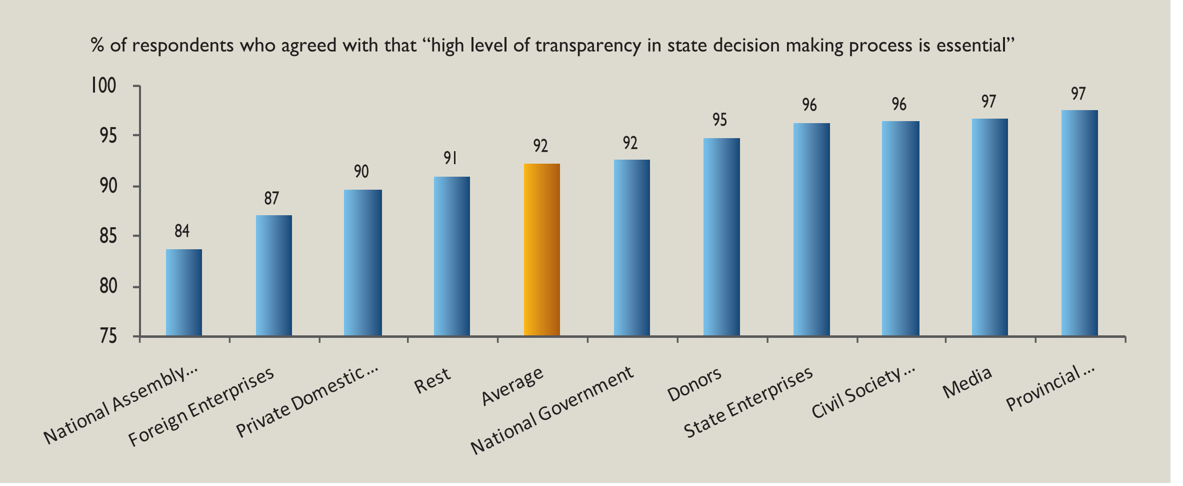
4. Given its current low level of transparency, the marginal benefit to the Vietnamese economy from increased transparency can be huge. The amount of fiscal, financial, and economic information that the Government of Vietnam currently collects and releases to the public is inadequate for the smooth functioning of a middle-income country. Even basic statistics such as sectoral composition of state spending, off-budget expenditure, international reserves, and balance sheets of state-owned enterprises are either not collected, not disclosed, or disclosed only after a considerable lag. But market participants such as equity investors, exporters, importers, foreign exchange dealers, bondholders, banks, enterprises, and even farmers need information on almost a daily basis to operate in a market economy. And if such information is not available, market participants resort to speculation, rumors, and even unscrupulous means to obtain information. That is why it has been argued that one of the sources of the current economic turbulence in Vietnam can be traced to lack of credible and timely availability of economic data and poor communication of policy changes to the market (see *Taking Stock*, various issues). Therefore, in our view, improving transparency is one of the "low-hanging fruit of transition" that has yet to be fully harvested in Vietnam.

Figure 4.2 Provinces with More Transparency Have Lower Levels of Corruption



Sources: PCI 2010; World Bank Land Transparency Database 2010.

Figure 4.3 Overwhelming Support for Transparency in State Decisions-making Process



Sources: CAMS 2011.

5. There is overwhelming support among Vietnamese for increased transparency in the decision-making process. In the World Bank-VCCI 2011 survey on "*Changing Attitudes toward Market and State*" (CAMS 2011), 92 percent of the 967 respondents agreed with the statement that a "high level of transparency in the state decision and policy-making process is essential for development." As shown in figure 4.3, the benefit of transparency for development is widely shared among all sections of the society, including the 84 percent of respondents of the National Assembly and Party and the 97 percent in the media and provincial governments. The survey results indicate that Vietnamese throughout society seem ready to move to a more open and transparent society.

6. This chapter looks at the importance of transparency and focuses specifically on the budget and release of financial information. It provides an overview of the importance of transparency for market economies, particularly the need to ensure the systematic release of economic data to build credibility of and confidence in economic policies. It then looks at the current state of budget and fiscal transparency in Vietnam and ways to improve it. It also examines the information being made available to some of the important stakeholders such as the National Assembly and media and explores ways to strengthen the demand side of information. The final section summarizes several ongoing reforms and key areas of focus to further improve the comprehensiveness, reliability, and timeliness of information, and suggest some next steps.

