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The Role of the State in Viet Nam's Economic Development

ENHANCING THE ROLE OF THE STATE IN FACILITATING A MORE COMPETITIVE AND PRODUCTIVE ECONOMY

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CONTENTS

LIST OF ABBREVIATIONS

ADB	Asian Development Bank
ASEAN	Association of Southeast Asian Nations
APD	Academy for Policy and Development
CIEM	Central Institute for Economic Management
CLM	Cambodia - Laos - Myanmar
CPV	Communist Party of Vietnam
CSOs	Civil Society Organizations
DSI	Development Strategy Institute
GDP	Gross of Domestic Product
GoV	Government of Vietnam
IBNET	International Benchmarking Network of Water & Sanitation Utilities
IMF	International Monetary Fund
MOIT	Ministry of Industry and Trade
MOET	Ministry of Education and Training
MOH	Ministry of Health
MOF	Ministry of Finance
MOLISA	Ministry of Labour – Invalids and Social Affairs
MONRE	Ministry of Natural Resources and the Environment
MPER	Master Plan on Economic Restructuring
MPI	Ministry of Planning and Investment
NCIF	National Centre for Socio-economic Information and Forecasting
NPLs	Non-performing loans
NFSC	National Financial Supervisory Commission
NGO	Non-Government Organization
OECD	Organization for Economic Cooperation and Development
PPP	Public-Private Partnership
PSP	Public Service Provider
PSU	Public Service Unit
SBV	State Bank of Vietnam
SDGs	Sustainable Development Goals
SEDP	Socio-Economic Development Plan
SOEs	State Owned Enterprises
VBSP	Vietnam Bank for Social Policies
VDB	Vietnam Development Bank
VIDS	Vietnam Institute for Development Strategy
WB	World Bank
WEF	World Economic Forum
WTO	World Trade Organization

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Raymond Mallon (Economist) provided advisory support and helped to compile this consolidated report.

EXECUTIVE SUMMARY

Report Background and Objectives

This report synthesises key messages from four thematic studies undertaken by Ministry of Planning and Investment (MPI) institutes on the role of the state in Viet Nam's economic development. The thematic studies were inputs to preparation of the Government of Viet Nam's (GoV) Socio-economic Development Plan 2016-2020, and the Viet Nam 2035 report. This report aims to translate the key messages from the thematic studies into options for action to facilitate implementation of policy directions provided by the SEDP. Specific report objectives are to:

- Provide a synthesis of current evidence and debates about the most appropriate role of the state in key areas of the Vietnamese economy.
- Identify areas where there is evidence of a need to strengthen the role of the state in Vietnamese socio-economic development, and to highlight other areas where there is potential to reduce state intervention.
- Identify those areas where further policy experimentation and adaptation are needed to define a role for the state that is appropriate to the specific needs and aspirations of the Vietnamese people.
- Suggest priority short to medium-term reform actions to ensure that the state plays a more effective role in Viet Nam's development.

Rethinking the Role of the State in Viet Nam's Development

Throughout the *Đổi Mới* period there has been a persistent (and still unresolved) debate about the role of the state in Viet Nam's development. It has been repeatedly stated that the state must play a "leading role" in the economy, with differing, and conflicting, interpretations of what a "leading role" implies. This debate has been used by some to justify preserving a dominant state role in business activity. Ongoing ambiguity about the role of the state has caused confusion, policy uncertainty and instability, and provided unproductive opportunities for corruption and encouraged "rent-seeking" behaviour, slowing socio-economic development.

Most economists and policy makers recognize that the state has a pivotal role to play in a competitive market economy, by being an effective regulator and facilitator, in correcting market failures, in providing a level playing field for all businesses and individuals, and in facilitating the provisions of essential public services and infrastructure. Viet Nam's future success in rapidly transitioning to a high-income country will depend on the state being restructured to more effectively facilitate Viet Nam's socio economic development. The issue is not whether the state or the market is better, but rather how best to design institutional arrangements to ensure that the state and market complement each other to achieve core GoV objectives.

While important lessons can be learned from international and national experiences, there is no single "best model" that could be applied to Viet Nam. Policy makers will need to continue to monitor and adapt systems and institutions to meet Viet Nam specific needs. However, international experience does suggest that the capacity of the state needs to be strengthened to better support the development of inclusive market economy institutions and to facilitate the development of factor markets. And as state capacity (financial and human resources) is limited, greater effort is needed to ensure that resources are directed to highest priority areas and issues.

Main Conclusions from the Thematic Studies

The thematic reports identify specific areas where state role needs to be strengthened (e.g., planning, standards, enforcement, developing market institutions and factor markets, and monitoring and oversight), and other areas where the role of the state needs to be reduced or streamlined (e.g., commercial activity, and administrative procedures). The state should not be a substitute for the private sector where markets are, or can, function effectively or where contestability can be realized. In some critical areas (e.g. targeting vulnerable groups, improving regulatory quality and enforcement, building independent regulators, and community participation in planning and oversight), further experimentation is needed to identify the best options for enhancing state effectiveness.

Another key message is that "changing mind-sets" will be critical to successful implementation of reforms. Vietnamese business leaders, researchers, and policymakers will need to work together to develop medium-term strategies for formulating, "marketing", and implementing reforms. They need to consult broadly and proactively to identify constraints to development and to build the evidence base for reform. The mass media and society need to become more involved in reviewing and monitoring progress and advocating for change.

The state needs to strengthen market institutions and state capacity to effectively regulate the market economy. Development of factor markets (land, labour and capital) are urgent priorities. There is need to build and develop more effective regulators in key areas, including competition, financial and capital markets, network industries, education and health standards, and food safety, and to build capacity to improve regulatory quality to ensure that national regulatory objectives are achieved in the most efficient manner. Policy makers need to be mindful of opportunities to minimize the regulatory burden on business when assessing the costs and benefits of regulation. Consideration should be given for periodic public inquiries into problematic industries and sectors to identify barriers to competition and productivity growth. Some form of annual reporting on regulatory quality and attempts to reduce regulatory costs could help increase the pressure to improve regulatory quality.

International experience shows that very different models for state delivery of essential public services (education, health and basic infrastructure) and public infrastructure can deliver successful and equitable outcomes. Many countries have achieved good outcomes with relatively strong direct state involvement in the provision of public services and infrastructure. Policy makers need to study, and recognize the plusses and minuses of each model, and adapt preferred models to the practical realities in Viet Nam. Ongoing monitoring, learning and adaptation should be an important element of efforts to build state capacity to provide public services and infrastructure.

While the state continues to struggle to provide essential services and infrastructure to disadvantaged groups, the demand for higher quality public services is increasing with a quickly growing middle class. Viet Nam public resources will be insufficient to cover the increasing costs of higher quality infrastructure and services. Private resources will need to be mobilized to cover some of these costs. The state should seek opportunities to empower poor people by stimulating competition between public service providers (PSPs), while also ensuring quality standards. However, the state should continue to subsidize the provision of public services and infrastructure to the most vulnerable groups in society and to the most disadvantaged regions.

There are new opportunities to innovate in the way that the state facilitates development. Information technology, independent regulators, private PSPs, and social enterprises provide options to improve state efficiency and effectiveness. In some cases, it may be more effective and efficient to subsidize the poor to pay PSPs, rather than directly subsiding the PSPs. The state could also develop autonomous units – accountable to local communities -- to provide essential and basic public services to local communities in areas where it is not feasible to attract privately owned (PSPs). This report identifies innovations to providing public services that could be piloted and adopted in Viet Nam.

Unbundling of public utilities, and increased use of performance benchmarking, has the potential to increase competition and efficiency. The state needs to play a more pro-active role in establishing, monitoring and enforcing national quality standards for public infrastructure and public service delivery (e.g. for roads, power, education, health, vocational skills, and water quality). Operators should not be allowed to engage in anti competitive conduct against the public interest. The focus of state oversight should be on promoting fair, transparent and open competition that drives improvements in the quality, and cost effectiveness, of public infrastructure services.

Increased transparency and openness, and stronger state engagement with civil society -- including ensuring that citizens have opportunities to provide input and comment on all planning, budgeting, implementation and monitoring and evaluation processes at all levels of government -- are needed to improve accountability. More independent state backed regulators and oversight institutions (that have no interests in commercial activity) will play a key role in strengthening transparency and accountability, and in building a more competitive economy. Greater mass media and public involvement in policy design, in reviewing and monitoring progress in implementing reform initiatives, and in advocating for changes in reform directions when necessary, could also build broader support for reform and help the state to implement a more effective reform program.

INTRODUCTION

Viet Nam's Ministry of Planning and Investment (MPI) requested technical support from the World Bank (WB) to undertake a research project on institutional reform to provide analytical inputs for Viet Nam's Socio-Economic Development Plan (SEDP) 2016-20, the joint Government of Viet Nam (GoV)/WB Viet Nam 2035 report, and to develop actions plans to reform the role of the State in facilitating socio-economic development. The MPI research teams, with WB support, produced background papers on the role of Vietnamese state in four areas: the financial system, state investment, the provision of public services, and logistics and public utilities.

This report synthesises the main themes from these studies with a particular focus on the enabling role of the state in Viet Nam's market economy. A key aim of this report is to translate the key messages from the thematic reports into actions that will facilitate implementation of the policy directions and guidance provided in the SEDP and other strategic planning documents[1]. While (CIEM, 2016) notes that the state plays a critical role in three areas: political, social and economic, the focus of this report is on the role of the state in the economy and economic development.

Specific report objectives are to:

- Provide a synthesis of current evidence and thinking about the most appropriate role of the state in key areas of the Vietnamese economy.
- Describe areas where there is evidence of the need to strengthen the role of the state in Vietnamese socio-economic development, and to highlight other areas where there is need to reduce state intervention.
- Identify those areas where further policy experimentation and adaptation are needed to define a role for the state that is appropriate to the specific needs and aspirations of the Vietnamese people.
- Suggest priority short to medium-term reform actions to ensure that the state plays a more effective role in Viet Nam's development.

Context: Viet Nam's Aspirations for 2035

Despite remarkable socio-economic achievements since "Đổi Mới" (renovation) policy was launched in 1986, Viet Nam continues to face many development challenges. Average per capita income remains well below national aspirations[2]. Productivity growth has slowed in recent years, pressing social and environmental problems remain, inequities persist, and economic institutions and governance remains weak. The SEDP (2016-2020) warns that Viet Nam must adapt more quickly and effectively to global opportunities and challenges if it is to avoid continuing to lag behind other successful regional economies.

[1] In particular, (i) CPV (2016) Political Resolution of the 12th Party Congress: (ii) WB/MPI (2016) Viet Nam 2035, and: (iii) GoV (2016) Socio-Economic Development Plan (SEDP) for 2016-2020.

[2] E.g., as defined in SEDP 2016-2020.

The political resolution of the 12th Party Congress (2016) identified innovation of the growth model and "perfecting the market economy" as two key tasks for period to 2020. The resolution states that "*The socialist-oriented market economy of Viet Nam includes many forms of ownership, many economic sectors, with the private sector an important driving force the economy; the market plays the major role in mobilizing and effectively allocating resources for development; the state plays the role in orientation, building and perfecting the economic institutions for fair, transparent and healthy competition.*" The resolution gives priority to completing the transition to a socialist oriented market economy, and that a "*fully-fledged, modern and integrated market economy with diversified ownership -- operating fully and efficiently in accordance with the rules of a market economy -- has to be developed and perfected*". The resolution highlights the need for institutional reforms to strengthen state management of a market oriented market economy, noting that *"many provisions in the legal system, mechanisms, policies and management and administration have not fully complied with the rules of market economy, especially in the allocation of resources, management of prices of goods and essential services and ensuring fair competition".*[3]

Viet Nam 2035[4], a 2016 joint GoV/WB report, identifies aspirations for Viet Nam to be a *"moderately prosperous society, at the upper reaches of upper middle income, by 2035*" (see Box 1). Its more mature market economy will be private sector-led, competitive, and intensively integrated with the global economy. The domestic private sector would benefit from strong and modern market institutions that will ensure free and fair competition, security of all forms of private property rights, and competitive and transparent land and capital markets. There will be relatively few State Owned Enterprises (SOEs). All corporations, private and public, will face a level playing field and be subject to universally enforced global good practice corporate governance regulations. Modern industries and a knowledge-based economy will thrive in an efficient and well-connected network of modern cities that encourages learning, innovation, and new product development, connecting people and firms to the world.

[3] CPV (2016) 12th Party Congress Documents.

[4] WB/MPI. 2016. Viet Nam 2035.

Box 1. Viet Nam 2035: Aspirations

- A prosperous society that will be at the upper reaches of upper-middle-income status. Its market economy will be private sector–led, competitive, and intensively integrated with the global economy. Modern industries and a knowledge-based economy, housed in an efficient and well-connected network of modern cities, will drive growth.
- A modern, creative, and democratic society will be the driving force for future development. The emphasis will be on creating an open and free environment that promotes learning and innovation for all citizens, who will be guaranteed equal access to development opportunities and the freedom to pursue their vocations, while fulfilling their responsibilities without compromising national and communal interests.
- A rule-of-law state will be effective and accountable. It will clarify the relationship between the state and the citizenry and between state and market. It will perform its basic functions effectively, including developing and enforcing legislation; managing international relations; ensuring public safety and national security; and ensuring that markets function freely while addressing market failures. It will develop strong social institutions to ensure that the power belongs to the Vietnamese citizens and protect their right of pursuing creativity. It will develop clear lines of responsibilities between the legislative, judiciary, and executive branches for adequate checks and balances on the government.
- The National Assembly will comprise fulltime deputies with the technical capacity and institutional autonomy to represent the sovereign people, exercise oversight over the executive, and pass quality legislation. The judiciary will similarly be suitably positioned, with autonomy and strong capacity to resolve disputes in a more diverse society and economy. The executive will be well integrated horizontally and vertically, with clear functions for central and subnational authorities.
- A civilized society will make every citizen and every political and social organization (the entire political system) equal before the law. Underpinning this will be robust, diverse people's social organizations that can exercise fundamental rights, including the people's direct democratic rights and the rights to information and association.
- A responsible member of the global community of nations will build global alliances and fulfil global responsibilities for peace and security while proactively seeking regional and global opportunities for economic integration.
- A sustainable environment will protect the quality of Vietnam's air, land, and water. It will build climate resilience into economic planning, social policy, and infrastructure investments to reduce the most severe risks posed by climate change. It will develop diverse, clean, and secure energy sources.

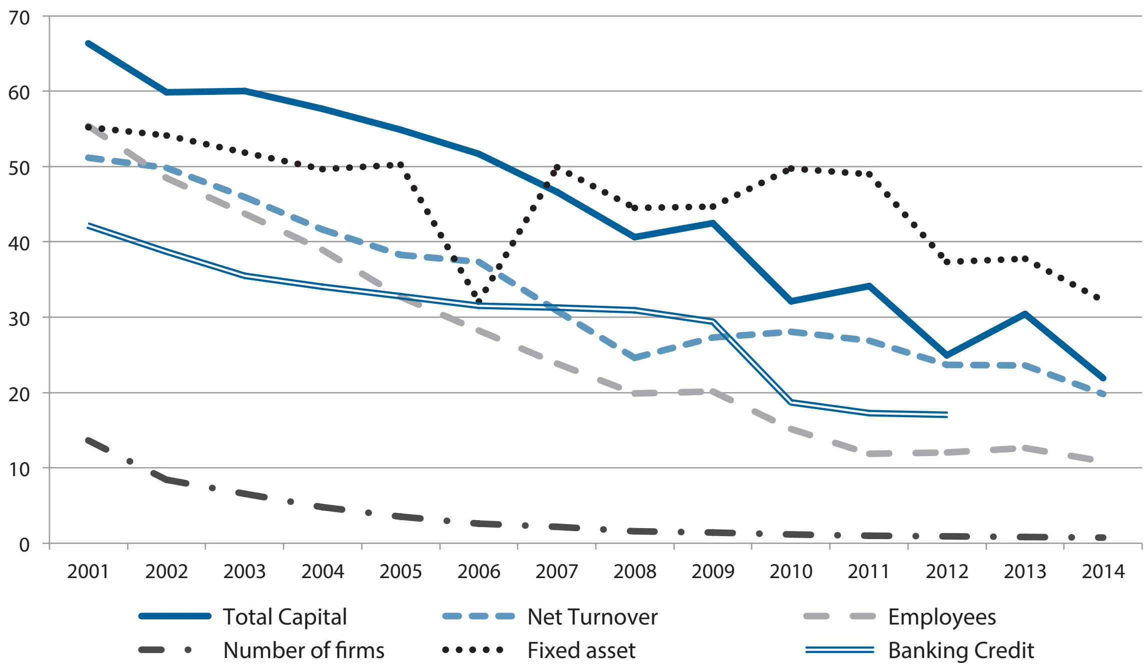
Source: WB/MPI. 2016. Viet Nam 2035.

Role of the State in Viet Nam's Development

While this report focus on weaknesses in state capacity, it is important to recognize that the Vietnamese state has been effective in some areas. Key outcomes in delivering education, health, power, rural roads, rural electrification, water supply and sanitation services have been impressive[5]. Per capita incomes have increased dramatically since *Đổi Mới*. Most importantly, state initiatives have contributed to a remarkable fall in poverty: from nearly 2/3 of all household living in poverty (subsisting on USD 1.25/day) in 1993, to only about 2 percent of households in 2015.

