



Viet Nam

Economic and financial management

Working Paper 1

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The Australian Government's
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The views presented in this paper are the consultant's and are not necessarily those of the Government of Australia or the Government of Viet Nam.

Glossary

AFTA	ASEAN Free Trade Agreement
APEC	Asia-Pacific Economic Corporation
ASEAN	Association of South-East Asian Nations
BOT	Build, own, transfer
CEPT	Common effective preferential tariff
EPZ	Export processing zone
FDI	Foreign direct investment
GATT	General Agreement on Tariffs and Trade
GDP	Gross domestic product
HCMC	Ho Chi Minh City
IMF	International Monetary Fund
MOT	Ministry of Trade
MPI	Ministry of Planning and Investment
NA	National Assembly
ODA	Official development assistance
PAR	Public Administration Reform
SBVN	State Bank of Viet Nam
SME	Small and medium enterprise
SOCB	State-owned commercial bank
SOE	State-owned enterprise
UNDP	United Nations Development Programme
VAT	Value added tax
WTO	World Trade Organization

The policies and institutions that characterise economic and financial management in Viet Nam are very much a ‘work-in-progress’, being developed as the transition to a market economy unfolds. The challenges being faced in the evolution of economic and financial management can best be appreciated through the perspective of the processes of *doi moi*.

Viet Nam's economic reforms

Central planning was never as entrenched or as pervasive in Viet Nam as in other transition economies. Effective control over rural production was never really established, and the planning apparatus – in the sense that it operated in China, the Soviet Union and Eastern Europe – affected only a limited range of goods and activities. However, socialist ideology and the legacy of many years of running the economy on a war footing meant that many of the legal and institutional underpinnings of a market economy were poorly developed, as were the mechanisms of public financial management.

The decision of the Sixth Party Congress in 1986 to undertake a comprehensive restructuring and renovation process is often seen as the main point of departure for Viet Nam's economic reforms. However, experimentation with reform and liberalisation started rather earlier, as a response to periods of economic stagnation and macroeconomic instability and to the cessation of Chinese and Western aid in 1979–80. These early reforms included introduction of a contract system for agricultural production and legislation of ‘fence-breaking’ – allowing enterprises to trade in the open market after making centrally planned targets.

The initial focus of the post-1986 reforms was on transforming economic institutions. Prior to the Congress, a number of decisions were issued on the family economy and the role of private cooperative and state sectors in agriculture. Administrative constraints on private sector activity and domestic trade were gradually relaxed, allowing rapid development of private markets for agricultural goods. In 1987 and 1988, the administrative structure was rationalised and streamlined, and price reforms were accompanied by a reduction in rationing. Reforms in land allocation and the land use right system formalised fundamental changes in the agricultural sector.

The reform process gained momentum as the crisis persisted, culminating in a comprehensive break with the old system in 1989. Major institutional and structural reforms were implemented. The economy responded well to these changes and weathered shocks, such as the collapse of the former Council for Mutual Economic Assistance – which provided Viet Nam's main trading partners – and the withdrawal of Soviet support.

Box 1 lists some of the main areas where reforms in economic and financial management have been occurring under *doi moi*. These structural changes have

1 Structural elements of *doi moi*

Key elements of the restructuring and renovation process have included:

- Reversal of the process of collectivisation of agriculture by granting individuals and families long term rights to use land;
- Price liberalisation to eliminate the 'two price' system that prevailed under central planning, and removal of barriers to internal trade;
- steps toward creation of a modern banking system, by splitting off the commercial banking functions of the State Bank, and facilitating establishment of new foreign and domestically owned banks;
- partial liberalisation of foreign investment and international trade, accompanied by efforts to formalise entry into the multilateral and regional trading system and to regularise bilateral trading and investment relations;
- foreign exchange market reforms and shifting to a more market determined exchange rate system;
- reform of the SOE system through enterprise restructuring, introduction of new approaches for management and oversight, changing the relationship between SOEs and the budget and the financial sector, and more recently changing structures of ownership through equitisation;
- formal acceptance of the private sector and steps towards creation of a legal framework for the functioning of a corporate sector; and
- budgetary reform, to change the basis of revenue raising to a more modern system of taxation, and adoption of a more formalised expenditure planning and control system.

been accompanied by a strong stabilisation effort involving hardening SOE budget constraints, increasing revenues, containing expenditures and strengthening controls over monetary expansion. This effort ended a long period of hyperinflation, and increased confidence in the dong and in the emerging financial system.

The economic reforms have also been paralleled by a far-reaching, if rather slow moving process of PAR. This process, in its broadest definition, encompasses many aspects of *doi moi*, being concerned with changes in the role that the state plays in economic management, as well as changes in the structures and systems of public sector management.

A continued reform agenda

It appears to be quite widely recognised within Viet Nam that maintaining growth and poverty reduction is contingent upon further reforms. Certainly, donors and international commentators have been urging faster changes with respect to, among other things, addressing weaknesses in the banking system and associated regulation and supervision, state enterprise reform, private sector development and trade and investment liberalisation. Officials within key

ministries, and even within organs of the party, appear to endorse the priority to be attached to such reforms.