7. There are several important aspects of information and transparency that are not discussed in this chapter, which constitute a work program for the future. These are: (a) the importance of acting on information once it is made available. The capacity of users to analyze information is currently low in Vietnam and requires strengthening; (b) the role and capacity of the media to effectively and accurately report on information; (c) the role of audits and disclosure of audit reports, although this is briefly discussed in Chapter 2 in relation to reform of the SOEs; (d) some of the transparency issues involving the land market are analyzed in Chapter 3; and (e) the critical issue of why information is not disclosed—an area that requires deeper analysis than was possible while preparing this report.

II THE IMPORTANCE OF TRANSPARENCY FOR MARKET ECONOMIES

8. Information is the lifeblood of markets. The importance of information flows for the functioning of markets has been well documented (Stigler 1961; Stiglitz and Weiss 1981, among others). Improvements in information can reduce the magnitude and consequences of principal-agent problems, leading to more efficiency in the allocation of resources in economic and financial markets.

9. Public disclosure of information can mitigate market inefficiencies. Transparency reduces market uncertainty about policy makers' preferences, resulting in more predictable monetary policy and more efficient financial markets (Bellver and Kaufmann 2005). Lack of transparency in policy making and limiting disclosure of information that otherwise helps to set rational expectations, adversely impacts asset prices, consumption, and investment, increasing the risk of investment. This translates into higher risk premiums and thereby the cost of investments. Public disclosure of information can, therefore, mitigate market inefficiencies and provide easier access to capital markets and better terms for government financing. This is highly relevant in Vietnam's context: despite its high growth rate and strong economic fundamentals, it consistently receives lower sovereign ratings and faces higher risk premia in the international market than countries that exhibit similar characteristics (see figure 4.4). A more transparent regime would help Vietnam mobilize significantly higher resources in the international market and at a much lower cost than currently.

10. Transparency and accountability can also play a big role in reducing macroeconomic instability. The economic crises of the late 1990s and early 2000s in emerging market and transition economies were in part caused by a lack of transparency (Rahman 1998). Mehrez and Kaufmann (1999) show that an increase in transparency of fiscal and monetary policy or macroeconomic data reduces the probability of a crisis following financial liberalization. These provide a strong impetus for establishing international standards for fiscal, financial, and monetary transparency as a means of both strengthening the international financial architecture and enhancing individual country performance.[79] Improved transparency in a number of East Asian and Latin American countries has enabled them to manage the current global economic crisis from a position of relative strength. Vietnamese policymakers saw first-hand the benefit of transparency when the State Bank of Vietnam in 2008 made its international reserves position known to the market, thereby significantly reducing the speculative pressure against its currency.

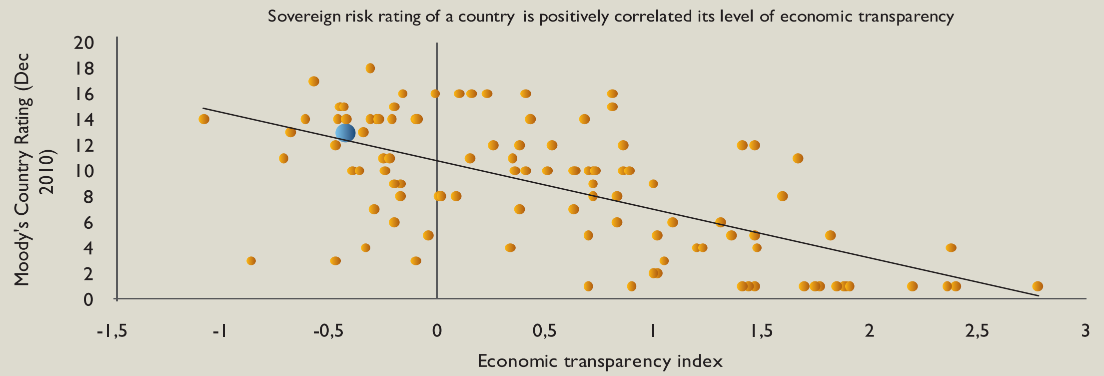
11. Cross-country evidence on the benefits of fiscal transparency is growing. Good transparency practices, as defined in the IMF Fiscal Transparency Code, should confer direct benefits to countries by giving them greater access to capital markets and lowering debt servicing costs. Published fiscal Reports on Observance of Standards and Codes data provide some evidence to support this view. Hameed (2005) showed that countries that were more transparent according to these indexes had better credit ratings, better fiscal discipline, and less corruption after allowing for other socioeconomic variables. In a study that focused particularly on disclosure of fiscal risks, Cebotari et al. (2009) find that countries improving disclosure of fiscal risks on all four disclosure attributes could improve credit ratings by a significant margin.