Nevertheless, recent declines in productivity growth are a concern. Poor public investment efficiency is a key contributor to slow productivity growth. Fragmentation (horizontally and vertically) of state power, has resulted in too many small, scattered and overlapping public investment projects. Poor public sector investment efficiency has been compounded by weak governance of public agencies and state enterprises and pervasive corruption. Poorly performing SOEs seek preferential treatment to protect them from fair market competition. With inefficient public investment and distorted market incentives, private sector productivity growth has suffered. Recognizing the generally poor performance of Vietnamese SOEs, the state has introduced reforms that have steadily reduced the number of SOEs and the share of resources allocated to SOEs. Consequently, the SOE share of GDP and employment have declined in recent decades as shown in Figure 1.

Figure 1: Share of SOEs in selected indicators (%)



Source: WB/MPI Viet Nam 2035: Private Sector Development

[5] See WB/MPI. 2016. Viet Nam 2035 and Pincus. 2015.

CIEM (2016) notes that policy makers are acutely aware that Viet Nam remains behind regional best practices in developing a state apparatus that effectively facilitates business, employment and economic growth. Recognizing this gap, the Government has developed annual reform initiatives (Resolution 19) since 2014 specifically aimed at reducing gaps with regional benchmarks[6].

There are also concerns about the capacity of the state to respond quickly to the changing social and market demands for public services, and the scope for using new technology to provide better services more efficiently. For example, the state has been slow to adapt training to meet the new skills needed in an increasingly sophisticated economy, and has been slow to respond to opportunities to use technology to streamline and improve the accountability of state agencies.

A Growing Consensus on the Need to Change the Role of the State

Throughout the *Đổi Mới* period there has been a persistent (and still unresolved) debate about the role of the state. There has been a continuing insistence that the state should play a "leading role" in the economy, with differing and conflicting interpretations as to what a "leading role" implies. This prolonged ideological debate has slowed the economic transition and socio-economic development. The ongoing debate has been used by some to justify preserving a dominant state role in commercial business activity. There has been a perception that "*the dogma disease is still prevalent, there is still impartial thinking, irrationality, fear of innovation; innovation thinking is not resolute and strong*"[7].

Most economists agree that the state has an important role to play in a functioning modern market-economy system (with the private sector at its core), by being an effective regulator and facilitator, correcting market failures, and in providing a level playing field for all businesses and individuals. Viet Nam's future socio-economic success will depend on progress in transforming the state to play a more effective role in facilitating the development of a modern internationally competitive economy. In some areas, the state role needs strengthening, especially in developing market economy institutions and facilitating the development of factor markets. In other areas state intervention needs to reduced, most notably in commercial business activities. There are other areas where further experimentation is needed to identify the most appropriate role for the state in Viet Nam's development.

A vision of the role of the state in socio-economic development is included in the Viet Nam 2035 report:

- An effective and accountable *rule-of-law state* will be in place well before 2035. The country's governance structure will clarify the relationship between the state and the citizenry, and between the state and market. The state will perform its basic functions effectively, through a well-organized government structure (both at the centre and locally) and a strong, meritocratic bureaucracy.
- An effective Vietnamese state will also apply market rationality to economic

[6] CIEM (2016).

[7] Luong Xuan Quy. 2015. "New Thinking on socio-economic development of Viet Nam in the new context"

policymaking. State–market relations will be characterized by a clearer division between public and private spheres. Government agencies involved in economic regulation will not engage in business of any kind. The state's role in the economy will focus on providing a level playing field in the economy, with enforcement of free and fair competition and more secure and transparent property rights, particularly around land issues.

- The state will develop strong institutions to ensure that the power belongs to the Vietnamese citizens with clear lines of responsibilities between the legislative, judiciary, and executive branches for adequate checks and balances on the government.
- The National Assembly will have the capacity and autonomy to represent Vietnamese citizens, exercise oversight over the executive, and pass quality legislation. The judiciary will have the autonomy and capacity needed to resolve disputes in a more diverse economy.
- Every citizen and every political and social organization are equal before the law.

Lessons from International Experience

Two core lessons from international experience are: (i) the need to be clear and focussed about the rationale and criteria for deciding when and how the State should intervene in the economy, and (ii) the critical importance of effective state governance mechanisms in ensuring efficient and equitable outcomes from state investments. These lessons are discussed in more detail below.

Economic Rationale for State Intervention in the Economy

International experience shows that strong state administrative and organizational capacity is directly related to growth in economic output and incomes, improved delivery of public services, and poverty reduction. Effective states are more likely to formulate and implement policies, institutions and regulations (including protection of property rights) that are consistently applied to reduce investment risks and provide equitable access to economic opportunities. Effective states are also likely to use public resources more efficiently and effectively to deliver essential public services and infrastructure[8].

However, there is no definitive answers about what model is the most appropriate role for the state in a market economy, or about what economic institutions will be most likely to deliver outcomes in line with national objectives. International and national evidence presented in the thematic studies strongly suggests areas where the state should play a critical role, and other areas where state intervention is likely to be counterproductive. In yet other areas, there is mixed experiences and evidence about the most appropriate form and level of state intervention[9]. While market failure and equity concerns provide a rationale for government intervention, there is no guarantee that state interventions will benefit society.

The thematic studies also highlighted the importance of state intervention in Viet Nam to address income inequalities (e.g. via taxation and social service payments). The studies also

[8] See CIEM. 2016. See Pincus. 2015." Viet Nam: Building Capacity in a Fragmented, Commercialized State", for a review of the international literature.

[9] This view was expressed to varying degrees in all thematic reports for this study.

argued that the state may also need to intervene in Viet Nam to address rigidities in factor markets to facilitate structural adjustment. CIEM (2016) highlighted particular concerns with respect to bottlenecks in land, labour and capital markets where state intervention is required to facilitate the emergence of more liquid, transparent and competitive factor markets.

Drawing on international experiences, the WB (2007) identified the potential rationale for state intervention as shown in Box 2. The CIEM (2016) thematic study suggests similar rational for state intervention in Viet Nam.

In summary, the issue is not whether the state or the market is better, but rather how best to design institutional arrangements to ensure that the state and market complement each other to achieve core GoV objectives of sustained strong economic growth, human development, equitable outcomes, and environmental protection[10]. A guiding principle is that **the state should only intervene in the economy when markets are not efficient and/or are not equitable, and when the intervention would improve efficiency and/or equity**. The first condition for state intervention is clear evidence of market failure. The second condition is that the state intervention will lead to an improvement in outcomes. This will depend on how significant the failure is and on the public sector's ability to design and implement an effective intervention[11].

[10] CIEM. 2016.

[11] GLA. 2006. "The rationale for public sector intervention in the economy." https://www.london.gov.uk/sites/default/files/gla_migrate_files_destination/rationale_for_public_sector_intervention.pdf

Box 2: Economic rationale for state intervention and some definitions

Market failure refers to the set of conditions under which a market economy fails to allocate resources efficiently. There are many sources of market failure and many degrees of failure. The implications for the role of the state and the form of public intervention can be quite different in each case.

Public goods are goods that are non-rival (consumption by one user does not reduce the supply available for others) and non-excludable (users cannot be prevented from consuming the good). These characteristics make it infeasible to charge for the consumption of public goods, and therefore private suppliers will lack the incentive to supply them. National public goods, such as defence, benefit an entire country; local public goods, such as rural roads, benefit a smaller area. Private goods are those that are both rival and excludable, common property goods are non-excludable but rival (an example is groundwater irrigation), and club goods are non-rival but excludable (examples are interurban highways and toll roads).

Externalities arise when the actions of one person or firm hurt or benefit others without that person or firm paying or receiving compensation. Pollution is an example of a negative externality, which imposes uncompensated costs on society; the broader benefit to society at large of a literate population is a positive externality of primary education. Governments can curb negative and promote positive externalities through regulation, taxation or subsidy, or outright provision.

A *natural monopoly* occurs when the unit cost of providing a good or service to an additional user declines over a wide range of output, reducing or eliminating the scope for competition. But left to operate freely, monopoly providers can restrict output to increase prices and profits. Governments have addressed this problem by regulating private monopolists or providing the good or service themselves. Changes in technology have created new scope for competition in services once considered natural monopolies, such as telecommunications and power generation.

Incomplete markets and imperfect or asymmetric information are pervasive problems and can result in inefficient outcomes. Markets are incomplete whenever they fail to provide a good or service even though the cost would be less than what individuals are willing to pay. Imperfect information on the part of consumers can lead to systematic undervaluation of some services, such as primary education or preventive health care. *Asymmetry of information* when suppliers know more than consumers, or vice versa can lead to excessive or supplier-induced demand, for example in the provision of medical care. Problems of adverse selection and moral hazard can lead to the failure of insurance markets. *Adverse selection* occurs when buyers of a service tend to impose higher-than-average costs on the service provider, or when sellers are able to exclude such high-cost customers. Health insurance provides an example: those who are more likely to need care are more likely to buy insurance, and more likely to be turned down by insurers. *Moral hazard* is present when persons carrying insurance have an incentive to cause or allow the insured-against event to happen. An example is the tendency of health care consumers to seek, as well as providers to provide, more treatment than they need when a third party, the insurer, is paying most of the cost. Governments have sought to address these problems by ensuring widespread coverage and holding down costs. They have done this by either regulating private insurance, financing or mandating social insurance, or providing health care themselves.

Equity may prompt state intervention even in the absence of market failure. Competitive markets may distribute income in socially unacceptable ways. Persons with few assets may be left with insufficient resources to achieve acceptable living standards. Government action may be required to protect the vulnerable.

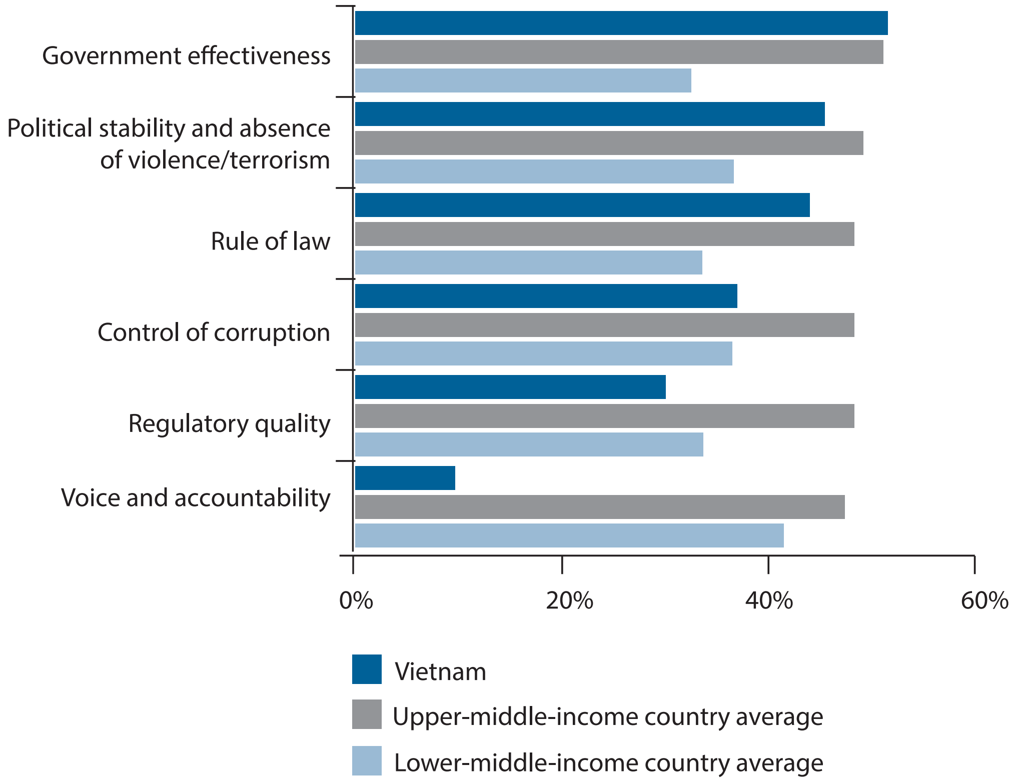
Source: WB. 2007. World Development Report (p.327).

Role of State Governance in Promoting Inclusive Economic Development

The OECD (2016) emphasizes the critical role of public sector governance in promoting inclusive growth (Box 3). Public governance can be thought of as the system of strategic processes and tools, as well as the institutions, rules and interactions for effective policy making. Public governance can strengthen or undermine the impact of economic policies aimed at inclusive growth via its impact on the quality of public spending and investment and the efficiency of service delivery. Governance failures can lead to widespread informality in the labour market, and limit access to education or to formal safety nets, such as unemployment and health insurance, all of which are drivers of inequalities.

From a global comparative perspective, Viet Nam performs well in terms of government effectiveness, political stability and absence of violence, rule of law, but performs poorly in terms of voice and accountability, regulatory quality, and control of corruption (Figure 2.). Addressing these weaknesses and further improved in government effectiveness remain important priorities. Renewed reform efforts will be essential if Viet Nam is to succeed in shifting to a new model of growth based on increased efficiency and productivity. Such a shift in focus will be essential if Viet Nam is to succeed in becoming a higher income country.

Figure 2: Global Governance Indicators



Source: World Bank, Worldwide Governance Indicators, www.govindicators.org.
Note: The Worldwide Governance Indicators (WGI) are a dataset summarizing the views of a large number of enterprises, citizens, and expert survey respondents in industrial and developing countries on the quality of governance. The WGI does not reflect the official views of the World Bank, its Executive Directors, or the countries they represent.

Box 3. Governance matters for achieving inclusive growth

There is a broad consensus, supported by evidence, that good governance is vital for a number of key outcomes at the national and subnational levels, including social cohesion, public expenditure efficiency and control of corruption. In addition, governance matters for achieving sustainable, inclusive economic growth. Coase (1960) argues that good institutions, such as strong property rights, reduce transaction costs and consequently support economic development. Similarly, North (1991) contends that institutions that strengthen contract enforcement are necessary to economic development. More recently, Rodrik, Subramanian and Trebbi (2004) empirically find that the quality of institutions is more important for growth than geography or trade. Other scholars (e.g. Acemoglu and Robinson, 2008) argue that institutions, including an efficient public sector and absence of corruption, are the fundamental drivers of economic growth.

Governance also matters for inclusiveness. Inclusive institutions ensure that markets are functional and open to competition, and allow for broad citizen participation, pluralism and an effective system of checks and balances, leading to better access to services and opportunity. In that respect, cross-country evidence shows that inclusive governance can improve development outcomes, such as better literacy and health, or lower infant mortality (e.g. Halperin, Siegle and Weinstein, 2010: Evans and Ferguson, 2013). Rajkumar and Swaroop (2002) also find that, for example, corruption disproportionately denies the poor access to education and health services.

Public governance is an essential lever for high-impact public spending, which in turn enhances the potential of economic policies aimed at inclusive growth. For example, stakeholder engagement and consultation can help identify needs and preferences, better targeting government programmes and increasing efficiency. Public governance also affects the quality and efficiency of public investment. In this respect, strengthening inclusive institutions has a great potential to enhance citizen participation, provide better public services, reduce transaction costs, and – ultimately – reduce inequalities while promoting economic growth.

Last, but not least, governance matters for well-being. People are more satisfied with their lives in countries having better governance quality. More importantly, actual changes in governance quality (understood as the way in which policies are designed and delivered) lead to large changes in the quality of life. Changes in average life evaluations in 157 countries over the 2005-12 period can be explained just as much by changes in governance quality as by changes in GDP, even though some of the well-being benefits of better governance are delivered through increases in economic efficiency and hence GDP per capita. The well-being payoff of improved governance in that period can be compared to a 40% increase in per capita incomes (OECD, 2014d).

Source: OECD. 2016.

Building State Capacity to Facilitate Economic Development

In addition to "catching up" economically, Vietnamese aspires to build modern institutions and the rule of law; a healthy, secure, learned, creative and equitable society; and an effective state accountable for the material and social welfare of its citizens. Viet Nam has also signed up to the United Nations Sustainable Development Goals (SDGs).

Despite improvements over the last three decades, there continues to be a large gap between state reform aspirations, and actual implementation. Vietnamese state institutions are commercialized and fragmented, which adversely impacts the state's effectiveness and economic efficiency. Mechanisms for ensuring accountability of public institutions and the delivery of public services to the country's citizens are still underdeveloped. Environmental problems are worsening and gaps in access to opportunities may be widening[12].

Party and Government documents[13] recognize that major challenges to sustaining growth in productivity, incomes and employment include: planning and implementing reforms to transform the role of the state to reflect the needs of a modern market economy, and; developing the inclusive economic institutions needed for a competitive market economy. Despite increasingly strong pronouncements about the need for change, implementation has proven difficult, partly because of decentralized power structures[14] and resistance to change from vested interests, but also because of varied views amongst policy makers about the most appropriate role of the state in a modern, market oriented, economy that is closely integrated with international markets and global production networks.

Building Consensus on Reforming the Role of the State

A recent VCCI survey[15] shows that there is broad based support for a market economy with private ownership. This provides a strong foundation for future reforms. While there is a growing consensus about the need for a strong, but less interventionist, state role in Viet Nam's economic development, and an often-stated commitment to transitioning to a *socialist oriented market economy*, there has been conflicting understanding as to what a *socialist oriented market economy* entails. Some vested interests use the "*socialist oriented*" element of the above definition to justify unproductive state intervention in the economy. Future reforms to the role of the state will face even greater resistance from increasingly sophisticated interest groups that may lose from reforms.