The Government has in various documents laid out a long list of economic reforms that must be addressed. The main elements are summarised in box 2.

2 **Agenda for further reform**

- Reform of the SOEs, including reform in the corporate structure and management of state enterprises, the legal provisions for the equitisation of state enterprises, and a shift in the ownership of selected state enterprises.
- Development of a comprehensive legal system to provide a clear, consistent and stable legal framework for all actors in the economy.
- Development of competition and antimonopoly laws and laws on public procurement, to limit restraints on trade and promote competition, including competition between different state enterprises.
- Reduction in policy and institutional constraints on private investment.
- Streamlining and strengthening of the public administration to increase efficiency and reduce corruption.
- Further development of an efficient system of labour, land, capital, fixed asset, goods and service markets.
- More effective geographical integration of national markets linking urban, rural and mountainous areas.
- Strengthened national planning capacity and an improved database, to monitor an increasingly sophisticated economy.
- A strengthened system for the identification, preparation and appraisal of investment projects and the capacity to analyse the impact of policies and design the most effective government interventions in the economy needed to be improved.
- Continued reform of the tax system to increase its transparency and predictability and to expand the tax base.
- Monetary policy instruments need to be strengthened, and the commercial banking sector needs further reform, banking ordinances need to be amended, and steps taken to develop a securities market and the insurance industry.
- The adjustment of foreign trade policies is an ongoing task, including reforms of tariffs, non-tariff trade restrictions, and import and export procedures, and liberalising access to import-export.
- Adjustments are needed in the policy/incentive regime to attract foreign investment, including steps to remove differentials in tax treatment and service charges paid by foreigners; to unify the provisions of the domestic and foreign investment laws; to streamline procedures for approval of foreign investment, to allow foreigners to hold shares in private companies and equitised state enterprises; and in general to reduce the restrictions on business activities.

Characteristics of the renovation process

The following observations can be made about the reform process.

- It has been extraordinarily wide ranging, reflecting the challenge of a transition from central planning to a market economy.
- There has been a strong element of learning by doing, as policy makers have implemented reforms and refined and reformulated policy on the basis of both lessons from the past and particular pressures of the day.
- The pace of reform has not been steady, and there have been periods of consolidation and even reversal – indeed, in periods of rapid growth and strong inflows of foreign savings, in the form of ODA and foreign direct investment (FDI), the scale and pace of change has moderated.
- The most radical changes have occurred in times of crisis, and the most difficult economic reform measures and adjustments were undertaken before the resumption of multilateral assistance in 1993.
- It has not been a top down, blueprint driven process – rather it has been characterised by search and learning processes, and there is no discernible pattern or apparent coordinated sequencing, except perhaps in late years as the Bretton Woods institutions have played a larger role in advising on the process.
- While there has been a rapid process of legislative development, implementation has often fallen far short of both the spirit and letter of new policies.
- Many contradictions remain in both policies and practices, reflecting both the scale and lack of coordination of reforms, and the existence of unresolved issues or lack of complete political support for some changes.

The persistent gap between laws and implementation, and the prevalence of contradiction reflects much more than issues of capacity and coordination. A strong debate still continues within the Party about the ideological and strategic implications of reform, and the challenges of reconciling the transition with the prevailing socialist orientation.

Assessment of selected components of the reform process

Private sector development

The 1992 constitution explicitly recognised a role for the private sector. However, official policies and the ingrained attitudes of many officials and agencies created little space for the development of private enterprises other than household enterprises. Private companies (joint stock and limited liability) account for little more than 7 per cent of GDP and 1 per cent of employment (table 3).

Development of the private sector – and efficient functioning of state-owned enterprises – has also had to wait upon the establishment of a legal framework covering the basic elements required for the operation of a market economy. This has involved promulgation of laws on companies, foreign direct investment, domestic investment, bankruptcy, land tenure, banks and financial institutions, mortgages and insurance and the clauses of the 1992 constitution allowing individuals to exercise property rights over income producing assets and personal property.

3 GDP and employment by type of ownership, 1998

Ownership	GDP	Employment
	%	%
Public (state enterprises and collectives)	49.1	9.1
Private	41.1	90.3
of which		
Households and farms	34.0	88.9
Private companies	7.1	1.3
Foreign invested companies	9.8	0.6
Total	100.0	100.0

Source: Riedel, Bui and Nguyen (2000).

Introduction of institutions for implementation and enforcement of these laws has been much slower than formulation of the laws. Economic courts and a Viet Nam International Arbitration Centre have been established, but expertise within the legal system with settling disputes and enforcing rights in the commercial arena is still limited. The development of a register of land titles is needed to facilitate a market in land use rights, which is also constrained by fundamental limitations in the nature of these rights. Developing an administrative appeals process to sort out problems of piecemeal legislation and overlapping responsibilities of government agencies has also been slow.