12. More transparent countries also seem to be more competitive in the global market. A more transparent institutional environment can contribute to higher rates of return on investments. When policies and administrative procedures that guide investment decisions are clear and transparent, uncertainty and business costs are lower, leading to more efficient investment decisions. Figure 4.4 shows that the global competitiveness index published by the World Economic Forum for 104 countries is strongly correlated with the overall transparency index constructed by Bellver and Kaufmann (2005).

79 The Standards and Codes Initiative was launched in 1999 by the IMF, the World Bank, the Organization for Economic Co-operation and Development, and other international financial organizations. Under the Standards and Codes Initiative, the IMF aimed to promote fiscal, monetary, and statistical standards among its member countries in line with its surveillance mandate.

80 The Fiscal Transparency Code was produced in 1998, and the Code and the Manual on Fiscal Transparency were published in 2001 and updated in 2007. Country compliance has been assessed through fiscal transparency modules of the Reports on Observance of Standards and Codes. See http://www.imf.org/external/np/sec/pn/2011/pn1138.htm for updated Board review.

Figure 4.4 Transparency and Competitiveness Are Positively Correlated



Sources: Bellver and Kaufmann 2005; World Economic Forum 2004.

III FISCAL TRANSPARENCY IN VIETNAM

13. Fiscal transparency plays a particularly critical role in Vietnam's economic transition, given the public sector's relatively big role in the economy. Fiscal management reforms initiated in the late 1990s have enabled the government to take important steps toward international standards for fiscal transparency. Early reforms were based on technical advice, initially from a joint IMF-World Bank review in 1999 (IMF-World Bank 1999), a Public Expenditure Review in 2004 (GoV and World Bank 2004), and then a Country Financial Accountability Assessment in 2007 (GoV and World Bank 2008). Recognizing that it started from a very low base against international Public Financial Management (PFM) standards, the government has approached the application of these standards cautiously and within its own institutional context.

14. Fiscal management in Vietnam has become more complex. The evolution of the PFM system has involved a great deal more than establishing a stable, transparent, and accountable national PFM system. As described in *Vietnam Development Report 2010,* institutional development has emphasized increasing reliance on market mechanisms and, more recently, devolution of authority not only to economic actors but to lower levels of government, service delivery units, the courts, and the media and civil society. The pace of PFM reform thus needs to be assessed in the context of these objectives, some of which are complementary but others of which are potentially competitive. A realistic PFM reform strategy must take into account links between PFM reform and other relevant national objectives as explicitly as possible.

III.A CURRENT STATUS

15. The government has made a good start in establishing the legal and institutional framework for fiscal transparency. The State Budget Law (2002), which came into effect in 2004, stipulates that "budget plans, budget final accounts, and auditing results of the central budget, local budget, budget planners, and organizations financed by state budget, must be made public." While the government is planning to amend the State Budget Law (2002) in the coming period to address a number of pending issues, the law does provide clarity on transparency issues. The government further broadened and deepened the scope of financial disclosure requirements through a Prime Ministerial Decision (192) and guiding circulars issued between 2004 and 2006.[81] The institutional framework is clear on who is responsible for

81 PM's Decision 192/2004/QD-TTg, November 16, 2004, and guiding circulars 03, 10, 19, 21, 29 (2005) and 54 (2006), Ministry of Finance.

reporting what information, including reporting formats and frequency. Although the quality of reporting varies, the 2007 Country Financial Accountability Assessment noted good compliance with reporting requirements across all agencies and units.

16. Information available on the State Budget in the public domain has improved. The State Budget is published on the Ministry of Finance website just before the start of the fiscal year; it presents the economic background and shows key budget aggregates but not details. The website also publishes summary quarterly budget execution reports, which include information on spending at the central, provincial, and district level, and estimated revenue collection.[82] Audited financial statements are published within 18 months of the end of the fiscal year.