CIEM (2016) argues that the 12th Party Congress helped clarify the role of the state and the market with the following statement:

> *"The market plays the main role in mobilizing and allocating resources for development, is the main driver for liberating productive forces; state resources will be allocated based on strategies, masterplans, and other plans in line with the market mechanism. The state plays a role in orientating and adjusting the economy, facilitating business activity, protecting the environment, ensuring social improvement, and ensuring equality in development policies."*

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[12] WB/MPI. 2016. Viet Nam 2035

[13] E.g. SEDP 2016-2020, Resolution of the 12 Party Congress, and the MPER (2013-2020). As discussed in CIEM (2016), Resolutions 19 (2014, 2015 and 2016) are concrete examples of Government action to change the role of the State towards "*facilitating – rather than controlling – business investment, by simplifying government regulatory and administrative processes, using ASEAN-6 and ASEAN-4 indicators as benchmarks*".

[14] Pincus, 2015, "Viet Nam: Building Capacity in a Fragmented, Commercialized State", Viet Nam 2035 Background Paper, 7 September 2015.

[15] VCCI. 2015. As cited in CIEM, 2016.

A clearer consensus amongst national leaders and policymakers and the leaders of business and civil society organizations, about the priority needs to accelerate Viet Nam's transition to a socialist oriented market economy, would facilitate implementation of reforms. Ambiguity could be reduced if leaders more explicitly stated that socialist orientation refers to a strong state focus on ensuring equitable access to social, political and economic opportunities, while avoiding (unproductive) state intervention in markets and business activities. Repeated high-level, and unambiguous, endorsement of the following core principles could help counter resistance to change by vested interests.

- All people -- irrespective of gender, ethnicity, and location of birth or family origins -- must have equality of opportunity to succeed in employment and/or in business.
- The state plays a leading role in guiding national development via macroeconomic management, the development of market economy institutions, ensuring effective and efficient delivery of public services and infrastructure, and by budget transfers to ensure that all people have equitable access to social and economic opportunities.
- The state will gradually withdraw from all commercial business activities that can be efficiently and effectively undertaken by the non-state sector.
- The non-state sector drives economic growth and job creation, and will be pivotal to sustained progress in reducing poverty and raising living standards.
- Competitive markets play the leading role in guiding resource allocation. The development of competitive factor markets is a critical element of the national development strategy.
- State success in building inclusive and efficient institutions is critical to realizing sustainable and equitable economic outcomes. Priority will be given to identifying and addressing barriers that impede equitable access to economic opportunities, and strengthening state capacity to effectively regulate to ensure a level and competitive playing field for all individuals (regardless of ethnicity and gender) and all businesses.
- The state is accountable to the population for effective, efficient and equitable provision of public services and infrastructure. With community participation, the state will monitor and evaluate state effectiveness, and be prepared to adapt institutions and policies in response to national and international experiences.

Political leaders and policy makers require close, frank, and interactive channels to interact with business leaders, technocrats and researchers to identify practical constraints to development, and to build the evidence base on the need for reform[16]. Vietnamese business leaders, researchers, policymakers, and technocrats are expected to continue playing a major role in guiding the reform process, working together to formulate, "market", and implement reforms. Greater mass media and public involvement in informing policy design, in reviewing and monitoring progress in implementing reform initiatives, and in advocating for changes in reform directions when necessary, should also build broader support for reform and help the state to implement a more effective reform program.

[16] Experience with Enterprise Law related reforms provides a model for successful use of this approach. The Government established a Task Force (of technocrats and researchers) for Enterprise Law Enforcement, with brought positive results in accelerating implementation.

SUMMARY FINDINGS FROM THEMATIC BACKGROUND PAPERS

National Investment[17]

International Experiences

State directed public investment is a feature of all market economies. Arguments given for public investment are that the potential benefits from the state investing in areas where the private sector is unable or lacks the incentive to invest, or for the state to otherwise correct for market failure. Areas where most states invest to facilitate economic development include: (i) macroeconomic management; (ii) provision of public services (education, health, water supply, sanitation, environment, etc.); (iii) provision of public infrastructure (roads, telecommunications, power, disaster protection); (iv) national defence and internal security; (v) protection of property rights; (vi) correcting market failures (competition policy, standards, safeguards, etc.); (vii) ensuring equitable access to economic opportunities (thereby promoting greater competition and productivity).

Most such state investments are linked to promoting increased and more efficient equitable private investment. Some states also invest directly in commercial activity, especially where there is potential for high economic rents (e.g. exploitation of natural resources and international trade). However, international evidence suggests that such state investment is both inefficient and distorts the allocation of national resources away from areas of greatest comparative advantage[18]. Studies on the impact of public investment on private investment is mixed but there is evidence from Asia[19] that excessive levels of public investment can crowd out private investment and contribute to macroeconomic instability.

A series of studies[20] have shown that public investment is positively correlated with economic growth. While public investment is generally seen as an essential element for socio-economic development, some international studies (e.g. Gosh and Gregoriou (2007)) have found inverse relationships between public investment and economic growth in some developing countries, due to inefficient resource allocation and corruption.

Technological changes are changing the areas where the state is seen as having to play a major role. For example, telecommunications in most countries is now largely privately financed, as is an increasing share of investments in power supply and distribution, airports, seaports, highways, and water supply. The mix of state and private financing of health and education also varies greatly between countries, but most countries use state financial resources to ensure that their populations have access to at least basic preventative health care and education.

Globally, the ratio of public investment to GDP had been trending downwards since the 1980s,

[17] This section draws heavily on CIEM (2016).

[18] CIEM (2016).

[19] E.g., Balassa (1998),

[20] E.g., World Bank (2007), Growth and Development Committee (2008), and Arslanlap (2011).

but with signs of an increase in recent years. The level of public investment to GDP declined in many emerging Southeast Asian countries until 2014, as private investment (mostly in the form of private public partnerships (PPPs)) supplemented public investment in infrastructure. This is consistent with trends in OECD countries, where the private sector is financing increasing shares of economic infrastructure (communications, energy, transport and water supply). CIEM (2016) reports that the level of PPP investment has reached 5% of GDP in transition and developing countries. As the private share of public infrastructure financing has increased, the share of total public investment being allocated to public services (such as education, health and other social services) have increased[21].

Another global trend has been the decentralization of an increasing share of investment to local governments, especially in developed and transition economies. Successful implementation of decentralized investment requires adequate subnational planning, implementation and financial management capacity, and systems to ensure that sub-national implementing agencies are accountable to community stakeholders. Partly because of limited subnational capacity and governance structures, many less developed countries still rely on the central government for most public investment.

There has also been an increasing trend to implement medium-term planning and budget processes (such as South Korea's medium term expenditure framework (MTEF)) with the aim of ensuring that public investment is directed to areas offering the highest returns. Very different countries (e.g., Brazil, Korea, Uganda, United Kingdom, Ireland and China) have established central level public investment and planning oversight agencies with responsibilities to provide strategic directions for public investment and to ensure that public investment resources are better targeted and used more efficiently. Successful countries (e.g. South Korea) typically assign central planning agencies a critical role in ensuring rigorous appraisal of the feasibility of large scale public investment projects. Systems are also designed to review and take action when project implementation deviates substantially from the approved design and costing[22]. While centralizing overall strategic planning and oversight, most countries still decentralize many of the details of implementation to subnational governments and business entities, and subnational governance structures contribute to overall central level oversight.

The shares of SOEs in public investment vary greatly between countries, and large SOE shares can be found in developed, transition and less developed countries. Recent OECD[23] and WB studies[24] have found that the role of SOEs has been maintained, or even increased in high, middle, and low income countries. SOEs now rank amongst the world's largest companies, investors, and actors in global capital markets. However, many rapidly growing economies have substantially reduced the role of SOEs in basic industries and services. China, in particular has drastically reduced the share of SOE investment in labour intensive industries and services since the late 1990s.

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[21] CIEM (2016).

[22] CIEM (2016, Box 2).

[23] OECD (2015). State-Owned Enterprises in the Development Process.

[24] WB (2014), Corporate Governance of State Owned Enterprises: A Toolkit.

OECD (2015, pp 34-35) argues that the potential contribution of SOEs in promoting economic (and other) development depends on several factors, including:

- The state needs to be backed by a competent bureaucracy that is empowered to exercise the ownership function effectively, reward success and punish failure.
- The developmental objectives need to be clearly spelt out and not interspersed with social policy objectives. A main source of inefficiency in strategic SOEs has been political demands that they act as "employer of last instance".
- The areas in which SOEs are expected to operate should be free of concentrations of commercial, financial and other market powers.
- The usefulness of SOEs usually diminishes, as a country becomes more developed. SOEs are generally less efficient than comparable private companies.

The OECD (2005) also stresses the state needs to establish a clear and consistent ownership policy for its investments in business activity, and ensure that SOEs are governed in a transparent and accountable manner. This implies a need for clear performance indicators and professional management, with best practice corporate governance arrangements.

Summary of Lessons from International Experience for Vietnamese Policy Makers

- Due to limited resources and limited capacity, the state should limit its role to a narrow set of activities that cannot be undertaken by the private sector. Excessive fragmentation of public investment undermines the efficiency of such investments.
- Effective use of state investment can play a role in stimulating equitable socio-economic development, but only if carefully targeted and directed, and used efficiently.
- Public investment needs to be focussed on developing high priority public infrastructure and services (e.g., education, health). Opportunities for public private partnerships (PPPs) should be explored to reduce the burden on limited public resources.
- Strengthening state capacity to prioritize, plan, appraise, monitor and implement major public investment projects is critical to improving public investment efficiency. The state should evaluate all potential alternatives to identify the optimal investment, including options to attract private investment as an alternative to public investment.
- Effective governance structures are needed to ensure that public agencies and officials (and those responsible for PPPs) are held accountable to stakeholders.
- Getting the right balance between national and sub-national public investment will help in targeting public investment and ensuring greater accountability.
- New technology is providing opportunities to: (i) improve the accountability of public investment and (ii) substitute private for public investment in infrastructure and services.
- While there may be a continuing role for a limited number of SOEs to provide essential public infrastructure and/or services, national investment efficiency will be enhanced if the state implements strategies to reduce SOE numbers and investment levels.

- Clear criteria and decision making authority need to be established monitoring SOE performance and for making decisions regarding SOEs liquidation and/or establishment.
- The state needs to establish a system of indicators and regularly monitor SOE performance for improving efficiency. Comparisons with regional benchmark indicators can help in overseeing SOE performance. Key performance indicators should be published on a regular basis.

Evolution of Thinking on the Role of the State in Viet Nam's National Investment

Views on the role of the state in the market economy have evolved considerably during the more than 30 years of "Đổi Mới". Party and Government documents[25] recognize the need to further transform the role of the state if in order to accelerate growth in productivity, incomes and employment. Despite increasingly strong pronouncements about the need for change, implementation of change has proven difficult, partly because of decentralized power structures[26] and resistance to change from vested interests, but also because of varied views amongst policy makers about the most appropriate role of the state. The transformation to a socialist oriented economy in Viet Nam has fuelled debates about what the state's "leading role" in socio-economic development means in practice[27]. Ongoing ambiguity provides opportunities for vested interests to resist change.

An emerging consensus view amongst policy makers might be summarized as that the state should: (i) manage the socialist oriented market economy via legislation, strategies, masterplans, policies, and economic instruments in line with market economy principles; (ii) develop institutions, manage the macroeconomic and business environments, and intervene to address market failure; and (iii) invest to provide public goods and services, and; (iv) own and manage a more limited number of SOEs. A clear enunciation of an emerging consensus view by senior leaders might help to change the mind-sets of those resisting change.

Need to Transform the Role of the State in National Investment

International experience suggests that state needs to play a more narrowly focussed role in developing the economic infrastructure and institutions needed for a competitive market economy. There are two core reasons for the state to play a more focussed role. Firstly, the state has limited capacity (institutional, human and financial) to intervene effectively. Secondly, state investment in commercial business tend to be less efficient than private investment.

There are indications of improvements in state capacity in recent years. This has been continued improvements in international rankings for governance and competitiveness[28],

[25] E.g. SEDP 2016-2020, Resolution of the 12 Party Congress, and the MPER (2013-2020). The resolutions 19 (2014, 2015 and 2016) are concrete examples of Government action to change the role of the State towards a more facilitating role.

[26] Pincus (2015), Viet Nam: Building capacity in a Fragmented. Commercialized State, Viet Nam 2035 Background Paper, 7 September 2015.

[27] Increasingly the "leading role" is seen as providing public infrastructure and services, and creating an inclusive institutional environment for private sector development, while reducing state investment in commercial business activity.

[28] E.g., relevant WEF global competitiveness indicators and the WB's Government Effectiveness Indicator http://info.worldbank.

and government revenue (at about 24% of GDP) and expenditure is high relative to other ASEAN-5 countries, despite declining budget receipts from oil revenue and reductions in both trade and company tax rates. An increasing proportion of state officials have graduate, or even post-graduate qualifications, some from leading international universities. However, Viet Nam continues to be rated poorly in terms of transparency in budget implementation.[29]

Moreover, rapid development and improvements in living standards have increased society's demand for higher quality public infrastructure and services (including environmental quality). And transforming the Vietnamese economy to a modern and creative economy will require the delivery of better quality services, human capital and infrastructure. Despite a relatively high budget revenue to GDP ratio, the fiscal deficit remains high, and debt levels are increasing.

Another concern is the rising share of recurrent expenditure in total budget expenditure, leaving insufficient budget for investment in essential public infrastructure and services. Because of its relatively large SOE sector, Viet Nam's ratio of state investment to total national investment remains higher than in most market economies[30]. CIEM (2016) argues that high levels of state investment risk crowding out private investment in key economic sectors in Viet Nam[31].

Moreover, overall investment efficiency has been declining and the productivity of state investments remain low[32]. Poor public investment efficiency is a major underlying contributor to slow productivity growth. Public investment has been fragmented -- partly because of the fragmentation (horizontally and vertically) of state power -- resulting in too many small, scattered and overlapping public sector projects[33]. This problem has been compounded by the lack of formal requirement for medium-term public investment plan prior to the 2014 Law on Public Investment[34].

Implementation delays resulting from weaknesses in management, and underestimation of project costs, further undermines the efficiency of public investment projects. This situation has been compounded by weak governance of both public agencies and state enterprises. Systems for public sector accountability remain weak, and existing legal provisions are inadequately enforced[35]. Poorly performing state enterprises seek preferential treatment to protect them from fair market competition. With poor public investment and state distorted market incentives, private sector productivity growth has also suffered.

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org/governance/wgi/index.aspx#countryReports

29 CIEM (2016, Figure 41).

30 In the region, China and Malaysia have higher shares of state investment in total investment (CIEM (2016), Table 7))

31 CIEM (2016), pp 58-63.

32 CIEM (2016, Figure 28).

33 Vividly demonstrated by the uneconomically high numbers of seaports and airports in the country that limit opportunities for economies of scale and that have slowed the emergence of internationally competitive logistics centres.

34 A public investment plan for 2016-2020 is being formulated.

35 Even the Government has not always complied with Law on Budget provisions regarding limiting the fiscal deficit to a maximum of 5% (the deficit exceeded 5% from 2012 unto 2014), and the budget deficit exceeded investment expenditure in 2014. CIEM (2016).

Figure 3: Current Steps in Public Investment Planning

1. Determine guidelines, strategic orientations and plans of state investment.
2. Preliminary assessment and evaluation of project proposals in comparation with guidelines, strategic orientations and plans
3. Evaluate and assess socio-economic efficiency of the projects
4. Review and re-evaluate the results of project evaluation
5. Select projects and elaborate budget plans; select contractors, estimate investment capital
6. Implementation and adjustment (if needed)
7. Completion, operation and maintenance of the assets
8. Monitor and evaluate the effectiveness of the projects, compare socio-economic effectiveness in reality with that according to evaluation

Source: CIEM (2016), M&E of Implementation of the MPER.

Despite improvements over the last three decades, there continues to be a large gap between state defined public investment priorities and plans, and actual implementation. Vietnamese state institutions are commercialized and fragmented. This adversely impacts state effectiveness and economic efficiency. Mechanisms for ensuring the accountability of public institutions to citizens are still underdeveloped[36].

There are also concerns about the capacity of the state to respond quickly to changing social and market demands for public services, and also to the scope for using new technology to provide better services more efficiently. For example, the state has been slow to adapt training to meet the new skills needed in an increasingly sophisticated economy, and has been slow to respond to opportunities to use technology to streamline, and improve the accountability of, state agencies. The state has also been slow to mobilize private sector financing despite clearer provisions for this under recent legal reforms[37]. And despite ongoing efforts to reduce corruption, social concerns about the level of corruption are increasing. A greater focus on strengthening transparency, consultative and accountability mechanisms will be important in resolving these concerns.

Conclusions and Recommendations on Public Investment

State leaders should make definitive and consistent statements about the role of the state in a socialist market oriented economy to remove ongoing ambiguity that is delaying implementation of the reform agenda and the realization of national aspirations for socio-economic development. CIEM (2016) suggests key orientations as outlined below.

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[36] WB/MPI. 2016. Viet Nam 2035

[37] E.g. The 2014 Investment Law allows private investment in any sector not prohibited by law, and new PPP regulations (including Decree 15/2015/ND-CP).