Separate – and often highly differentiated – legal regimes apply to similar activities that differ only by the ownership of the entity carrying them out. For example, foreign investment and domestic investment are handled under separate laws. Consolidation of the underlying framework for economic activity and enterprise governance is needed to facilitate the more complex transactions and entities that a modern developed economy will require.

The recent passage of the revised Enterprise Law should help to speed up the process of company formation by reducing discretionary approval requirements and the removal of many of the existing business registration and approval–licensing requirements, which prevent market entry and increase costs. However, much more needs to be done. Areas where further reforms are required include:

- clarifying and improving the law relating to the making and enforcement of contracts

- enhancing the ability of enterprises to make credible commitments to repay debt by introducing a summary judgement procedure, and enhancing the effectiveness of enforcement regimes for court judgments and arbitration awards
- improving the law on secured transactions, and providing for registration of security interests, to facilitate access to credit
- removing legal restrictions on interest rates for deposits and lending
- making high quality domestic arbitration procedures available in Viet Nam
- improving the law on bankruptcy
- facilitating commercial payments between firms by introducing a new law on negotiable instruments, including cheques, and making provision for electronic transactions
- clarifying ownership rights in respect of land use rights and buildings, and the ability to grant security interests over land use rights and buildings, to improve access to land and buildings for industrial projects, and
- improving the processes by which laws are made and implemented and publicised, to reduce uncertainties and compliance costs faced by business.

Addressing these issues will also play an important role in setting the framework for operation of commercially oriented SOEs.

SOE reforms

The Government commenced reforms of state enterprises in the mid-1980s. Early state enterprise reforms under *doi moi* included the introduction of a number of measures to increase autonomy and efficiency within the state enterprise sector, including introduction of profit-based accounting, reduced budgetary support, retention of depreciation charges and termination of state supply of inputs.

A second ‘wave’ of reforms commenced in 1991. Prompted by the continuing financial difficulties facing a majority of state enterprises, these reforms focused on reorganising and consolidating the state enterprise sector. This led to the number of SOEs falling from 12 297 in November 1991 to 6264 by 1 April 1994. Some 2000 enterprises were liquidated and around 3000 were merged with other enterprises. Most of the enterprises affected this way were small, locally managed SOEs with less than 100 employees and less than US\$45 000 in capital. A second phase of reregistration was initiated in 1994 requiring umbrella organisations – such as unions of enterprises and State Corporation – to be registered or dissolved. The second phase led to a further fall in the number of enterprises to under 6000 by end-1995.

Despite the reduction in the number of state enterprises, the sector continues to pose a serious threat to macroeconomic stability and prospects for sustainable growth. SOEs account for some 30 per cent of GDP, 20 per cent of total

investment and 15 per cent of non-agricultural employment. They also account for about 50 per cent of outstanding bank credit, so their financial performance has important implications for the soundness of the banking system. The sector is highly concentrated: the 200 largest SOEs account for some 60 per cent of state capital and 40 per cent of total debt, and many of the other enterprises are extremely small.

Data on financial performances of SOEs are hard to obtain and hard to interpret. Data gathered by the Ministry of Finance on 5429 (out of a total of some 5800) enterprises showed that 40 per cent were making losses in 1997 (IMF 1999).

Loss making enterprises appear to be less labor-intensive and less export oriented than profitable enterprises, and are concentrated in Hanoi, HCMC and Haiphong. Loss makers are typically highly indebted, with a significant proportion (around 30 per cent) of their loans overdue.

State enterprises generally are highly indebted, and their indebtedness appears to have grown as their performance has deteriorated in the last couple of years. The MPI is reported as saying that SOE debts reached US\$14.2 billion at the end of 1999, over 50 per cent of GDP.

Four major developments in the reform process are shaping the future directions for the state sector. These are the:

- establishment of the *Law on State Enterprises* (1995)
- establishment of a number of enterprise groupings (state corporations) (1994)
- introduction of the pilot equitisation program (1992), and
- setting up the basis for leasing and divestiture of small SOEs.

The law on state enterprises

The Law on State Enterprises was passed in April 1995. The law establishes state enterprises as separate legal entities with limited liability. It provides for both public service enterprises – producing or providing public goods and services – and state business enterprises. State business enterprises are expected to operate on the same basis as private companies, with similar corporate governance structures and with profit maximisation as the main objective.

The law also made important progress in clarifying responsibilities and accountability regarding the management of state enterprises and the nature and exercise of ownership rights over enterprises.

Although the law has been in place for a number of years there have been significant delays in issuing detailed implementation guidelines and in effective implementation of the key provisions. The process of clarifying SOEs as public service or business enterprises has been delayed by the absence of criteria and clear allocation of responsibilities for the process. The financial performance reporting requirements of the law are not functioning well.

State corporations: establishment of enterprise groupings

The Government issued two decisions in 1994 (Decisions 90 and 91) which set out the procedures for establishing and registering state corporations. The main objectives for the establishment of state corporations are to:

- rationalise state enterprise supervision
- facilitate the termination of line ministry and local authority control over state enterprises, and
- realise economies of scale in management.