17. Vietnam's State Budget has a detailed classification structure, but it has yet to systematically publish information using the Government Finance Statistics standards.[83] The budget released to the public is presented at a relatively aggregate level by functional and administrative categories, not economic categories, although it is broken down by central and subnational governments. Budget execution reports provide detailed reports on spending across economic, functional, and program categories. The absence of a clear connection between budgeting and accounting data makes it difficult to assess the execution of budget policies in detail. The government has, however, integrated the Chart of Accounts for budget and treasury, and is upgrading its Management Information Systems, which should help strengthen accounting and reporting.

18. With increased decentralization in recent years, the transparency of intergovernmental fiscal relations has gradually been strengthened. Expenditure and revenue assignments across all four tiers of government (center, province, district, and commune) are clearly set out in the State Budget Law (2002). The Provincial People's Councils also have the authority to decide on specific tax assignments at the subnational level. To promote equitable distribution of resources, the Prime Minister issued Decisions 59 and 60 in 2010 with allocation norms based on socioeconomic criteria for the transfer of resources from the national to subnational governments. There are detailed provisions on reporting requirements for spending and revenue mobilization at all levels of government. The State Treasury is responsible for compiling and publishing all budget execution reports. While the State Budget Law defines the role of the National Assembly, given it limited oversight role, supplementary budgets (e.g. recent stimulus package) are not approved by the National Assembly. As discussed later, strengthening the capacity of National Assembly to fulfill its oversight role for domestic accountability is an important issue for Vietnam.

II. B AREAS IN NEED OF GREATER ATTENTION

19. Greater compliance with fiscal transparency principles could further improve fiscal management and analysis. The budget already embodies a number of transparency improvements; for example, carryovers from underspending in the previous fiscal year are reported in budget outturn data and included in the next year's budget. Some important management issues that could be better addressed by applying the principles of the fiscal transparency code are as follows:

- The *separation of the capital and recurrent budgets* makes it difficult to estimate medium-term recurrent implications of capital spending and to establish a sound long-term balance between the creation of public assets and their operations and maintenance.

- A number of *off-budget expenditures* are not accounted for in the aggregate budget or deficit calculations. For instance, there are over 20

82 See http://www.mof.gov.vn/portal/page/portal/mof_en/sbd?p_pers_id=2421305&p_recurrent_new_id=24736364

82 The IMF's "Government Finance Statistics Manual 2001" is an internationally accepted methodology for compiling fiscal data. It provides "economic and accounting principles to be used in compiling the statistics and guidelines for the presentation of fiscal statistics within an analytic framework that includes appropriate balancing items".

extra-budgetary funds that carry out government functions in infrastructure, social sectors, SOE restructuring and other areas. But their non-inclusion in the budget makes it difficult to obtain a consolidated picture of fiscal risks.

- With regard to *assessment of broader fiscal risks,* although there are detailed provisions on financial reporting by state enterprises,[84] the capacity to analyze this information and inform government responses is still limited.

- As one would expect with such *high levels of decentralization,* the quality of reporting is mixed. Sector agencies at each tier of government provide regular financial reports to the Treasury Office at that level of government, which are then aggregated up through the Treasury structures. A formal requirement for upward financial reporting within sectors should facilitate setting priorities on sector resource allocation.

20. Improved data quality through technical reforms should allow much more openness in the release of detailed budget data. For example, even though Vietnam's Open Budget Index score has increased in recent years, it remains very low at 14 out of 100 in the most recent Open Budget Survey.[85] Areas where Vietnam falls particularly short in relation to the Open Budget Index include publication of the Pre-Budget Statement and the Executive Budget Proposal, and preparation of A Citizens' Budget Mid-Year Review. As discussed above, however, if the data are improved to give a reliable fiscal and financial picture, publication of data should present few risks. In the case of Open Budget Index criteria, Vietnam can make important gains at little cost through publication of the Pre-Budget Statement and the Executive Budget Proposal.

21. The government is implementing PFM reforms to address these challenges and to further improve the comprehensiveness, reliability, and timeliness of fiscal information.

84 PM Decision 224/2006/QD-TTG (October 6, 2006) and Circular 115/2007/TT-BTC (September 25, 2007) on supervision and assessment of SOE performance.
85 Open Budget Index 2010: Vietnam.

These reform measures are set out in the government's PFM Single Strategy Document approved in early 2008 for the period through end-2010. An updated Financial Development Strategy is being finalized for 2011–20. Examples of important reforms to improve fiscal transparency include:

- *Treasury and Budget Management Information System:* This is an integrated computerized financial management information system. It will be rolled out to all budget units across the government so that there is a common system for loading budget appropriations, standardized budget execution procedures, and standardized accounting and reporting arrangements. This will be a major step toward ensuring a more timely and reliable picture of the government's budget and budget implementation.