- The expected goal of a socialist oriented market economy is to create equitable access to an expanded range of socio-economic opportunities, including life-long education, health, employment and living environment.
- The private sector is expected to be the leading contributor to future growth in economic output and employment in Viet Nam[38]. The state should make every effort to reduce barriers to the legitimate entry and expansion of private sector activity.
- Due to limited resources and efficiency considerations, the state should withdraw from directly investing in commercial business activity to focus on facilitating business development and the equitable access of the population to socio-economic opportunities.

More specifically, CIEM (2016) defines the core overarching roles of the state as to:

- Manage and maintain macroeconomic stability.
- Protect and efficiently enforce property rights (including contract enforcement), and ensure fair competition in the market place.
- Correct market failures and avoid imposing market distortions.
- Reallocate income to reduce inequality, and provide equitable access to social and economic opportunities.
- Provide public infrastructure and public services, and ensure basic social protection.

[38] A resolution of the 12th Party Congress state that "*the state economic sector plays a dominant role and the private economic sector is an important driver/pillar of the economy; all players in different economic sectors cooperate and compete fairly under the law*". There is a danger that vested interests will focus on the word "dominant" to slow SOE reform.

Table 1: Action Plan to 2020

Recommendation and Actions Needed	Target
1. *Providing Clear Direction on the Role of the State*	
• Provide clear high level statements on a more focused state role in socio-economic development (see also thematic conclusions).	2016-20
• Sustained Resolution 19 regulatory reform process and continue to improve ranking in the WB Doing Business Index, and the WEF World Competitiveness Index, relative to ASEAN-4 countries.	2016-20
2. *Role of the State in Public Investment*	
• Strengthen institutional capacity in developing national, regional and sector medium-term plans with clear and feasible project financing plans.	2016-20
• Publicize and seek community feedback on draft public investment and expenditure plans before finalization.	2017-20
• Decrease the share of state financing (public and via SOEs) in national investment. Increase the level and share of non-state sectors in national investment.	2016-20
• Strengthen discipline, transparency and accountability in public expenditure management, strictly monitoring public debts.	2016-20
• Continue strengthening systems & capacity for selecting public investment projects.	2016-20
• Strengthen project completion evaluation and auditing, and strengthen the role of the National Assembly, people and civil society in monitoring public expenditure.	2016-20
• Act quickly to reject or cancel projects that don't meet government priorities or appraisal criteria.	2016-20
3. *Role of the State as an investor in SOEs*	
• Ensure that all SOEs are subject to the discipline of the market and competition, face hard budget constraints, and comply with the bankruptcy law.	2016-20
• Establish and develop at least two model independent regulators (e.g., to regulate competition and/or network industries) to ensure more transparent and equitable regulation.	2017-20
• Develop and publicize a strategy for reducing state investment in business activity. Continue reducing the business areas where the state is permitted to invest, and continue to divest non-core investments.	2016-20
• Provide a clear policy statement on the criteria for retaining state ownership of businesses and the objectives of state ownership policy.	2016-20
• Encourage private participation in providing public goods and services.	2016-20
• Clarify non-commercial objectives of state businesses, publicize the costs of fulfilling these objectives, and finance non-commercial objectives from the state budget.	2017-20
• Develop SOE performance indicators; strengthen engagement between SOE management and representative of the state as investor; strengthen transparency and publish performance reports.	2017-20

Public Services

Introduction

The state has an essential role to play in ensuring that the whole population has equitable access to basic services to meet the common and essential needs of society and local communities. Few would disagree with the assertion that the state should be responsible for ensuring the provision of essential services such as education, health care, water supply, and sanitation. The state is directly engaged in the provision of at least some of these services in most countries. But even when states transfer responsibility for providing public services to community organizations or the private sector, the state still plays a leading role in regulating and ensuring the provision of essential public services.

Viet Nam's National Centre for Socio-economic Information and Forecasting (NCIF)[39] defines public services "*as the services for meeting essential needs of the society, for the common interests of the community and society in which the state plays the role of "ensuring", directly delivering, or authorizing and facilitating others sectors to carry out the task*[40]. In other words, *"Public services are the activities for meeting the common and essential needs and basic rights and obligations of the citizens that are implemented or authorized to non-state organizations by the state authorities"*. NCIF (2016) defines the following characteristics of public services:

- The main goals of public services are to serve the interests of the community and needs of all citizens regardless of social status to ensure equity and social stability.
- Public services may be delivered directly, or via organizations or individuals, to meet society's needs.
- Public services transactions are not fully market based. Services may be financed directly from the state budget, or user charged may be applied. But generally, the services would not be generally accessible without state intervention.
- There are often positive externalities associated with public services. That is benefits extend beyond those receiving the service (e.g. connections to sanitation services benefit the whole community, education benefits individual receiving training and society as a whole).
- Public services are mostly non-exclusive and non-rival. Non-exclusive means that they can be used by all the people, and the use by one does not exclude others from using the service. Non-rival means that one person's consumption of services does not prevent the simultaneous consumption of the service by other users.

NCIF (2016) notes that public services can be categorised based on how essential the services are for society:

- Essential services must be provided to every citizen to ensure the minimum needs of society (e.g., primary education, child immunization, basic sciences that are prerequisite for research and application of science and technology);
- Basic services are necessary for developing society and every citizen, but the level of basic services provided depends on the state's (financial and institutional) capacity and

[39] NCIF (2016), "The Role of the State in Public Services Investment and Promotion in Viet Nam".

[40] Nguyen Huu Hai and Le Van Hoa (2010) "Criteria for assessing the quality of public service provision in the state administrative bodies". NIPA Magazine, No. 3, 2010

the capacity of the people to use the services;

- Value-added services are necessary to raise the quality of the society and every citizen, but the capacity to use these services depends on individual needs and abilities.

Options for public service provision include:

- Public services directly provided by state agencies.
- The state contracts non-governmental organizations (NGOs) or the private sector to provide public services under state supervision.
- Public services jointly delivered by state institutions, NGOs and private sector organizations.

The role of the state in providing public services can include: (i) establishing mechanisms for funding and implementing the delivery of public services; (ii) directly funding or supplying public services and engaging with society to oversee the delivery of these services; (iii) managing, monitoring, and overseeing the operations of public services providers (PSPs). More specifically the state may:

- Exercise macro-management function promulgating legal regulations on the provision of public services investment and the operations of entities providing such services.
- Act as an investor in the supply of services using a line agency mechanism for managing public professional services units.
- Finance essential services and basic services such as primary education (with partial financial support for secondary education and universities); preventive medicine and health care; and for services targeting the poor, ethnic minorities, or other disadvantaged groups.
- Monitor and supervise the compliance of public service providers and users (to ensure that the support reaches the targeted people and/or groups).

International experiences

The NCIF (2016) examined a range of international experiences, and concluded that Viet Nam does not directly follow any one international model. Prior to *Đổi Mới*, Viet Nam applied the state subsidized public services model, but has limited resources to fully subsidize all essential services. Since the launch of *Đổi Mới*, Viet Nam has gradually shifted towards a policy of "socialization" of public services, seeking social contributions from all sectors in the society to providing quality health and education and services. This policy aims had some similar elements to the international public-private partnership (PPP) model, but actual implementation has resulted in something closer to the model of privatizing public services, without sufficient attention to strengthening governance and social oversight over the quality of services.

NCIF (2016) identified the following disadvantages and advantages for Viet Nam in applying a range of international models for the provision of public services

- In the state subsidized public service delivery model, where the government covers all or most costs, all citizens have equitable access to public services, but the burden on the government budget is very high.
- Fully privatizing public services results in inequitable access to public services and economic outcomes. Families who have better jobs and higher income or wealth will enjoy high-quality public services, while the poor will have inadequate access to public services. However, privatization can help promote innovation in public services delivery.

- The "Gap filling" model contributes to public service delivery that is both equitable and efficient. However, this model remains more suited for high-income developed countries because of the substantial budget revenues need to cover the costs of this model.
- Many countries adopt the PPP model because of state budget constraints. A well designed and implemented PPP model can help the state to share the cost burden with private sector, and improve the quality of public services. However, not all states have been able to effectively implement this model. A truly competitive and transparent business environment and a competent and transparent bureaucracy are important for successful implementation of PPP models.
- Most countries apply a mix of models to different public service areas, taking account capacity and other socio-economic development conditions.

NCIF (2016) argues that, given international experiences, a case can be made for applying a mix of PPP and "gap filling" models to provide public services taking advantages of the positive features of each model while limiting the defects of each model. The PPP model can help Viet Nam to mobilize investment capital and private sector's technology and management skills in public services provision, while the "gap filling model " can be applied to certain important public services where the private sector would not otherwise participate because of a lack of financial incentives.

The most important lesson is that the state needs to know how to design and organize the provision of public services in the most efficient manner to bring about the desired results. Priority should be given to ensuring equitable access to public services because most Vietnamese are on low incomes and would not be able to access basic public services if they have to pay the full price for such services. Equitable access is an important objective in its own right, but it is also important for society to ensure that all the population have the best chance of developing their potential and contributing to the country's economic development.

Viet Nam: Current arrangement for the provisions of public services

The role of the state in public services delivery is defined in Party and Government guidelines. Recognizing that past attempts by the state to subsidize all public service delivery costs resulted in "very low quantity and quality of public services in Viet Nam"[41], guidelines have increasingly focussed on the "socialization" of public service delivery. A resolution of the 7th Party Congress[42] defined socialization as "*diversifying the forms of health care service provision (state, collective and people), with the state health sector playing the leading role*". The current focus of efforts is to expand the participation of non-state entities and the community at all stages of public service delivery, while shifting the focus of the state role to overseeing and assuring the provision of quality public services in line with state defined objectives and targets. The state plays an important role in the socialization process as defined below:

- The state specifies the social services and locations where socialization of public services is encouraged. The state decides on incentives and calls for non-state investments (including domestic and foreign investment) to provide public services.
- The state supports, encourages and creates favourable conditions for social enterprises, NGOs, or individuals to provide public services. Such support may be in the form of

[41] NCIF (2016).

[42] Reconfirmed in subsequent Party Congresses.

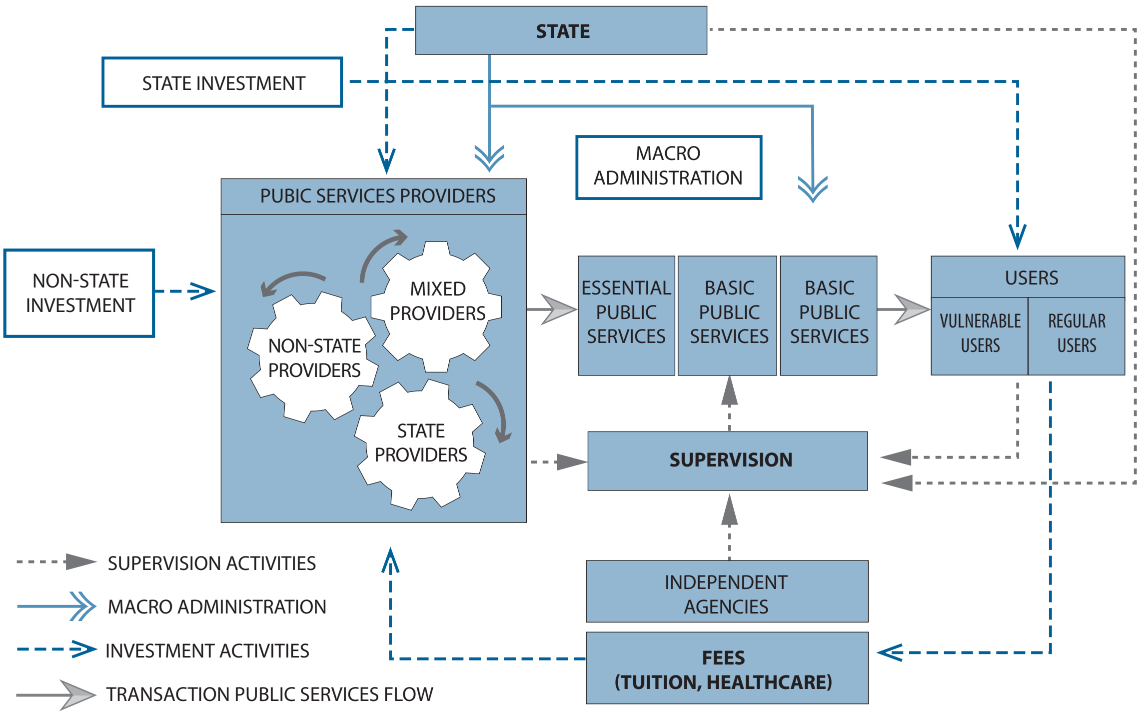
financial support, tax relief, physical resources, training, or relaxations of regulations.

- The state aims to provide a level playing field for all forms of entities to compete in providing public services to create a healthy competitive environment for sustained improvements in the quality of public services provided to society
- The state establishes mechanism to oversee the delivery and quality of services provided.

More recently there have also been attempts to separate the state's role as the owner of state PSPs from its macro role in planning and overseeing public service delivery. The Government requires that state owned PSPs develop a roadmap for shifting from funding based on budget estimates, to being contracted by the state to provide services based on a system of economic and technical norms and quality standards for each type of public services[43]. The decree also sets guidelines on prices that can be charged for delivery of different categories of public services. The aim is to complete the shift in funding arrangements by the end of 2020. Thus, the foundation and directions have been laid for creating healthy competition in terms of quality and costs among service providers, within state regulated pricing arrangements. However, considerable strengthening of capacity and sustained high level efforts will be needed to implement these changes.

From institutional perspective, public services provision in Viet Nam can be summarized in the following model (NCIF (2016)).

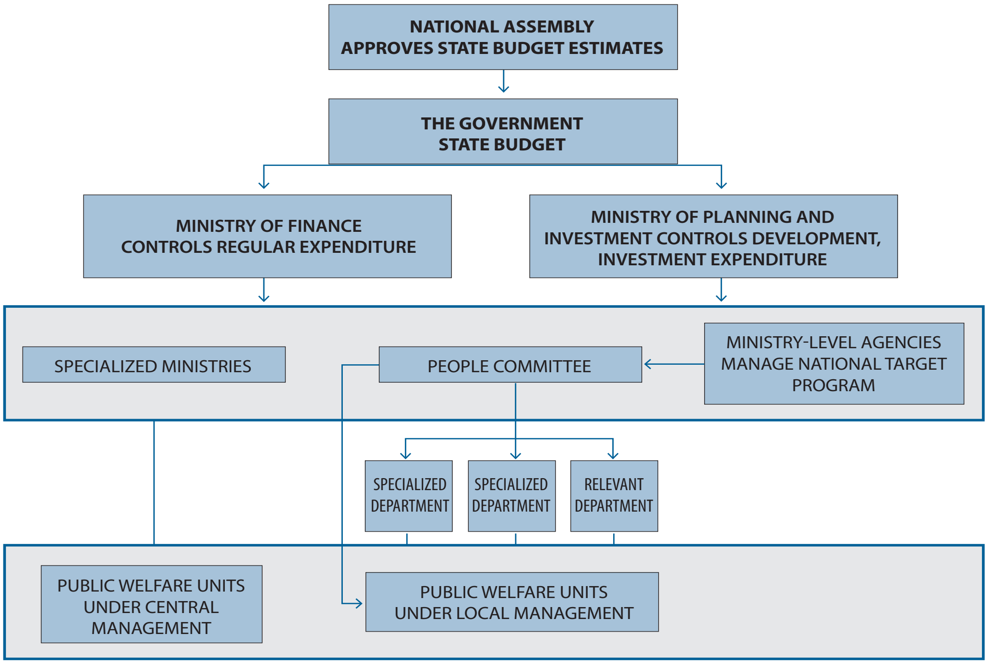
Figure 4: Public Services Provision in Viet Nam



Source: NCIF (2016)

43 Decree 16/2015/ND-CP (14 February 2015).

Figure 5: State budget allocations to public professional service providers



Source: NCIF (2016)

The model indicates the main entities involved in providing and receiving public services and the main flows of investment, financing, inspection, and service quality monitoring as specified in the current institutional (legal and policy) environment. Key characteristics of the current model are:

- The **role of the state** in public service delivery includes:
  - The state establishes the institutional environment for public service delivery based on the objective needs of the society in order to achieve state specified objectives. This provides the foundation for the effective delivery of public services in line with state objectives. The state exercises its macro-management role via promulgation of legislation on public services delivery and establishes the legal framework for the operation of public service providers.
  - The state acts as an investor and directly delivers public services mainly through public service units (PSUs). The state funds the costs of the PSUs in supplying services to users, and directly manages PSUs through relevant line agencies. With the recent trend towards "socialization" of public services, the state is gradually allowing non-state investors to provide some public utility services, healthcare facilities, and educational services (especially at the tertiary level).
  - The state directly finances many essential services and basic services such as primary education, preventive medicine and health care, and partially finances secondary education and universities. The state also financed targeted social groups, the poor, and ethnic minorities. However, most financing continues to be provided through

state-owned service providers, not based on the outcomes and rarely on the level of public service necessity.

- o The state (central and subnational levels) monitors, inspects and supervises compliance of PSPs and users to ensure that support reaches the right targets in an efficient manner. Monitoring requires objectiveness, independence and adequate competence as well as financial mechanisms for handling violations. In practice, monitoring is mostly undertaken by inspection units in sector management agencies that are rarely sufficiently objective or diligent. Mass organizations and social and professional organizations are also entitled to monitor public service delivery, but their efficiency and effectiveness in monitoring remain limited. Service users also have the right to report violations and provide feedback about service quality, but institutional arrangements make it difficult for service users to exercise this right.