Eighteen general corporations and around 64 smaller special corporations have been established since the decrees were issued.

In practice, state corporations do not appear to have made much of a contribution to the objectives laid out for their establishment. Contrary to early expectations, the creation of Boards of Management for Corporations has not resolved conflicts and confusion over the exercise of ownership rights, nor has it consistently improved management skills available to enterprises. The state still directly exercises control over final decisions on major policies, investment plans and on the appointment and dismissal of senior management. Line ministry officials remain actively involved in a full range of day-to-day management decisions. In some cases, membership of state corporations has weakened, rather than strengthened, the financial viability of enterprises as key commercial functions and autonomy with regard to pricing, sales and purchasing has been taken away. And there is no immediate evidence – in the form of readily available financial statements, especially consolidated statements – of improvement in accountability and transparency (CIE 1998a, 1999a).

The Government conducted a review of general corporations early in 1999. The review noted deficiencies in their performance, including low productivity, high costs and a tendency towards monopoly, but called for efforts to strengthen their performance and for the development of plans to form conglomerates on a pilot basis (IMF 1999).

Equitisation

The National Assembly (NA) agreed to a pilot equitisation program to commence in 1992 following a resolution in the Seventh Party Congress in the previous year. The specific objectives of the scheme were to:

- mobilise increased capital for investment
- increase efficiency through improved management and incentives, and
- allow enterprise employees to also be owners.

Only nonstrategic enterprises are eligible for equitisation. Strategic enterprises will remain 100 per cent state owned. Shares are to be offered to both employees and to persons outside of the firm.

While the equitisation program has been in operation for eight years progress has been slow. This appears to be partly due to administrative deficiencies such as inexperience within responsible agencies, a lack of clear and transparent guidelines (especially in the valuation and sale of shares) and complex valuation problems posed by inadequate accounting systems. It also reflects the continued role of SOEs in providing services and benefits to various parts of the administration, and the complexity of dealing with the role of workers as owners.

There are strong incentives for agencies exercising powers of ownership and control (such as local people's committees or line ministries) or the management of enterprises to resist equitisation. For many line ministries and people's committees, state enterprises remain a significant source of resources (and political power). For managers of enterprises a major concern is the loss of privileges associated with being a state enterprise such as preferential access to land, quotas, credit, etc. Workers are concerned with changes in security of employment and the status attached to working with a state enterprise, and with resolving their ownership rights over assets of enterprises.

A series of initiatives to accelerate equitisation were introduced in 1998 following a review of the SOE reform program. These initiatives included issuance of decrees clarifying the policies towards equitisation and the overall process, establishing the National Enterprise Reform Committee to oversee the equitisation process and other aspects of SOE reform, and setting targets (150 enterprises to be equitised by end 1998, 400 by end 1999 and 1000 by end 2000).

Despite these initiatives, the process moved slowly, and fewer than 300 enterprises were reported to have been equitised at the end of 1999.

Leasing and divestiture

The Government issued regulations setting out procedures for divestiture and dissolution of SOEs in mid-1996 (Decree No 50-CP of 28 August 1996 on the Establishment, Reorganisation, Dissolution and Bankruptcy of State Enterprises). Although a fair degree of dissolution and divestiture of small enterprises accompanied the re-registration exercise in 1991, and de facto leasing of SOE assets appears to be a reasonably common occurrence, further progress on dealing with the large number of very small SOEs that are too small to equitise has waited on clear directions from the leadership.

The Prime Minister's address to the NA indicated the Government's intention to ... make a final settlement concerning the unimportant and loss-incurring enterprises of which almost all are of small or too small size, and which make up about half the total number of enterprises. Depending on specific enterprises, an appropriate settlement alternative may be chosen, such as merger with another enterprise, equitisation, sale, rent or contractual assignment by open bidding, dissolution or declaration of bankruptcy by law. (*Viet Nam Economic Review* 1997)

More recently, the resolution of the 4th plenum of the 8th central committee of the CPV endorsed this approach, and a program of complete divestiture of enterprises with capital less than VND1 billion by tender or complete sale to employees was announced in 1998. However, regulations to implement the program have been slow to be issued. A pilot program to experiment with different forms of divestiture was initiated in Haiphong during 1999.

Priorities for reform

Features of the current situation regarding SOE reform that are a cause for concern and which could be addressed in the action program include clarifying ownership, rationalising the portfolio, improving supervision and enforcing hard financial constraints.