- *International Public Sector Accounting Standards:* Although an accounting law was passed in 2004, the accounting system across the government is quite fragmented. A new State Accounting General System is being developed, and a roadmap is being prepared for the adoption of International Public Sector Accounting Standards. This should improve the accuracy and integrity of accounting and reporting.

- *Disclosure of public debt information:* On April 27, 2011, the government issued Decree 53 expanding the scope of the Debt Bulletin, which at present covers only external debt. It will now include actual borrowing and debt service payments and annual projections of borrowing and debt-servicing flows for the central government including guarantees, subnationals, on-lending, and total public and private external debt.

- *Monitoring State Enterprises:* The government has stepped up its efforts to monitor the performance of state enterprises through independent audits and stricter enforcement of financial reporting to the Ministry of Finance. The Ministry is now looking to take stock of the financial situation of state enterprises, establish a database to report financial information, develop indicators of financial vulnerability and fiscal risk, train staff to compile and analyze these indicators; and publish reports on the Ministry of Finance website. The indicators will be set out in a law to be issued by the Prime Minister.

22. Another area that needs improvement is strengthening the capacity of the oversight institutions. Transparency is key to developing the oversight systems. Even those officially entrusted with oversight duties, such as the National Assembly, lament that they often do not have the information they need to do their jobs. Ironically, they also feel they have too much information. The need to strengthen the system of support staff and research institutions under the National Assembly, noted in Vietnam Development Report 2010 - Modern Institutions - remains true now that a new National Assembly has been elected. At the same time, oversight bodies would have potentially millions of allies in sorting through information if it were made publicly available. Civil society organizations, the media, and citizens can be adept at managing such tasks including monitoring public investment and developing a score card for basic service providers, if the information is available to them.

IV FASTER AND FAIRER ACCESS TO INFORMATION[86]

23. A transparent and rules-based system for releasing macroeconomic data across government can help minimize market volatility and economic shocks. Ensuring predictability by controlling when and how data are released helps to set and manage expectations. A state agency that releases economic data at fixed times and in fixed formats projects an image of credibility and reliability. Numbers released in an ad-hoc fashion or leaked by unidentified sources fuel speculation and create uncertainty. Being systematic about releasing data is also a good way to help ensure that the information is kept secure until the government wants it to be made public, and reduces the likelihood of mistakes and confusion.

24. The release of macroeconomic data in Vietnam has gradually become more systematic. Most agencies use their websites to communicate information. The State Bank of Vietnam provides regular and timely information on exchange rate adjustments on a daily basis. However, the publication of interest rate decisions is less predictable now than it was a year ago. The Ministry of Finance systematically announces weekly bond auctions. Release of Consumer Price Index (CPI) data by the Government Statistics Office provides another good example. The data are e-mailed to the foreign media with a 30-minute embargo time. This allows reporters sufficient time to prepare stories, which are released at the same time to the market. In theory, there is a penalty for breaking the embargo. More recently, the Government Statistics Office has started e-mailing the CPI data with a 10-minute embargo prior to publication on its website, but this leaves less time for reporters to prepare their analysis.

25. Further improvement of the predictability of macroeconomic data release by key agencies in Vietnam could easily be achieved, and with a beneficial impact. The release of much other economic information is on a more ad-hoc basis and does not follow a set timetable. The Office of the Government uses its website to communicate economic information. It holds a monthly press conference attended by local media. The Government Statistics Office could also take steps to further strengthen the way it releases CPI data by (a) fixing the time and day of the month when the information is released (currently, it takes place during the same week each month), and (b) preventing leaks to the local media ahead of the official release.

26. A range of options is available to strengthen the arrangements for sharing macroeconomic data. At one extreme, agencies can adopt "lockup" arrangements where data are shared electronically with journalists behind closed doors with no external communication allowed until a specified time. A variation on this would be to have a simple in-room embargo controlled by officials who hand out hard copies of data reports simultaneously to all journalists present, who then communicate the information

86 This section was prepared with assistance from Reuters news agency.

to their offices by phone for publication. Other agencies electronically communicate information at a fixed time by e-mail, fax, or through their websites, which is a predictable and low-cost way of sharing economic information. The preferred method will, of course, vary according to the type of information and market sensitivity. The key, however, is to ensure that the information flows are systematic, equitable, and transparent (see box 4.1).