- o State sector management agencies (health, education, science and technology) are responsible for promulgating and enforcing legislation and policies while also acting as PSPs. This creates potential conflict of interest and makes it difficult to ensure a level playing field for non-state PSPs.

- Public service providers (PSPs) include PSUs (with state, non-state or mixed ownership). State owned PSUs dominate public service delivery, but other forms are increasing (despite some ambiguities in the legal framework for their operations).

- Types of public services are classified by level of public need for the public services: essential services, basic services and value added services. However, this definition is still to be made operational.

- Public service users include most members of the society with diverse demands for services and different level of accessibility to services. The state applies different policies to target different groups with priority given to targeting groups such as martyrs' families, those who have provided special service to the country, heroic mothers, invalids, and some vulnerable groups such as young children and ethnic minorities. However, targeting remains inconsistent in practice with limited funds available for some of the most vulnerable, and/or for public service providers focussing on servicing the most vulnerable.

Conclusions and Recommendations

Effectively managing public services delivery is one of the most important functions of the state in a modern society. The key challenge faced by the state is meeting the priority demands for public services from society constrained by the limited resources of the state. Key roles of the state in managing public service delivery include:

(i) Developing and implementing the institutional framework needed to provide public services throughout the country;

(ii) Directly supplying or ensuring resources for provision of essential types of services and part of basic services;

(iii) Monitoring and evaluating the level, quality and targeting inspection and supervision of service supplying activities.

The NCIF (2016) study on public service delivery highlights that the key challenge to improving the level and quality of service delivery will be renewing institutions and institutional structures. State mechanisms and policies need to be rebuilt to consistently reflect the "public" nature (or the level of necessity) of public services with a clear definition of the State's functions at each stage of planning, delivering and overseeing public services. Systems for allocating resources and modes of support for public service delivery should be results (or outcomes) focussed. The role of society in public service delivery needs to be clearly defined and encouraged, with a particular focus on the respective roles of government and society in the monitoring and evaluation of the level and quality of service delivery.

1. Defining the function and role of the state in public service delivery

The state plays the leading role in ensuring public service delivery. However, the boundaries of the state role need to be more clearly defined to maximize efficiency and the quality of outcomes:

- *Managing public services:* The state should focus on establishing the institutional environment for public services delivery. State agencies responsible for managing and overseeing public service delivery need to disengage from a direct role providing public services. Regulations and the institutional environment should not discriminate between different categories of PSP owners. Regulations should only differ depending on how essential the services are and the level of state financial subsidy provided. In particular, ownership rights over affiliated professional PSPs such as hospitals and schools should be transferred, from specialized agencies like MOH and MOET, to specialized state ownership agencies (or holding companies), not engaged in regulating public service delivery. State owned PSPS need to be forced to compete fairly with non-state PSPs.
- *Develop systems for handling conflicts between different state role in PSP.* Potential contradiction exists between community health objectives with development policies of some industries that are harmful to health (e.g., tobacco, alcohol), or even with the development of the pharmaceutical industry. A core principle should be to ensure that impacts on people are central to decision making. Public consultation before the promulgation, adjustment and implementation of policy are critical in this regard.
- *Enhance the skills of workers in line with labour market requirements.* The state needs to establish mechanisms that will promote strong effective link between schools, family (parents and students), society (especially businesses), and the state. The state also needs to build national information and forecasts system for human resource supply and demand.
- *Ensuring equitable access to high-quality public services for the whole society:* all essential services must be made available to everyone. The state supports the delivery of basic services with some cost recovery. The state will facilitate the supply of value added-services and other services on a cost recovery basis for most users. The state will increasingly rely on autonomous PSPs, especially for value-added services, rather than providing these services directly.
- *Enhancing people's access ability to healthcare services.* Develop a clear strategy and targets for facilitating the development of a market based universal health insurance system, while also providing support to ensure that all vulnerable groups have access to insurance. Specifically, the state needs to reduce the level of contributions paid by poor

people for insurance and insure that PSPs to not require poor people to make additional contributions. The state also needs to promote insurance companies to provide value-added insurance (including commercial health insurance)

- *Investing in PSPs*. Based on nature of services (essential, basic or value added), the state decides to make direct investment (fully or partly) or encourage investment into PSPs. Priority is given to investing in the provision of essential and basic public services, especially in areas where it is difficult to attract private investment.
- *Strengthening investigation, inspection and supervision of enforcement.* Specialized inspection agencies need to be established and/or strengthened to monitor and evaluate PSPs in order to increase state management efficiency. Mechanisms need to be established to cooperate with -- and receive information from -- social organizations, CSOs and individuals to protect and ensure public service quality.
- *Improving accountability for quality and efficiency in health service PSPs.* Improve the transparency and accountability of health service providers (doctors and nurses) to service users (patients and patients' family). The immediate priority is to increase the involvement of PSP users in the planning, management and provision of health services. The state needs to encourage the development of tools and mechanisms to gather feedback from service users for the quality of services offered, and to provide feedback to users on measures taken to address common concerns raised by consumers. Mechanisms also need to be developed to provide sufficient medical information for health care service users to better ensure that they receive appropriate advice from providers of medical services. Establishing community groups of service users is another option for strengthening the position of users and increasing accountability.

2. Establishing an equal and competitive environment for all public service providers (PSPs).

Despite decades of attempts to develop and implement policies on socialization of public services, only limited changes have been made to the modes of PSP operations. There is now an urgent need for strong leadership to hold agencies accountable for implementing real changes.

- The state needs to clearly define its boundaries as a provider and financier of public service delivery. The state should commit to pay for: (a) 100% of the investment and operational costs of essential services (such as primary education, primary health care, and basic science); (b) part of the investment and operational costs of basic services (such as secondary school, vocational training, and hospitals); and (c) none of the investment or operational costs for value added services, but instead develop and apply mechanisms and policies to encourage non-state investment in the provision of such services.
- *Ensure no discrimination between state owned and non-state PSPs.* Both state and non-state owned PSPs should operate as independent accounting units. PSPs should have to engage in competitive bidding for the supply of services, with the state directly paying PSPs to deliver services. Services should meet state regulated quality standards regardless of PSP owner, or where the services are provided.
- *Establish clear and transparent system for determining costs of services and user fees.* There needs to be transparency in cost structures and in the level of financial support provided by the state to ensure equitable access to opportunities.

- *Establish and strengthen supporting institutions.* A range of institutions -- including medical and healthcare insurance, intellectual property rights – also need to be developed to ensure equitable outcomes from public services. The state should act to implement universal medical and healthcare insurance with contribution levels applied depending on family income and/or wealth. Medical and healthcare insurance fees for the most vulnerable people in the society should be financed fully or partly by the state. The state will also need to help promote the development of public non-commercial services such as education and training (and health) service quality assessment organizations.

3. Strengthen independent monitoring, evaluation, and enforcement functions

- *Enhance the efficiency and effectiveness of state oversight.* State management agencies need to focus more on post-inspection using good practices in state oversight and governance. Violations need to be addressed in a strict and timely manner with appropriate level of sanctions to discourage future non-compliance. Oversight roles and responsibilities need to be clearly defined and streamlined to reduce overlap and wasted of resources.
- *Enhance the involvement of civil society organizations (CSOs) in oversight of PSPs.* Empower CSOs to represent public service users to implement the rights of inspection and supervision and build mechanisms for CSOs to provide information to state oversight agencies to handle detected violations[44]. Define the legal responsibilities of CSOs in publicizing investigation and supervision results, the responsibilities of state agencies in receiving and handling CSO complaints, and the rights of CSOs when state agencies do not act on their complaints.
- Regulations should draw on international experience that recognize the important role of experts, employers and learners in assessing education and training quality[45]. NCIF (2016) provides examples of good practices that could be applied in Viet Nam.
- *Establish assessment and ranking criteria in line with international standards.* This needs to be established as a foundation for assessing and ranking PSPs in an exact, fair and efficient manner to increase transparency and competition on the market.
- *Strengthen M&E of healthcare services.* Establish a specialized agency with responsibility for building and implementing a health information and monitoring and evaluation system. Clearly specify legal rights and obligations with respect to providing, compiling and disseminating health sector performance indicators. Restructure outcome targets to focus on priority targeted National Health Care outcomes. Strengthen the capacity of systems for collecting, compiling and verifying data. Community consultation mechanism should be established to check the consistency of the formal indicators of

[44] This will require amendments to Decree No. 45/2010/ND-CP, Decree No. 33/2012/ND-CP amending and supplementing a number of articles of Decree No. 45/2010/ND-CP (NCIF (2016)).

[45] Japan has established a university assessment system that includes self-supervision and self-evaluation of relevant experts. Schools can use results to identify ways to improve quality of education and students can choose schools. Singapore's Consumer Association introduced Case Trust education certificate to increase the confidence of students in private schools which must obtain this certificate to compete in recruiting students. Singapore's Quality Class for Private Education Organizations (SQC-PEOs) is a quality certification issued by SPRING Singapore. SQC-PEOs ensure that private educational institutions implement quality management systems. In the Netherlands, parents and pupils have the legal right to give opinions on schools planning and responsibilities, and learners are directly involved in quality assessment and supervision. Harry Anthony Patrinos. (2010). Private Education and Training Provision and Public Finance: The Netherlands. Washington, D.C.: World Bank (cited in NCIF (2016)). Australia's Register of higher education advisors is available at http://www.teqsa.gov.au/national-register.

people's health care with general perceptions.

- *Improve mechanism for ranking educational and training PSPs*[46]*. The state needs to issue and implement clear guidelines and communicate this information to all stakeholders.*

4. Encourage organizations and individuals to invest in providing services

- *Remove barriers to establishment of PSPs in existing legislation*[47]. It is important to facilitate the establishment and ongoing operations of non-profit PSPs providing education and training, medical and healthcare, science and technology, and other services.
- *Provide clear guidelines in investment incentives for PSPs.* The state needs clearly structured sectoral, regional and local master plans with calls for external investors to establish PSP operations (e.g. building and/or operating hospitals and schools). The state should not invest in areas where legitimate investors are interested in investing. Incentives could include exemption of land use levies; access to preferential credit; or tax exemptions or reductions.
- *Provide maximum preferential treatment to non-profit PSPs.* At the same time, the state needs to implement mechanisms to verify that non-profit status of not-for-profit entities.

5. Increase the autonomy of PSPs.

- *Incrementally equitize and/or corporatize PSPs.* Basic and value added service PSPs should be gradually equitized (but not essential PSPs which are 100% state financed). Hospitals, schools and science research units that are partly (or fully) self-financing should be the initial priority for equitization. Enterprise management models need to be implemented in PSPs that cannot be equitized.
- *Ensure PSPs meet clearly specified financial management standards.* The state will temporarily finance financial deficits (if any) faced by essential or basic PSPs. Units with low financial efficiency and low service quality should be dissolved.
- *Expand autonomy in human resource management.* PSPs must be given to efficiently and flexibly recruit appropriately qualified human resources and provide the incentives needed to promote creativeness and occupational passion. Independent quality assessment of PSP service quality will provide PSPs with incentives to recruit the most appropriate staff.
- *Expand autonomy in academic programs.* Schools should be given autonomy in setting academic programs subject to meeting state training outcome standards. This will strengthen the motivation of PSPs to develop and improve education and training quality.
- *Enhanced autonomy in enrolment:* As state and CSO capacity to oversee the quality of educational outcome are strengthened[48], higher education PSPs should make enrolment decisions taking account of PSP strengths, local employment demand, and local and national human resource development plans.
- *Improving accountability of autonomous PSPs.* The ultimate purpose of accountability is

[46] Decree No. 73/2015/ND-CP on the stratification of higher education has been issued but there is no specific guidance.

[47] Need to review and address any barriers in legislation on enterprise, education, vocational training, medical and healthcare examination and treatment, and science and technology

[48] For an example of a national educational quality standards regulator http://www.teqsa.gov.au/

to ensure that PSPs maintain basic ethical principles in its operation. The state needs to establish a policy framework requiring PSPs to be transparent about accountability. All PSPs should maintain websites with up to date information on resources, fee structures, and annual and other compliance reports

Table 2: Recommended Action Plan to 2020

Recommendations and Action Needed	***Target***
1. Define the function and role of the state in public service delivery	
• State agencies responsible for managing and overseeing public service delivery need to disengage from a direct role providing public services. State owned PSPS must compete fairly with non-state PSPs.	2016-20
• Promote equitable access to high-quality public services for the whole society, with increasing reliance on autonomous service providers.	2016-20
• Reform the *ho khau* system to ensure equal access to administrative and public services for urban migrants in places of their residence.	2018
• State to continue support the provision of essential and basic public services, especially in areas where it is difficult to attract private investment. Withdraw from funding value added public services.	2016-20
• Establish and/or strengthen specialized inspection agencies to monitor and evaluate public service providers. Establish mechanisms to cooperate with, and receive information from CSOs and individuals to ensure public service quality.	2016-20
• Build national system for human resource supply and demand to help enhance skills of workers in line with labour market needs.	2016-20
• Implement and evaluate efforts to: o Develop a market based universal health insurance system to ensure that all vulnerable groups have access to services. o Improve accountability for health service PSPs quality and efficiency. Priority is to increase PSP users' involvement of in planning, management and provision of health services. o Establish a specialized agency responsible for building and implementing a health information and M&E system.	2016-20
2. Establish an equal and competitive environment for all public service providers (PSPs)	
• Clearly define the boundaries of the state as a provider and financier of public service delivery. The state should commit to financing: (a) 100% investment cost and operation cost of essential services; (b) part of the investment and operation costs of basic services; and (c) none of the costs for value added services.	2016-20
• Ensure no discrimination between state owned and non-state PSPs. Both state and private PSPs to operate as independent accounting units.	2017-20
• State PSPs to develop a roadmap to shift from budget estimates based funding, to contracts with the state to provide services based on economic and technical norms and quality standards. (Decree 16/2015/ND-CP).	2020
• PSPs engage in competitive bidding for the supply of services, with the state directly paying PSPs to deliver state regulated quality standards public services.	2016-20

• Establish clear and transparent system for determining costs of services and user fees (Decree 16/2015/ND-CP).	2020
• Improve transparency and accountability of autonomous PSPs. Require all PSPs to maintain websites with up to date information on resources, fee structures, and annual and other compliance reports.	2016-20
3. Strengthen independent monitoring, evaluation, and enforcement functions	
• Enhance the efficiency and effectiveness of state oversight with stronger focus on post-inspection with clearly defined and focused roles and responsibilities to ensure consumer rights are protected.	2016-20
• Enhance the involvement of civil society organizations (CSOs) in PSP oversight.	2017-20
• Draw on international experience to recognize the important role of experts, employers and learners in assessing service quality (e.g. for education and training) in developing regulations determining and assessing service quality standards.	2016-20
• Establish and enforce (education and health) PSP assessment and ranking criteria consistent with international standards.	2017-20
• Develop systems for handling conflicts regarding state role in PSP to ensure that impacts on people are central to decision making.	2016-20
4. Encourage organizations and individuals to invest in providing services	
• Remove barriers in existing legislation to establishing PSPs.	2016-20
• Provide clear guidelines on investment incentives for PSPs, and provide preferential treatment to encourage non-profit PSPs.	2017-20
5. Increase the autonomy of PSPs	
• Pilot the equitization of PSPs (other than essential 100% state financed PSPs), and evaluate pilot initiatives. Adopt enterprise management models in PSPs that are not to be equitized.	2016-20
• Ensure PSPs meet clearly specified financial management standards.	2017-20
• Expand autonomy in human resource management, academic programs and enrolment.	2017-20

Public Infrastructure Utilities

Introduction

Development of infrastructure is one of three breakthrough areas targeted under the Socio-Economic Development strategy, 2011-2020. The resolution of 12th Party Congress highlighted the constraints resulting from weak infrastructure including the poor coordination and efficiency of infrastructure development.

The Viet Nam Institute for Development Strategy (VIDS, 2016) undertook case studies of seaports and water supply services to identify evidence of the need for practical institutional reforms to help develop more effective, efficient and inclusive infrastructure services. Problems with effective coordination of water supply and seaport services had been noted in the 12th Party Congress. Seaports provide a good case study of commercially viable infrastructure development where the key role of the state could be to develop the enabling environment and ensure coordination with the development of other transport and other physical infrastructure to maximize throughput and economies of scale. Water supply infrastructure is an example of public infrastructure that is critical to meeting essential social needs.

International trends

A process of privatization that started in many developed economies in the 1990s has seen a gradual transformation in the role of state, from the direct provision of infrastructure service, to an increasing focus on developing the institutional environment (including policies and regulations) to attract commercial investment in infrastructure. There has also been a trend, in some countries, away from state ownership to private ownership, and the vertical unbundling of enterprises providing infrastructure services. There have also been reforms in institutional processes for infrastructure development with attempts to adopt more economy wide approaches to planning, developing, operating and maintaining infrastructure so as to maximize economic returns and economic efficiency. There has also been an increasing focus on performance measurement to help improve governance and accountability and also to provide benchmarking to help identify potential areas for improvement.

Seaport utilities

Internationally there are examples of a full range of port ownership from fully state owned to wholly private owned. In some cases, the state retains ownership of the land, but leases out part, or all, of the operations to private investors. Globally, performance indicators for seaports vary greatly, suggesting that much can be learned from best practices to improve efficiency.