The scope and pace of the first wave of reforms has not been maintained. The number of SOEs was quickly reduced from 12 000 to 6000 but since then progress has been slow. Attempts to improve supervision and management of SOEs have bogged down. This may be explained by a number of factors, including:

- delays in articulating the practical meaning of a commitment to maintain a leading role for SOEs (In practice, this could range from targeting state enterprise activity to provision of public goods and services and areas where strong public policy – and weak regulation capabilities – might justify state production, to an older style 'commanding heights' role throughout key sectors. But no such models have been clearly articulated, leaving scope for interpretation by line ministries, people's committees and SOEs themselves.)
- the absence – until now – of a perceived crisis requiring further reform, despite mounting evidence of problems in the SOE and banking sector mirroring those encountered in countries in the region currently in crisis
- elements of the reforms implemented to date – such as creation of general corporations – creating a stronger basis for resistance to reform, and
- the channelling of FDI to joint ventures with SOEs creating large resource flows through the SOE sector and opportunities to appropriate economic rents.

An increased pace and scale of SOE reform will require that these sources of impediments be addressed. Some clear priorities are as follows.

- Ownership rights over the operation of SOEs need to be clarified. Laws setting up general corporations leave exercise of ownership rights diffused across a wide range of agencies – central and line ministries, provincial governments, people’s committees and enterprise management itself.
- A clear separation of regulatory, operational and ownership responsibilities is needed. Regulatory and policy directions that are in a particular enterprise’s interest are usually not in the nation’s interest.
- Clarification and enforcement of a return to ownership is also needed as a discipline to ensure sound financial practices, good investment and operational decision making.
- There are still too many enterprises for effective management, and many are too small to equitise or include in a revamped system. A further round of rationalisation involving liquidation and divestiture is required. For those enterprises that remain with the state, better systems to ensure accountability of management for performance are required, along with mechanisms to monitor and enforce performance contracts.
- Increased autonomy for enterprises needs to be accompanied by stronger enforcement of restrictions on access to budgetary resources, and phasing out of preferential access to credit from the financial system.

Policies toward foreign investment

The Law on Foreign Investment introduced in 1987 ushered in the era of the ‘open-door’ policy. The law has been revised on a number of occasions, largely in response to suggestions from foreign investors. These changes, among other things:

- reflected the official encouragement of the domestic private sector and allowed private enterprises to enter into joint ventures with foreign investors
- reduced biases against 100 per cent foreign owned investment
- simplified and imposed deadlines on the bureaucratic approval process
- targeted incentives to specific classes of activity, and
- removed constraints on exports.

The legal framework for foreign investment, along with the development of a broader structure of business law, has created a more favourable environment for foreign investment. Together with efforts such as those leading to the lifting of the US embargo, the changes have prompted substantial inward flows of foreign capital with the value of approved projects reaching US\$34.1 billion at the end of 1997. Foreign investment has brought in its train a rapid expansion of imports of capital goods – and, more recently, producer goods – prompting requests for streamlining the trade regime and its administration. At the same time, it has created pressures for selective protection.

Policy issues for foreign investment

There are a number of regulations that have a negative effect on the environment for foreign investments. These are:

- restrictions on the transfer of ownership, including a requirement for central government approval
- the inability to issue stock
- requirements on the management structure of joint ventures
- limitations on ability to use land rights as collateral, and
- limitations on the period of investment licenses – authorisation for a joint venture is normally limited to 20–30 years, with renewal requiring government approval.

In addition, major joint venture decisions must be made by unanimous agreement of directors regardless of equity holdings and this requirement has led to concern about investors' ability to influence the use of their investment. (Although the 1997 amendments to the Law on Foreign Investment have relaxed this requirement in some areas.)

Implementation of policies and regulation toward foreign investment is also an issue that is frequently reported to be obtrusive and at variance with stated principles.

The privileged position of SOEs with respect to access to land and influences on administrative processes has meant that they are much more attractive as joint venture partners than private enterprises. This is not only a source of substantial bias, but it also is associated with the granting of high protection and other preferences to foreign investment projects. Equally importantly, it has meant that the large FDI flows have served to bolster and entrench the position of SOEs when absence of these resources might have prompted more radical reforms.

The current crisis in the region, which is affecting the major sources of FDI for Viet Nam, requires a major reconsideration of policy toward foreign investment. Investor interest in Viet Nam was already declining in the face of perceived problems with the overall regulatory environment before the crisis erupted. Now Viet Nam faces the prospect of drastically reduced flows from Asia, and the effects of a general reassessment in the global investment community of the risks and rewards of investing in the region. In these circumstances, some major changes in the regulatory regime are needed.

Trade and exchange policies

Changes in trade and foreign exchange policy, along with liberalisation of controls on foreign investment, have been key features of the opening up of the Vietnamese economy since the introduction of *doi moi*.