Box 4.1 Different Ways to Release Data to the Mass Media

The U.S. Department of Labor's "Lockup" System

This system is the most air-tight method for releasing data. In a lockup, journalists are invited to the government agency, locked in a room with the data, and only allowed to communicate with the outside world at a predetermined time, after the embargo time. Here's how the system works at the U.S. Department of Labor.

In the lockup room, each news outfit has an assigned desk with a permanent company computer. Journalists are allowed to arrive a few minutes before the data release to set up their system. Then the door is closed, nobody is allowed in or out, and the reporters are required to switch off their mobile phones and hand them in. Internet connections to the computers in the room are cut by a master switch controlled by a Department of Labor official and then a press release and CD containing the data are distributed.

The journalists have a half hour to prepare their stories and the department has at least one economist on hand to answer questions. When the embargo time has expired, the labor department official flips the Internet switch back on and everyone is allowed to send their news story.

In some cases, agencies do not control the Internet connection or the use of personal phones in a lockup, but they enforce the embargo with the threat of a severe penalty for breaking it. (A few years ago, a news agency broke an embargo at the Federal Reserve in Washington and that agency was banned from receiving embargoed data for six months.) A modification of the lockup is a simple in-room embargo controlled by officials.

Simultaneous Physical Delivery of Data (Australia and the Philippines)

At the Australian Statistics Office in the mid-1990s, for instance, journalists in a designated press room were allowed to call an editor and keep the phone line open ahead of the end of the embargo, and then when the embargo expired, an official standing behind them handed over the data report. The Philippines uses this method today, passing reporters hard copies of the information simultaneously and considering it live.

This method is secure in that it ensures that the data are never in the hands of anyone other than an official until it is allowed to go public, and thus reduces the risk of leaks. On the downside, though, releases like this are highly stressful for the reporters involved. Reporters are under pressure to locate the key data in the report as quickly as possible and then read it over the phone to a colleague who will publish it instantly.

By email, fax, and website

Many government agencies around the world e-mail or fax data at a fixed time with no embargo. This increases predictability, because the information reaches the market at roughly the same time each month. However, it, too, leaves reporters scrambling to pluck out the key numbers. Moreover, emails do not always land in inboxes simultaneously, which may disadvantage one or more of the journalists reporting the information.

Some government offices post information on their website at regular times or hold press conferences at set times each month with no embargo. This is predictable (and better than doing so randomly), but, again, forces reporters to scramble, which can lead to errors.

V | CONCLUSION

27. Vietnam has made steady progress on transparency in the last 10 years, but further advances in transparency should confer significant benefits for economic management. A clear commitment by the Government of Vietnam to provide more economic information more systematically, more in depth, and in a fast and fair manner would both help address some key macroeconomic challenges facing the country and send strong signals to the financial markets. Explaining the rationale for key policy changes through regular press briefings by professional spokesperson will also help. Providing more information to the public in an easily understood form would gain support for government reform program and improve market perceptions. For example, addressing hidden fiscal risks associated with state-owned enterprises is of direct benefit to policy making, will lead to a more sustainable fiscal policy and greater public support for such reforms.

28. Ongoing reforms should further strengthen fiscal transparency. More sophisticated information is needed today to accurately assess the government's financial position than 10 years ago. Some of the examples highlighted above target high-priority areas for transparency in Vietnam, including public debt and state enterprises. A genuine commitment to reform (and practical ownership) should involve development of a clear strategy to improve objectively assessed good practice standards while giving priority to addressing basic weaknesses and environmental factors specific to the country system.

29. The Financial Development Strategy (2011-20) offers a real opportunity to regain momentum on the PFM reform agenda in general, and fiscal transparency in particular. As the PFM landscape becomes increasingly complex, it will be important set clear priorities for transparency, including managing competing objectives around: (a) devolution of authority; (b) application of technical controls and assurance of data quality by all levels of government; (c) increasing openness and distribution of fiscal data to the public and the international community; (d) increasing public participation in the budget process; and (e) establishing strong, independent and open oversight of PFM processes. As evidenced in other transition economies, careful sequencing of these measures can have major payoffs in terms of the cost of borrowing and access to financial markets; fiscal discipline and macroeconomic stability, and the efficiency of spending and the quality of public service delivery.

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