Better performance monitoring and benchmarking is seen as a critical first step to identifying opportunities for improving the operational performance of seaports. The international literature identifies a range of approaches to measuring the performance of seaports. UNCTAD published seaport performance indicators in 1976 to help improve the efficiency of existing seaports and to provide information to better plan the development of new ports. Since then, more sophisticated indicators have been developed to better capture financial performance and also to capture the contribution of ports to local economic development (e.g. via stimulating the development of freight forwarding, logistics, and industrial enterprises). However, there is still no international consensus on the best indicators to use for assessing and benchmarking seaport performance.

Given the importance of other ASEAN countries as competitors, Viet Nam should seek to identify indicators and benchmarks that can be compared with these countries to assist in raising its competitive position relative to these countries. Viet Nam may also need to develop indicators that reveal the linkage between institutional reforms and seaport performance.

Freight activities in Viet Nam are highly concentrated in the two main shipping centres around Ho Chi Minh City (HCMC) and Hai Phong port, including the satellite ports of Cai Mep-Thi Vai and Cai Lan. These two centres account for some 97% of national container shipping (VIDS (2016), but new centres are emerging. In Viet Nam the state invests in the construction of ports infrastructure and equipment, and assigned a SOE to manage and operate the port and to use the land and entire port infrastructure and equipment in ports[49].

The major port developer and operator in Viet Nam is the Maritime Corporation of Viet Nam (Vinalines). Vinalines currently control eight ports (Sai Gon, Hai Phong, Da Nang, Quang Ninh, Cai Lan port), accounting for 30% of maritime transport market share[50]. It also has broad range of other business activities, including maritime transport, port operation and maritime services, with member companies involved in shipping, ship leasing, freight forwarding, and ship repair. Vinalines also had plans to develop the deep-water seaports of Lach Huyen (Hai Phong) and Van Phong (Khanh Hoa). However, in the face of mounting debts, the government instructed Vinalines to restructure and divest many of its port assets, including reducing its stake in Sai Gon and Hai Phong ports, and selling its stakes in the joint-ventures. However, there have been repeated delays in this restructuring process[51].

The Ministry of Defence operates the container pier at Cat Lai in HCMC, is developing a container berth in Cai Mep-Thi Vai (Vung Tau), and owns four inland container depots. Some local provincial people's committees also develop and manage ports, including Ben Nghe Port (HCMC) and Hon Khoi port (Khanh Hoa). In other cases, the state invests in developing the port infrastructure and leases out the port to an operator while retaining ownership of the port (e.g. Cai Lan port). Some private companies have been granted the right to use land to construct seaports and operate the assets. However, there is no system of competitive tendering for the right to operate port facilities.

Increasingly foreign investors have entered into joint-ventures, often with Vietnamese SOEs, to develop and operate ports[52]. In some cases the foreign investors have contributed 70-80% of foreign capital and are playing a major role in transforming port management systems (e.g. VN International Container Terminal (VICT)[53] and Saigon International Terminals VN (SITV)[54]). The mix of seaport models in Viet Nam are summarized in Table 3.

There is still no clear delineation between state administrative and economic functions in managing seaports.Economic regulation (especially price ceilings[55]) applied in the port industry restrict competition and discourage innovation in port enterprises.

Table 3: Stakeholders in Vietnamese Seaports

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[49] Before 1990, the marine services activity in Viet Nam conducted by SOEs. Specific maritime services were allocated to individual SOEs with monopoly power. State management of the maritime industry was divided into two organizations in 1996: Viet Nam Maritime Bureau was made responsible for managing seafarers; with the Viet Nam National Shipping Line responsible for business and production activities.

[50] A list of all the members of the Viet Nam seaports association, together with throughput data for each ports is available at http://www.vpa.org.vn/english/information/info_static2014.html.

[51] http://english.vietnamnet.vn/fms/business/157218/vinalines--deferred-ipo-deters-foreign-investors.html http://www.vneconomictimes.com/article/business/vinalines-to-sell-64-of-charter-capital-in-ipo

[52] VINALINES has entered into joint ventures for Cai Mep International Terminal (a joint-venture with the Netherlands-headquartered APM Terminals), SSIT (US-owned SSA Marine's subsidiary SSA Holdings International – Vietnam), and SP-PSA with Singaporean-owned PSA Viet Nam Pte. Ltd.

[53] http://www.vict-vn.com/

[54] http://www.sitv.com.vn/Home.aspx?Cul=En

[55] The provisions of decision No 98/2008/QD-BTC dated 4 November 2008 and the previous regulations.

Port management unit	State ownership	Examples of ports
Vinalines	Directly under the Prime Minister	Hai Phong, Da Nang, Quang Ninh, Saigon, Can Tho, Nghe Tinh, Nha Trang, Quy Nhon
Port operation (state or joint-stock company)	Directly under the Ministries	Cam Pha, Tan Cang Company (Saigon, Cat Lai, Cai Mep)
Local departments	Cities or provinces	Hon Khoi, Ben Nghe
Joint venture company	Joint-ventures. Some State equity	VN International Container Terminal (VICT), Saigon International Terminals VN (SITV), Mat Vu Ba Ria Ports

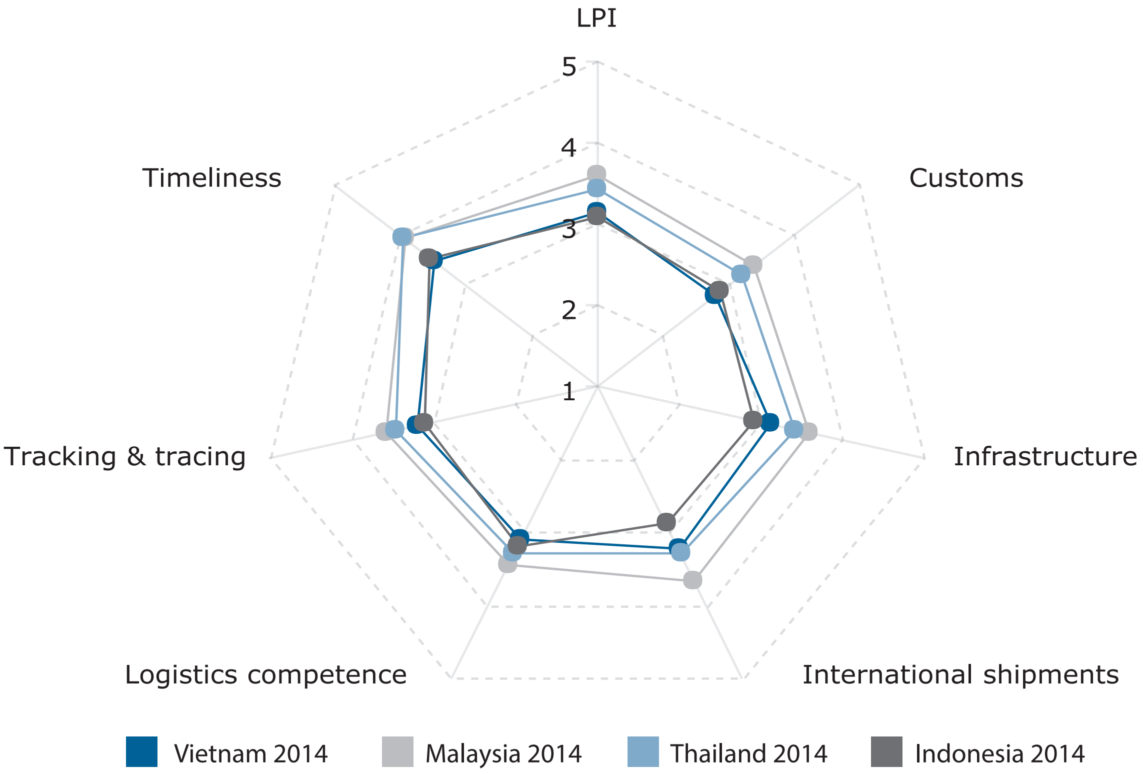
Planning for port service development remains weak with overlapping responsibilities. This undermines the efficiency of both the ports and the broader economy. Planning is insufficiently linked to broader national and regional development considerations, and multi-modal transport development planning. Plans tend to go into too much of the technical detail which should be left to the seaport developers and operators. Local interest group lobby for too many fragmented and unviable seaport projects. This undermines efforts to develop logistics centre with sufficient scale to be regionally competitive. Viet Nam still lacks an institution with the capacity to support the restructuring of the port business, and to plan the development of the multi modal transport, as part of broader national program to build the competitiveness of shipping and logistics industries.

Diversified ownership, decentralization of investment policies, and variations in institutional structure contribute to some degree of competition in providing port services, but opportunities to participate in seaport development are not awarded transparently or competitively. There are some indications that the restructuring and introduction of limited competition have helped improve port efficiency. And increasing throughput at Vietnamese ports is helping to reduce costs through economies of scale. Viet Nam's logistics performance index has improved, from 2.5/5 in 2007, to 3.1/5 in 2014 (see Figure 6), with strong improvement in the infrastructure measure in 2014. VIDS (2016) notes that port charges in Viet Nam are now lower than in China and Indonesia.

Figure 6: Viet Nam: LPI 2007-2014

Source: WB (2016), Logistics Performance Index.

Figure 7: Viet Nam LPI Ranking Compared with Selected ASEAN Countries



Source: WB (2016), Logistics Performance Index.

Water supply enterprises

The development of water supply is especially important in Viet Nam as it has one of the fastest urbanizing populations in Asia. The government's urbanization policy framework is defined in the Master Plan for Urban Development in Viet Nam to 2025 and Vision to 2050. Its main objective is to achieve balanced and strategic growth, through the establishment of a national urban system consisting of urban centres distributed throughout the country, including the development of medium and small urban areas as development hubs within larger urban areas and provinces.

Water supply capacity and coverage have increased dramatically since the 1990s, with supply increasing, from 0.7 million m^3/day in 1990, to 7.1 million m^3/day in 2015, with the ratio of "non-revenue water" dropping from 40% to 25% over the same period. Demand is expected to increase to 9.5 million m3/day by 2020[56].

The state provided water supply services through a local government administrative unit during the 1990s. These water supply units were not independent legal entity. Efforts to establish water supply enterprises as independent enterprises intensified from 2004. By 2007, a total of 91 water supply enterprises -- owned by subnational government agencies -- were members of the Viet Nam Water Supply and Sewerage Association. The government adopted a policy to equitize water supply companies in 2007. Since then, 43 water supply enterprises have been converted into joint-stock companies, and 42 enterprises have been converted into limited liability companies. The remaining 6 enterprises are yet to be restructured.

Equitization has not yet generated the intended benefits, because water supply companies still mainly perform assigned tasks, and have little incentive to expand distribution system out of their vicinity. The state budget is still used to directly invest in water supply infrastructure. Despite operating under the Enterprise Law, water companies are not independent of state administrative intervention. The state continues to exercise a great deal of influence over equitized water supply companies because the state continues to supply much of their capital and appoints members of their management boards.

The sector has not yet attracted substantial resources from the non-state sector. Potential profits are limited by controlled water tariff. These tariffs are set by the state with the principles of full cost recovery plus a reasonable profit for water supply companies. Tariff is issued by the provincial people's committees (PPCs) within ceiling set by the Ministry of Finance. The PPCs often face pressures to set low tariffs and tariff adjustment has tended to be slower than market developments. There is not independent institutional structure to set prices that are both equitable and reflect market realities.

VIDS (2016) notes that following the government decision to promote the socialization of the water supply industry, "many enterprises and domestic and foreign individuals invested in water supply system using BOO, BOT, and BT models"[57]. However, the state continues to dominate the water supply sector. While some water supply companies have used their own capital, or borrowed to invest in the construction of water supply system, many water supply

[56] VIDS (2016).

[57] VIDS (2016).

companies continue to rely heavily on the state for investment capital

Benchmarking indicators for water supply enterprises

Benchmark indicators have been used internationally to determine the performance of the water supply business for decades. The International Benchmarking Network of Water and Sanitation Utilities (IBNET) methodology is used worldwide. The South East Asian Water Utilities Network uses IBNET method to determine the performance for water supply enterprises. Eleven Vietnamese water supply enterprises have joined this association.

The Vietnamese Government institutionalized some important conditions for benchmarking in a 2009 decision of the Prime Minister[58] which instructs the Ministry of Construction to coordinate with the Ministry of Natural Resources and Environment (MONRE) to build a database of urban water supply and sewerage sector. Four benchmarkings have been conducted and the results fed into policy changes and new laws to improve water service. The most recent benchmarking programs in Viet Nam used the IBNET methodology to compare performance of utilities. An electronic portal has been established to collect data and calculate the benchmarking for water supply utilities in Viet Nam. However, benchmarking has not been institutionalized, and there has been no systematic use of performance benchmarking to strengthen the incentives faced by the managers, to encourage technological innovation, to provide access to capital, or as a basis for increasing the service price

The water supply industry is a network industry with monopoly characteristics and important social objectives. The state has been reluctant to let go its control as a result. More needs to be done to improve performance incentives, including exploring options to unbundle services to encourage competition and innovation. A professional and independent price regulator will be needed to set prices that reflect market realities and that are independent of the influence of vested interests.

Conclusions

The state aims to promote regulated competition in both the water supply and port industry in Viet Nam. The state has not explicitly expressed a long-term vision of the intended state role in developing and providing the sea ports and water supply services. Areas that the state has attempted to regulate include price, access, and performance and quality of services. There has been no clear strategy and/or action plan for developing the institutional capacity needed to effectively regulate these two public services to meet national objectives.

State efforts to promote competition in seaports and water supply services have only been partially effective, and state capacity to effectively regulate the services remains weak. Despite prolonged states commitments to diversify ownership, actual results to date indicate that state agencies are reluctant to fully give up their ownership powers in both water and sea port services. While the state has introduced some reforms to encourage non-state participation in the development of infrastructure and provision of services, the weak institutional environment continues to result in distorted incentives and limited and unfair competition.

Partly because of weak regulatory policy making and enforcement capacity, the state continues

[58] Decision No. 1929/QD-TTg (20/11/2009).

to administratively intervene in business decisions. Moreover, the state agency regulating the industry often also represents the state interests as owner in the sector. This undermines fair competition and increases investment risks.

The other core weakness, especially for the development of seaports, is the poor quality of national and regional planning, and very limited relevance of planning for subsequent implementation of major investments. Fragmentation of political power, and strong local vested interests, result in fragmented and poorly coordinated investments in transport and urban infrastructure. This is limiting potential opportunities for Viet Nam to improve competitiveness by developing concentrated logistics hubs that generate the economies of scale needed to compete effectively in the international market.

Recommendations

Table 4: Recommended Action Plan to 2020

Recommendations and Action Needed	Target
1. Clarify the role of the state in facilitating infrastructure development	
• Commit the state to (a) strengthen its role in facilitating infrastructure development via stronger institutions and better regulation, enforcement and oversight, and (b) reduce its ownership of businesses that develop, operate and deliver infrastructure services.	2016-20
• Develop a clear policy statement and regulations to facilitate the unbundling of commercially viable infrastructure services (and other network industries) from the public good elements of these services, to encourage competition and innovation.	2017
• Explore opportunities to unbundle infrastructure services and develop systems for transparent and competitive bidding for the supply of unbundled services. At the same time facilitate "reasonable"[59] horizontal mergers to achieve economies of scale.	2017-20
• Entrust state regulatory functions over utilities to a strong regulatory agency that (preferably) has no ownership rights over any business activity. Re-focus state efforts on developing an appropriate institutional framework to encourage other economic entities to invest in developing and operating infrastructure services.	2017-20
• Develop clear and independent structures for regulating service quality, access and pricing of infrastructure services. Agencies with regulatory responsibilities should not be permitted to exercise state ownership rights in any business enterprises.	2018
• Abolish regulations requiring the state to retain ownership of equity in particular infrastructure services (e.g. seaports).	2017
• Social objectives (i.e. to provide water to poorer, isolated, or underserved communities) should be clearly specified. Social objectives should be realized by contracting out the provision of social services on a competitive basis, using financing from the state budget where needed.	2017-20

[59] Subject to compliance with Competition Law provisions.