These changes have involved actions on six main fronts:

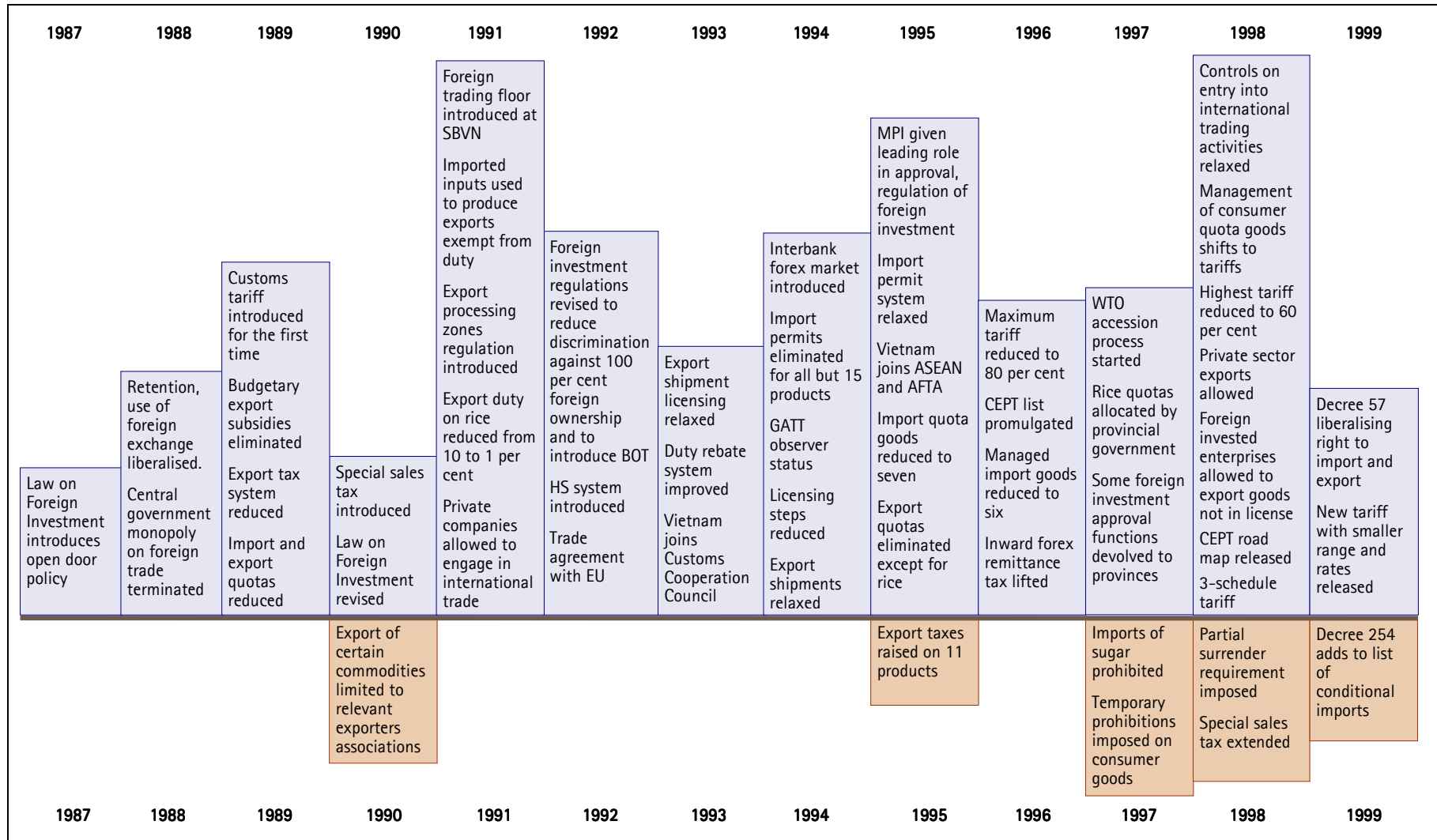
- phasing out of foreign exchange controls and adoption of a more market oriented exchange rate policy, accompanying large scale restructuring of the financial system
- relaxation of controls on entry into foreign trading activities
- relaxation of controls used to manage imports and exports
- creation and amendment of a system of taxation of imports and exports, as part of a comprehensive change in the revenue raising system
- joining regional and multilateral trading arrangements and establishing bilateral trade agreements, and
- development of a legal and regulatory framework to permit and encourage foreign investment.

Chart 4 summarises the main actions taken with respect to trade, exchange and foreign investment since the introduction of *doi moi*.

As a result of these changes, the trade and investment regime – and Viet Nam’s trade and overall economic performance – have undergone a significant transformation. According to some measures (such as the ratio of trade to GDP), Viet Nam appears to be a fairly open economy. As table 5 shows, exports now account for over a third of GDP, and the ratio of imports to GDP is over 40 per cent. Foreign invested enterprises have, on average, accounted for over a quarter of gross investment since 1991, and now account for 10 per cent of GDP (20 per cent of manufacturing GDP) and around 20 per cent of total exports. Growth in exports accounted for over 40 per cent of the growth in GDP between 1990 and 1998.

Despite the changes and the impressive growth in trade and investment that they have prompted, important features of the regime that preceded *doi moi* linger on, and, as chart 4 shows, in recent years the direction of change has sometimes been to restrict rather than liberalise trade. An intricate framework of administrative and legislative barriers to trade is still in force. Current account payments – interest, profit repatriations, etc. – are still not free of restriction, and capital repatriation for foreign investors is not guaranteed.

4 A timeline of trade and investment reform



Source: Warner (2000).