• Ensure that public infrastructure, competition and enterprise reform strategies and institutions are consistent with international and regional economic cooperation agreements.	2017-20
2. Strengthen state infrastructure planning and management	
• Strengthen state institutional capacity to develop, implement, monitor and enforce national, regional and provincial infrastructure development plans. Develop the institutional capacity to ensure that major local level infrastructure development plans are linked to national development strategies.	2016-20
• Develop and implement a comprehensive national and regional transport and urban development strategy to ensure more coordinated investments to facilitate the development of efficient multi-modal transport corridors and logistics hubs.	2018
• Drawing on international good practice, establish clear, transparent and competitive systems for contracting out the supply of infrastructure services.	2018
3. Strengthen state oversight of infrastructure services	
• Build a system for monitoring key performance indicators for all network industries in Viet Nam, including regular benchmarking with neighbouring countries. Submit an annual report to the National Assembly comparing the performance of Viet Nam's network industries with that of its key regional and international competitors.	2017-20
• Provide for flexibility in pricing to reflect the differing costs structures and needs in different areas in order to attract commercial investments.	2017
• Require all utilities to publish annual reports with audited financial statements, and information on performance efficiency relatively to regional benchmarks.	2017-20
• Require all utilities to publish their mutually charter and corporate objectives, fees and charges, and other relevant information to promote accountability.	2017-20
• Encourage stronger community participation to improve planning and governance of infrastructure services (especially local infrastructure), and to ensure that investments are directed to highest priority areas.	2017-20

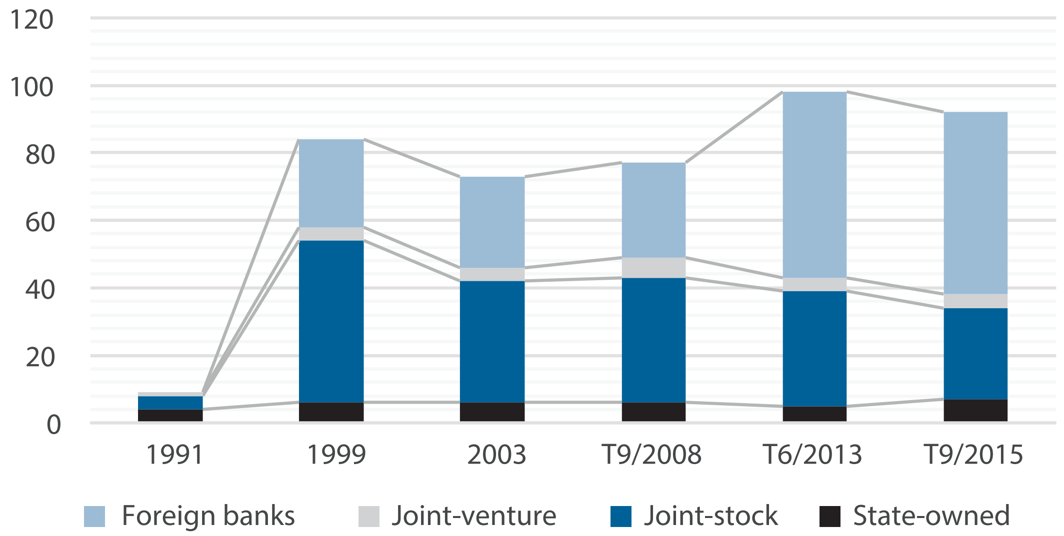
Financial sector Development

Introduction

Total assets of Viet Nam's financial system amounted to Viet Nam Dong (VND) 9.7 million billion at the end of 2015, approximately 231% of Viet Nam's GDP. Total assets of credit institutions were VND 7.319 million billion, or approximately 75% of total financial system assets. Viet Nam now has about 350 financial institutions, including over 140 credit institutions, 151 securities companies, and 58 insurance companies. Participants in Viet Nam banking institution include a diversified mix of owners including: state-owned, majority state-owned, joint stock, private, joint venture, and foreign enterprises (Figure 8). State owned commercial banks (SOCBs) share of assets in the commercial banking system has decreased remarkably from 85% in 1993 to 47% in July 2015[60].

[60] APD. 2016.

Figure 8: Number of commercial banks by ownership

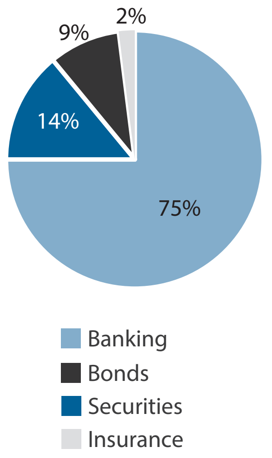


Source: APD. 2016

The market capitalization of the stock, bond and insurance markets accounts for 14%, 9%, and 2% of total financial system assets, respectively. The value of the bond market was equivalent to about 16.9% of GDP in Q3 2013, lower than the average size in EEA countries (56.5%). In Malaysia, Indonesia, and the Philippines, financial resources for development mainly comes from securities and corporate bond markets. In contrast, these markets remain under developed in Viet Nam (Figures 9 -10). While insurance penetration rates of around 1.4% are comparable to that of Indonesia and the Philippines, Viet Nam's insurance penetration rate remains far below that of Thailand and Malaysia, and the global average of 6.6%. In other word, financial resources for economic development in Viet Nam still depend mainly on the banking system.

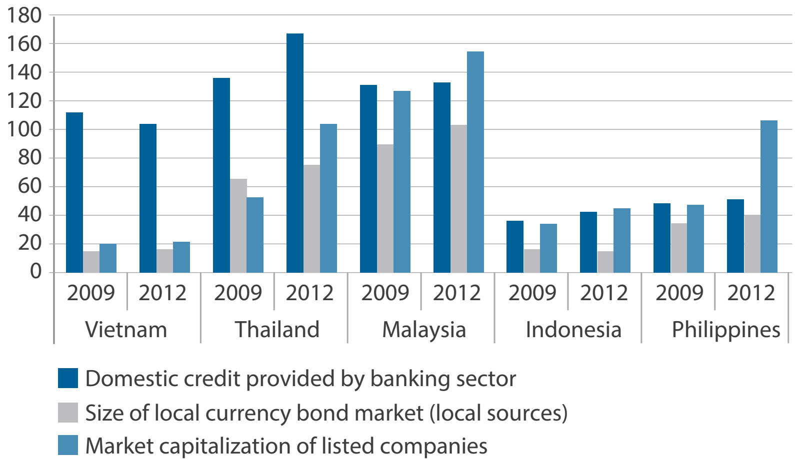
Limited enforcement of stock market regulation resulted the establishment of a large number of mostly small-scale securities companies from 2005–2007. Many of the 105 securities companies established in that period have capital equity of less than VND 50 billion and only perform brokerage and advisory services. As part of the restructuring, some securities companies had to merge or be restructured, with the number of securities companies falling to 83 in early 2016, with an average charter capital of VND 445.6 billion per company. Viet Nam's total market capitalization is much lower than elsewhere in the region as shown in Figure 11.

Figure 9: Viet Nam's financial system structure in 2015



Source: APD. 2016

Figure 10: Financial system structures in Viet Nam and other South East Asian countries (% GDP)

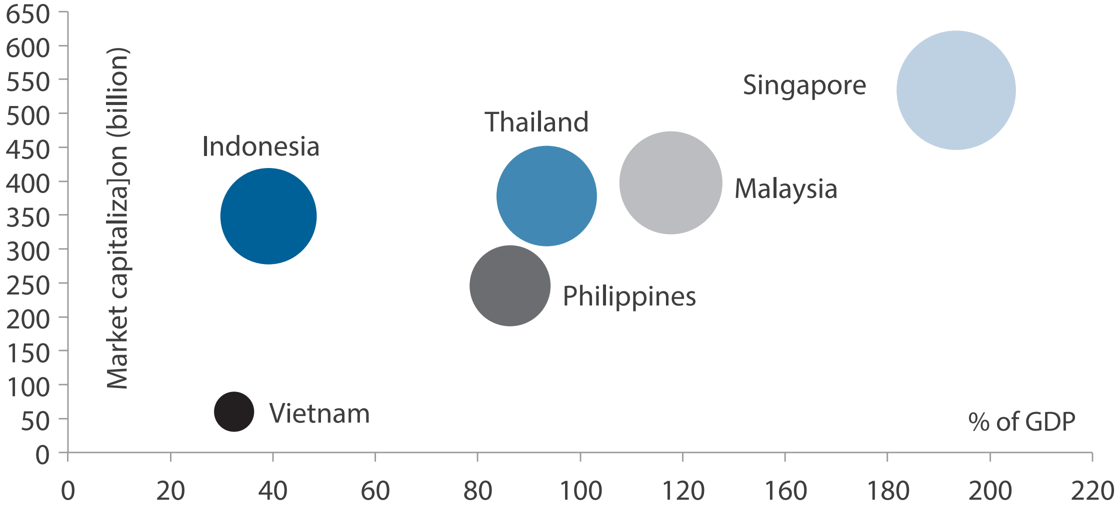


Source: ADB (as reported in APD 2016)

Source: APD. 2016

Source: ADB (as reported in APD 2016)

Figure 11: Securities Market Capitalization in ASEAN: Size and Ratio (%) to GDP



Source: Dragon Capital (as cited in APD 2016).

International models and experience

No optimal and unified model for a financial system development has been identified that can be applied for all countries in the world. Each country adopts a different financial structure, which is in line with both financial market development and the history and culture of that country. In general, there are two main types of financial systems in the world today: (a) a bank-based financial structure system (e.g., Germany, Japan); and (ii) a market-based financial system (e.g. the USA).

Despite considerable research, there is no credible evidence that the bank-based financial system is better than market-based one, or vice versa. Hence, the best financial structure system for development does not depend on whether it is the bank-based structure or market-based structure. It depends on ensuring elements of the financial system, including diversification, fair competition, transparency, high levels of specialization and level of development to ensure that limited financial resources are mobilized and allocated most efficiently.

Internationally, there exist different views about state ownership in commercial banks. Stiglitz (1993) asserts that state ownership in commercial banks originally aims to support state-owned enterprises that are charged with improving social welfare and solving market failures. More recently, some researchers argue that the state's participation in commercial banking leads to inefficiency and that commercial banks should be privatized. Other researchers[61] argue that the state-owned banks should be considered as a last resort, and should only be taken where equitization causes instability within the top of the hierarchy in the banking structure. On the other hand, others argue that government ownership of banks have a positive impact on long term economic growth in some circumstances, especially where market failures occur which requires government's intervention in the financial system (e.g., the 2008-2009 global financial crisis)[62]. Among 96 surveyed countries where the government owns one or more commercial banks, state-owned commercial banks account for an average 21% of the total assets of the banking system. Countries with high level of state ownership are Iraq (98%), India (72%), Greece (50%), and Russia (41%). Countries with less than 10% of state ownership in the banking system include Italy, South Africa, Hungary, France and Croatia.

Policy lending has been used in both developed and developing countries to support development. Policy lending was frequently used in Asia in the 1960s and 1970s to implement industrialization and export expansion strategies. The share of policy lending in total mobilized capital was high in some Asian countries, reaching 50% in India and in Korea in the 1970s. In Japan and South Korea, policy lending mainly focuses on the exporting and key industries. In China, policy lending mainly focuses on major state-owned enterprises whereas in India's targets for policy lending include state-owned enterprises, small enterprises and farmers. A feature of policy lending in Japan and South Korea was the strict supervision of the allocation and utilization of funds, and relatively low levels of losses and bad debts. Supervision was less efficient in China and India where key decisions were decentralized to local governments, where resources were sometimes allocated for inappropriate and inefficient purposes, and levels of bad debts and losses were often high. The role of policy lending has declined from

[61] R. Levine (2003), Berger et al. (2005), and Bortolotti B. & E. Perotti (2007). Cited in APD 2016.

[62] APD. 2016.

the 1980s in the face of growing evidence of the negative impacts on development (including high levels of indebtedness) resulting from the distortions caused by policy lending.

Financial integration -- including foreign indirect investment (FII) -- has played an especially important role in economic development in Asia. However, financial integration also generates macroeconomic risks, if FII flows are not properly managed. Despite a surge of FII when Viet Nam joined WTO, the level of financial integration in Viet Nam remains relatively low with negligible outward investment. However, with increasing economic integration and continuing improvements in the business enabling environment, the level of FII can be expected to increase and needs to be carefully managed.

There is no ideal financial sector supervisory model that can be applied in every country, because each country has different political institutions, history and culture. However, there has been an increasing trend towards centralized state monitoring and supervision of banking, securities and insurance. The main advantage of the centralized supervision model is that it enhances the effectiveness of supervising financial corporations involved in multiple financial sectors, and especially helps in risk monitoring, facilitate systemic risks evaluation and management and minimize the spreading of risks. It also allows for economies of scale. Strong state capacity is essential to effective implementation of financial supervision. Whatever model is adopted the state needs to develop a concrete roadmap with specific steps for implementation.

Key issues

Financial market and banking system restructuring is one of the three focal points of the Master Plan on Economic Restructuring (MPER)[63] to transform the growth model towards improving quality, efficiency and competitiveness for the period 2013-2020. The MPER was designed to "stimulate the state's creative capacity and development supports through institutions, policies, economic stimuli, and reducing the use of administrative intervention". A series of measures to reform and restructure the financial market and banking system – including the encouragement of domestic private and foreign investors in the financial system -- has helped accelerate progress and mobilization of substantial financial resources for economic development.

While reforms introduced under the MPER have helped with financial market and banking system restructuring, the financial system remains small relative to other regional economies, is dominated by the banking sector, and has not been able to mobilize adequate medium and long term funds. Viet Nam's financial system lacks large-scale financial institutions that are capable of competing in regional markets. Commercial banks use a high proportion of short-term deposits to finance medium and long-term loans. Markets for corporate bonds and derivatives market are still to be developed in Viet Nam. No mechanisms exist to monitor and manage instability inflows of foreign capital. There remains a large gap between corporate governance of Vietnamese banks and international good practices. Cross ownership and other ownership issues undermining transparency have been partly resolved, but continue to contribute to systemic risk. There are continuing concerns about the level of non-performing loans (NPLs), and the reliability of data on NPLs.

[63] Approved by the Prime Minister in February 2013

The institutional framework for the restructuring of credit institutions system has been gradually improved, under schemes on "restructuring the credit institutions system in the 2011-2015 period" and the "resolution of non-performing loans of the credit institution". Reforms include the establishment of Vietnam Asset Management Company (VAMC). The schemes have provided the roadmap, principles and groups of solutions to restructure the credit institutions system and to settle bad debts issue, in detail: (i) to audit, inspect, evaluate and supervise of credit providing activities and credit quality; (ii) to establish VAMC as a channel to resolute NPLs; (iii) to diversify of ownership structures and types of credit institutions; and (iv) to encourage voluntary M&As of credit institutions while ensuring the interests of depositors and the rights and obligations of other stakeholders in accordance with the law. Although VAMC's operations and its effectiveness in resolving NPLs, and the acquisitions of distressed banks remain matters for debate, the schemes have helped to avoid a financial crash, and in regaining the people's trust in the credit institutions system. Nevertheless, more resolute action is needed to resolve NPL and insolvent financial institutions.

Despite state commitments to international financial integration, reform momentum has been insufficient to stimulate the development of an internationally competitive financial systems in Viet Nam, and Viet Nam has minimal indirect investments in other countries. Despite progress in improving the legal framework for financial sector development, not all regulations meet international standards, and critical regulations are not effectively enforced. The legal framework for customer protection remains weak. The private sector still encounters barriers to competing equally in insurance and voluntary pension funds.

Viet Nam used a decentralized and specific sector model of supervision. The Banking Supervision Agency (under SBV) is responsible for the inspection and supervision of banking system. The State Securities Committee (under MOF) performs on-site inspection and remote supervision of security companies, investment management companies, securities investment funds, securities investment companies, and securities markets. The Insurance Supervisory and Authority (under MOF) conducts on-site inspection, remote supervision of insurance and reinsurance companies. The National Financial Supervisory Commission (NFSC) is the state agency responsible for overall financial system supervision. However, its capacity remains limited, with no power to carry out on-site inspection. There is a lack of effective coordination among specialized supervision agencies, leading to the limitations in cross-risk supervision. Supervision of banking, securities and insurance in Viet Nam is compliance-based, rather than risk-based. There is very limited application of information technology in supervising Viet Nam financial system. The lack of transparency in monitoring and supervision remains a major concern.

The core state objective for intervening in financial sector development should be to ensure that the financial system can safely mobilize and allocate financial resources effectively (i.e. to areas providing the highest socio-economic returns) in an increasingly integrated economy. While arguments can be made for short-term state interventions in financial system operations, long-term interventions are likely to distort the financial system with negative consequences for sector development. Rather than directly engaging in the sector on a long-term basis, the state should aim to facilitate sector development by creating a complete, transparent legal framework and developing a fair and competitive environment for the operation and effective regulation of financial institutions that are strong enough to cope with domestic and external shocks. The state is expected to play an increasingly effective role in the regulation oversight of the financial sector, while steadily reducing the share of state ownership of financial institutions.

Conclusions and Recommendations

Separate state ownership and regulatory roles

The government should consider developing a proposal, for submission to the National Assembly, to convert the State Bank of Viet Nam(SBV) into a truly independent central bank, in line with international standards and good practices. The focus of monetary policy management should be on inflation targeting, and the government should reduce administrative intervention and employ indirect instruments in accordance with market principles. The government should relax exchange rate management in line with the plans to move towards full convertibility of the Vietnamese dong.

In order to improve the effectiveness and competitiveness of commercial bank operations, the state needs to separate its role as owner of financial institutions from its role as a financial sector regulator and policy maker. In practice, this means that responsibilities to act as state owner of financial institutions should be transferred from regulatory agencies such as SBV. The state should also: reduce the proportion of its ownership in state-owned commercial banks (SOCBs); review and adjust the rights of representatives in state ownership in these banks; facilitate the development of joint-stock commercial banks-foreign banks (JSCBs–FBs) to diversify types of ownership; promote competition; and avoid policy and targeted lending at commercial banks and the VDB to the VBSP. More generally, the government should also develop institutions and policies that encourage the development of existing commercial banks to become large-scale and with sufficient capacity to compete in domestic and international markets.

The state needs to closely manage, supervise, and review existing regulations of financial and development institutions in order to reduce the dependence of these institutions on state budget. The state should formulate an appropriate operating and supervision model to fit with Viet Nam's conditions.

State oversight and governance of financial system

The state should also promulgate regulations to improve the efficiency and transparency in the operations of the financial system. Government agencies, enterprises, and investors must be transparent in providing information that reflects correctly the operation of the financial system and must avoid concealment or distortion of information.