5 Trade and GDP, 1990–98

	Unit	1990	1991	1992	1993	1994	1995	1996	1997	1998
Trade										
Exports	US\$m	1 731	2 042	2 475	2 985	4 054	5 198	7 337	9 145	9 365
Imports	US\$m	1 775	2 107	2 535	3 532	5 250	7 543	10 480	10 460	10 346
Share of GDP										
Exports	%	22.8	24.7	25.0	23.2	26.1	25.6	31.0	37.7	36.2
Imports	%	23.4	25.4	25.6	27.5	33.8	37.1	44.3	43.2	40.0

Source: CIE (1998b); World Bank (1999b).

And more recently, surrender requirements were imposed on enterprises in receipt of foreign exchange inflows. Imports of key inputs and consumables – construction steel, cement, fertiliser, sugar, paper, glass and petroleum – are controlled according to administrative assessments of the balance between domestic demand and domestic supply. A similar balancing process is used in controlling exports of rice. Imports of consumer goods have been controlled by a range of administrative measures, including licensing, bans and foreign exchange restrictions.

The import tariff system provides high levels of protection to a range of local production, and is subject to frequent changes and inconsistent implementation. The trade-off between revenue and protection objectives does not seem to have been fully resolved in tariff setting, and there are large variations in tariff rates and considerable volatility in rates over time. Tariffs and quotas appear to be adjusted according to the ‘needs’ of established firms. In this way, protection is ‘tailor made’ with a view to meeting the requirements of local firms to maintain employment and output at the least possible cost to consumers.

More fundamentally, some trade is still manipulated with a view to its effects on other aspects of economic and enterprise management. SOEs play a leading role in the economy, and remain important sources of resources and influence for central provincial and local authorities and agencies. The interests of SOEs play a disproportionate role in the determination of trade policy, a situation facilitated by the continued close links between certain enterprises and policy-making ministries. But at the same time it appears that trade policies are shaped with a view to controlling SOEs in the absence of full fiscal and financial disciplines as well as to restraining competition and maintaining SOE revenues. Export processing zones (EPZs), and more recently industrial zones, have played a role in addressing the problems caused by the unresolved status of commercial and industrial land tenure. Because the transition to a modern tax system is still under way, and fiscal relations between central and local authorities are being reconstructed, allocation of rents created by trade restriction is an important part of the process of government finance.

These judgments need, of course, to be placed in context. One context is the trade regime of Viet Nam’s neighbours and main trading partners. But it is also

important to assess changes against Viet Nam's starting point at the beginning of *doi moi*.

It has been argued that Viet Nam's current regime is more restrictive than those of other countries in the region (see, for example, IMF 1999). Such cross-country comparisons are an important gauge of how well Viet Nam is doing relative to its neighbours. However, it is also important to look at what has been achieved over what time period in order to get an accurate picture.

In the mid-1990s some commentators were judging Viet Nam's trade regime to be quite open on the grounds that they could not identify legislated restrictions. In recent years the Government has acted to codify practices in law and supported greatly increased transparency of the trade regime – and economic policy generally – so that laws, regulations and decrees are available quickly and in the English language. Moreover, various government ministries, including the Ministry of Trade (MOT) have facilitated various trade policy reports and studies documenting and analysing the regime. The MOT also completed the accession document for WTO membership, which laid out the trade regime in great detail for all WTO members to examine. This transparency and analysis should provide the basis for reforming trade. But greater knowledge and awareness of trade barriers does not necessarily mean that there are more of them.

Only ten years ago, as most trade activities were centrally determined, incentives, taxes and conditions for trade such as licences and quotas were largely irrelevant in shaping trade outcomes because individuals and firms had no capacity to respond to them. Since then, the transition to a market economy with decentralised, commercially oriented decision making with respect to production, consumption and investment has been accompanied by the development of market-oriented trade and investment policies.

Property rights, enforceable contracts, access to information about markets – domestic and international – have developed so that individuals and firms have a greatly enhanced capacity, interest and willingness to engage in trade.

For most of Viet Nam's neighbours and trading partners, these conditions have existed for some time. It could be argued that the fact that conventional trade barriers as they are understood in a modern market economy now exist and are relevant is an indication of just how far Viet Nam has come in liberalising trade from the ground up.

Recent reports (CIE 1998b, 1999b) have reviewed the content, pace and direction of Viet Nam's trade reforms. They concluded that:

- there has been considerable liberalisation of trade and investment
- this liberalisation has been effective and most Vietnamese people are better off as a result, and

- while extended commitments, such as those made under AFTA, accession to WTO and APEC, and bilateral trade agreements still need to be met, they indicate a commitment to continued liberalisation.

However, it is clear that the pace of reform slowed after 1997. As the CIE's report on non-tariff barriers pointed out (CIE 1999b), a much wider range of products has come under the reach of quantitative restriction on imports, and access to foreign exchange has become subject to a range of direct and indirect rationing devices, which has tended to erode the effects of changes in the foreign investment regime and liberalisation of entry into international trade (under Decree 57 of 1998).