The state should establish and improve its legal framework to protect consumers and to ensure competition. In order to protect investors and reduce market risk for investors, the government should require securities companies to have separate accounts of investors from their total assets and strictly apply listing requirements in accordance to the regulations.

As discussed in the thematic report, the state should continue to develop and improve the infrastructure for financial system development. First, the government should continue to invest in information technology infrastructure to support inspection and supervision and eventually move to development of an automatic supervising system that forecasts and warns of risks in the areas of banking, securities, and insurance. The government should further develop the bank payment systems[64] as the foundation for the operation of a modern financial system and to provide advanced financial products and services. Credit rating agencies and valuation agencies need to be developed using international standards in order to establish and develop corporate bonds market and derivatives market.

The government should review and introduce further reform in the supervision and regulation of the financial system toward improving and strengthening capacity and effectiveness of industry-wide supervisory agencies, taking a further step to formulate a unified supervisory model. As a first step, the licensing function should be separated from the supervision function of industry-wide supervisory agencies. Financial system supervision should be transformed, from compliance-based supervision, to risk-based supervision systems. The State needs to take more resolute action to resolve NPLs, and to deal with insolvent financial institutions.

Develop market institutions for competitive financial and capital markets.

(a) The government should improve the legal framework to further develop the equity and insurance markets. In particular, the state needs to:

(b) Establish the listed corporate bond market, and the derivatives market.

(c) Classify the stock exchanges with different categories to fit each group of listed companies;

(d) Restructure securities companies by dissolution, and consolidate weak securities companies to reduce the number of securities companies to between 40 and 50.

(e) Encourage the development of private funds.

Promulgate legislation allowing operation of voluntary pension funds, private insurance companies, and limited liability insurance companies.

The state should develop policies and institutions to encourage listed companies to invest in the manufacturing and business industries that generate higher productivity employment, and that increase domestic value added to the economy.

State role in facilitating international integration of finance and capital markets

The government should formulate proactive macroeconomic policies to prevent risks and to control the inflow and outflow foreign investment. The Vietnamese government should be proactive in implementing financial sector integration according to commitments under regional and international agreements. Policies need to be adopted to gradually liberalize the capital account at a pace appropriate with Viet Nam's development conditions and international commitments, while also ensuring national economic stability.

[64] See thematic report for analysis of the progress already made in developing payment systems. The WB has supported efforts to improve payments systems and other financial infrastructure.

Table 5: Recommended Action Plan to 2020

Recommendations and Action Needed	Target
1. Separate state ownership and regulatory roles	
• Restructure the State Bank of Viet Nam as an independent Central Bank in line with good international practices. Monetary policy should be oriented towards targeting low inflation with reduced reliance on administrative intervention.	2020
• Clearly separate the state's role as financial sector regulator from its role as owner of financial institutions. Ownership rights in state owned financial institutions need to be transferred from state agencies (such as the SBV and MOF) involved in regulating the sectors as soon as possible (e.g. by end of 2017).	2018
• Shift all policy and targeted lending from commercial banks and VDB to VBSP. Strengthen the governance of the VDB and VBSP to ensure that their policy objectives are realized in the most cost-effective manner.	2017
• Reduce the proportion of state ownership in commercial banks.	2016-20
• Establish and improve the legal framework for consumer protection. The state should ensure that securities companies separate investors accounts from their assets and should strictly enforce listing requirements for listed companies.	2018
• Further develop and implement modern payment systems.	2018
2. State oversight and governance of financial system	
• Move to a more unified regulatory oversight agency model. Build regulatory oversight and enforcement capacity of specialized regulatory agencies.	2017-20
• Separate the licensing function from the supervision function of specialized regulatory agencies.	2017
• Shift the focus of supervision, from compliance-based supervision, to risk-based supervision. Build capacity to implement risk based approaches.	2017
• Establish and maintain an effective financial system infrastructure, including more effective use of information technology for monitoring and oversight including automatic supervision and risk warning system for banking, securities and insurance.	2017-20
• Promulgate and implement regulations to improve the transparency of financial and capital markets. Require all commercial banks to meet international standards of corporate governance, transparency and reporting.	2018
• Take resolute action to resolve NPL and insolvent financial institutions.	2017-20
3. Develop market institutions for competitive financial and capital markets.	
• Ensure that domestic and foreign financial sector investors compete equally with each other and with state invested financial institutions.	2017-20
• Develop international standardized credit rating agencies and valuation agencies to establish and develop corporate bonds and derivatives market.	2020
• Establish a listed corporate bond market.	2018

• Establish a derivatives market.	2020
• Establish different categories of stock exchanges to fit the risk profile of different group of listed companies and investors.	2017
• Close or merge insolvent securities companies.	2017-20
• Encourage the development of private funds.	2017-20
• Promulgate legislation to permit voluntary pension funds, private insurance companies and limited liability insurance companies.	2018
4. Facilitate international integration of finance and capital markets	
• Develop clear and transparent macroeconomic stability policies to limit volatility in levels of foreign investment inflows and outflows, while also liberalizing the capital account in line with national realities and international commitments.	2016-20
• Proactively implement finance and banking integration plans in accordance with time lines agreed under regional and international agreements.	2016-20
• Deregulate exchange rate management with the aim of ensuring full convertibility of the Vietnamese Dong.	2020

SUMMARY CONCLUSIONS AND RECOMMENDATION

The Role of the State in Developing the Vietnamese Economy

The ongoing ambiguity about the role of the state in Viet Nam's economic development has caused confusion and policy uncertainty, and increased perceptions of investment risk. Ambiguity has also provided unproductive opportunities for corruption and encouraged "rent-seeking" behaviour. More precise statements by senior leaders about the role of the state in key areas of economic development could help reduce ambiguity and uncertainty, and increase confidence. In particular, explicit statements to clarify that socialist orientation refers to a strong state focus on ensuring equitable access to social, political and economic opportunities, while avoiding (unproductive) state intervention in markets and business activities could help reduce opportunities to slow the reform process.

A clear message from the studies is that while there are important lessons that can be learned from international and national experiences, there is no single "best model" that can be applied to Viet Nam. Policy makers will need to continue to monitor and adapt systems and institutions to meet the specific needs of different institutions in Viet Nam. In many areas (e.g. targeting vulnerable groups, improving regulatory quality and enforcement, building independent regulators, community participation in planning and oversight) further experimentation is needed to further enhance state effectiveness role in supporting socio-economic development.

The studies emphasized that because state capacity (financial and human resources) is limited, greater effort is needed to ensure that resources are directed to highest priority areas and issues. The studies identify areas where the state role needs to be strengthened (planning, standards, enforcement, developing market institutions and factor markets, and monitoring and oversight), areas where the role of the state needs to be reduced or streamlined (commercial activity, and administrative procedures). The state needs to both strengthen and streamline its regulatory role.

Another message is that "changing mind-sets" will be critical to successful implementation of reforms aimed at improving state effectiveness and accountability. Vietnamese business leaders, researchers, and technocratic policymakers will need to work together to develop medium-term strategies for formulating, "marketing", and implementing reforms. They need to consult broadly and proactively to identify constraints to development and to build the evidence based on the need for reform. Political leaders and policy makers will require close, frank, and interactive channels to interact with business leaders, technocrats and researchers[65]. The mass media and society have to be involved in informing policy design, and in reviewing and monitoring progress and advocating for changes in reform directions as appropriate.

The studies also noted a need for clear statements about the rights of non-state actors to take action when state agencies abuse state powers to the detriment of non-state actors. There

[65] Experience with Enterprise Law related reforms provides a model for successful use of this approach. The Government established a Task Force (of technocrats and researchers) for Enterprise Law Enforcement, with brought positive results in accelerating implementation.

is also need to further develop institutional mechanisms to empower non-state actors to monitor and protect their rights when state representatives abuse their powers. More work is needed to study and identify best practices used in other countries to protect non-state actors from the abuse of state power.

Innovate to Mobilize Resources to Deliver Equitable Outcomes

While the state continues to struggle to provide essential services and infrastructure to disadvantaged groups, the demand for higher quality public services is increasing with a quickly growing middle class. Viet Nam public resources will be insufficient to cover these increasing costs of higher quality services. There is a compelling need to mobilize private resources to cover some of the costs, especially for non-essential and non-priority services and infrastructure. Nevertheless, the state should continue to subsidize the provision of public services and infrastructure to the most vulnerable groups in society and to the most disadvantaged regions with the aim of ensuring more equitable access to economic and other opportunities.

International and national experiences show that very different models for state delivery of essential public services (education, health and basic infrastructure) and public infrastructure can deliver successful and equitable outcomes. Many countries have achieved good outcomes with relatively strong direct state involvement in the provision of public services and infrastructure. Policy makers need to study, and recognize the plusses and minuses of each model, and adapt preferred models to the practical realities in Viet Nam. Ongoing monitoring, learning and adaptation should be an important element of efforts to build state capacity to provide public services and infrastructure.

There are exciting new opportunities to innovate in the way that the state facilitates socio-economic development. Information technology, independent regulators, private PSPs, and social enterprises are providing options to improve the efficiency and effectiveness of the state as a facilitator of economic development, and as a provider of public services and infrastructure. The state needs to continue to look for opportunities to empower poor people to stimulate competition between public service providers. International experience suggests that it may sometimes be more effective and efficient to subsidize the poor to pay for some public services themselves, rather than subsiding the institutions to provide public infrastructure and services. The state should explore options to provide subsidized credits to the poor which can be used to pay for services from licensed PSPs. This will allow the poor to decide what public services they value most and from what suppliers and, thus, increase competitive pressures of service providers.

Greater autonomy[66] can help PSPs and infrastructure developers to innovate, compete and respond to local needs, and should be encouraged to improve quality and relevance. Unbundling of public utilities, and increased use of performance benchmarking, have the potential to increase competition and efficiency. The state needs to play a more pro-active role in establishing, monitoring and enforcing national quality standards for public infrastructure and public service delivery (e.g. for roads, power, education, health, vocational skills, and water

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[66] E.g. Directions from Government to move to more autonomous service providers are included in resolution 40NQ-CP 9/8/2012).

quality). Operators should not be allowed to engage in anticompetitive conduct against the public interest. The focus of state oversight should be on promoting fair, transparent and open competition that drives improvements in the quality, and cost effectiveness, of public infrastructure services.

Build Market Institutions, Promote Competition, Entry and Exit of Business

Another recurring theme was the need for the State to withdraw from commercial activities to focus on helping build inclusive institutions to facilitate competition and proactively avoid and reduce impediments to competition. The state should not be a substitute for the private sector where markets are, or can, function effectively or where contestability can be realized. Priority should be given to reducing the role of the state in all commercial business activities, including reducing direct involvement in the provision of public infrastructure, public services, network industries, and financial markets. Clear statements on the relative roles of the state and the private sector in business and economic development could play an important role in changing mind-sets and business confidence. Suggested principles include:

- The state will gradually withdraw from all commercial business activities that can be efficiently and effectively undertaken by the non-state sector.
- The non-state sector drives economic growth and job creation, and will be pivotal to sustained progress in reducing poverty and raising living standards.
- Competitive markets play the leading role in guiding resource allocation. The development of competitive factor markets is a critical element of the national development strategy.

The state needs to strengthen market institutions and state capacity to exercise its responsibilities to effectively regulate the market economy. Development of factor markets (land, labour and capital markets) are urgent priorities. There is also an urgent need to build and develop truly independent regulators in key areas, including competition, network industries, education standards, health standards, and food safety. The state needs to develop autonomous units – accountable to local communities -- to provide essential and basic public services to local communities in areas where it is not feasible to attract privately owned PSPs.

Ongoing efforts to promulgate a new Competition Law provide an opportunity for Viet Nam to develop a model competition policy and competition agency in line with international best practices. There is now an opportunity for Viet Nam to draw on international good practices to develop competition policy institutions and structures (including periodic regulatory reviews) that may serve as a model for competition policy elsewhere in ASEAN. This could help to maximize national benefits from regional economic cooperation agreements such as AEC, RCEP and TPP.

The state also needs to build capacity to improve regulatory quality and to ensure that regulatory objectives are achieved in the most efficient manner for the national interest. State agencies need to be mindful of opportunities to minimize, wherever possible, the regulatory burden on business when assessing the costs and benefits of regulation. Consideration should be given for periodic public inquiries into problematic industries and sectors to identify barriers to competition and productivity growth, and to work with stakeholders to identify recommendations to resolve these bottlenecks. Some form of annual reporting to the National Assembly on efforts to improve regulatory quality and reduce regulatory costs on consumers and businesses could help increase the pressure on government agencies to improve regulatory quality.

Strengthening Governance and Accountability

All thematic studies highlighted the need for the state to be held responsible to society for facilitating the equitable, effective and efficient delivery of public services and infrastructure, and broader socio-economic development. This message is reinforced by a recent OECD (2016) study on "The Governance of Inclusive Growth". Greater transparency, and non-state participation, in the planning, implementation, monitoring and evaluation of public infrastructure and services are critical in promoting accountability. Transparent and competitive bidding for public projects is important in promoting efficiency and equity. Strengthen and enforce guidelines regarding competitive bidding for public procurement, including guidelines for advertising opportunities to participate in PPP projects.

The studies also highlighted the need for state agencies to be accountable for achieving clearly defined results. Ideally, all state agencies should be required to prepare clear charters and performance targets. And all central government agencies should be required to submit annual financial and performance reports for review by the National Assembly and the general public. These reports should provide evidence of compliance with charters and of progress towards achieving performance targets.

Civil society organizations and the mass media and the general public are essential in holding the state accountable. Despite some progress in recent years, more effort is needed to establish and enforce clear guidelines on public sector transparency, including ensuring that citizens have opportunities to provide input and comment to all planning, budgeting, implementation and monitoring and evaluation processes at all levels of government. It is especially important to encourage increased non-state stakeholders in the planning and oversight of state provision of public services and infrastructure.

Table 6: Recommended Action Plan to 2020

Recommendations and Actions Needed	Target
1. Clarify the role of the State in Viet Nam's Economic Development	
Senior leaders clearly enunciate the priority obligations and responsibilities of the state to its people and economic actors. Suggested principles include: • The state will ensure that all people have equality of opportunity to succeed in life, human development, employment and/or in business. • The state will play a leading role in guiding national development via macroeconomic management, the development of market economy institutions, ensuring effective and efficient delivery of public services and infrastructure, and by budget transfers to ensure that all people have equitable access to social and economic opportunities. • The state will build inclusive and efficient institutions that are critical to realizing sustainable and equitable economic outcomes. • The state will identify and address barriers that impede equitable access to social, economic and political opportunities, and will strengthen state capacity to effectively regulate to ensure a level and competitive playing field for all individuals (regardless of ethnicity and gender) and all businesses.	2016-20
• Further develop institutional mechanisms to empower non-state actors to monitor and protect their rights when state agencies abuse their state powers.	2017-20
• Regularly monitor and report (to the National Assembly and society) on progress in strengthening the role of the state in effectively and equitably delivering the public services and infrastructure expected by an emerging middle-income country.	2018
2. Innovate to Mobilize Resources to Deliver Equitable Outcomes	
• Continue to explore opportunities to mobilize private resources to finance the provision of public infrastructure and services.	2016-20
• Continue to subsidize the provision of essential public services and infrastructure to the most vulnerable groups in society and to the most disadvantaged regions to ensure more equitable access to economic and other opportunities.	2016-20
• Ensure that PSPs have greater autonomy[67] to innovate, compete and respond to local needs, while also ensuring that national quality standards are met (e.g. for education, health, vocational skills, and water quality), and ensuring that PSPs do not engage in anticompetitive conduct against the public interest.	2016-20
• Strengthen the enforcement of improved national standards on the quality of public infrastructure and public service delivery.	2016-20

[67] E.g. Directions from Government to move to more autonomous service providers are included in resolution 40NQ-CP 9/8/2012).

3. Build Market Institutions, Promote Competition and Get the State out of Business	
The state should make clear commitments with regard to the respective role of the State and the private sector. Suggested commitments include: • The state will gradually withdraw from all commercial business activities that can be efficiently and effectively undertaken by the non-state sector. • The non-state sector drives economic growth and job creation, and will be pivotal to sustained progress in reducing poverty and raising living standards. • Competitive markets play the leading role in guiding resource allocation. The development of competitive factor markets is a critical element of the national development strategy.	2016-20
• Develop and approve a national competition policy framework to guide all government agencies on measures to strengthen competition to accelerate productivity growth.	2018
• Develop and strengthen an independent competition agency (outside of line agencies) with sufficient capacity and power to identify and address barriers to fair and equitable competition in line with national economic interests.	2018
• Develop and strengthen network industry regulators that are independent of line agencies.	2017-20
4. Strengthen Governance and Accountability	
• Require all state agencies to prepare clear charters and performance targets, and require all government agencies to submit annual financial and performance reports to the National Assembly and the general public.	2018-20
• Strengthen and enforce guidelines on competitive bidding for public procurement, including guidelines for advertising and awarding opportunities to participate in PPP projects.	2016-20
• Establish and enforce clear guidelines on public sector transparency, including providing opportunities for the public to provide input to all planning, budgeting, implementation, monitoring and evaluation processes at all levels of government.	2018
• Encourage increased non-state stakeholders in the planning and oversight of state provision of public services and infrastructure.	2016-20

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