Fiscal and monetary policy

Viet Nam's stabilisation efforts during the 1990s have been very successful in combating inflation and placing government finance on a more sustainable basis. Inflation has been brought under control by a combination of monetary, fiscal and exchange rate management policies. Tight credit policies, reduction of subsidies to SOEs and enhanced revenue collection addressed fundamental fiscal and monetary sources of inflationary pressure. Exchange rate unification and an effective large real devaluation at the beginning of the decade – combined with trade liberalisation and the reduction of constraints on agricultural supply and the operation of the private sector – facilitated disinflation without recession.

The success of stabilisation efforts through the 1990s has not, however, reduced the urgency of further fiscal and monetary reform. The revenue system needs to be put on a basis that will free government at all levels from dependence on non-tax revenues from state enterprises – and so remove one of the obstacles to enterprise reform.

On the overall fiscal management front a number of key initiatives are being pursued. These initiatives are embodied in the work on:

- a new Law on State Budget
- a review of public expenditures to assess the effectiveness, value for money and consistency of overall expenditures with the Government's development objectives, and
- a Public Investment Program (PIP), to place development expenditure planning on a consistent and coherent basis.

Of these, perhaps the most far-reaching initiative is the Law on State Budget since it:

- codifies the preparation, execution, accounting and examination of the state budget and defines the responsibilities and rights of state agencies at different levels in state budget management

- requires that state expenditures must be subject to a range of legal and reporting conditions and overall approval by the NA
- specifies the revenue raising and expenditure power and responsibilities of the different levels of government
- provides for sharing of specified revenue sources and transfers from higher to lower levels of government, and
- provides for accounting and auditing of expenditures, and accountability for breaks of the law.

In 1999, the Government for the first time published information on the state budget. While this represented an important step towards fiscal transparency, it is clear that there is a long way to go to provide the public with a detailed and comprehensive accounting of the disposition of public resources.

Taxation

Viet Nam's tax system is in the process of transition from an arrangement most accurately described as one of negotiated tributes to one of payments of a predictable proportion of a well defined measure of enterprise activity or surplus.

Until the introduction of tax reforms in 1988 and 1990, state revenue collection relied primarily on contributions from SOEs. In 1988, the customs tariff was introduced to raise revenues directly from international trade transactions and in 1990, a turnover tax and a profits tax were introduced as a major step in linking domestic revenue collectives to reasonably objective measures of enterprise income and domestic consumption.

These structural reforms were accompanied by major institutional changes, including the creation of a national tax collection office (later to become the General Department of Taxation) under the Ministry of Finance, and the General Department of Customs.

In 1999, two major changes in the tax system came into force when a value added tax (VAT) was introduced to replace the turnover tax, and a business income tax replaced the multi-rate profits tax.

Four features stand out about the current tax system:

- the overwhelming reliance on indirect taxes – taxes on production and business transactions, including international trade – to raise the bulk of budgetary revenues
- a continued heavy reliance on contributions from the SOE sector
- the complicated nature of the leading nontrade taxes (VAT and company income taxes) because of the wide array of concessions, exemptions and multiple rates (CIE 1998a)

- the absence of a comprehensive personal income tax, and
- the large amount of discretion that is used in the administration and collection of taxes which, together with the collaborative nature of the administrative effort (between levels of government and different agencies), leads to tax payments being more in the nature of a negotiated tribute than a payment based on measurable transaction values or income flows (CIE 1998a).

While SOEs are a major source of tax revenue to the budget there are no dividend or profit flows from these enterprises to the Treasury (apart from a fixed capital use fee). This reflects the complex nature of ownership relations for SOEs. As the tax system is modernised, the absence of a return to the Treasury on the state's investment in SOEs will need to be addressed, otherwise it will be a source of budget imbalance and a distortion to the 'level playing field' being created for enterprises in the private and public sector.

The financial sector

The transition to a market economy required a fundamental change in approach to the role of money and credit, and in 1988, major reforms were implemented to bring the monobank system to an end.

The reforms created a separate State Bank of Viet Nam with full central banking responsibilities, and formed two new commercial banks from the industrial and commercial loan department and the agriculture credit department of the old state bank. Enabling legislation introduced in 1990 facilitated the establishment of commercial joint stock banks (*Commercial Banks Decree Law* of 1990), and legislation introduced in 1991 paved the way for establishment of foreign bank branches and representative offices and joint venture banks.

The *Commercial Banks Decree Law* also established a basis for regulating credit cooperatives – prompted in part by a collapse of many urban credit cooperatives in 1990. In 1994, regulations were introduced allowing the formation of people's credit funds.

At the end of 1996, the financial sector had expanded to comprise (World Bank 1997):

- 4 state-owned commercial banks
- 51 joint stock banks
- 23 foreign bank branches
- 4 joint venture banks
- 62 foreign bank representative offices
- 68 credit cooperatives
- nearly 900 people's credit funds

- 2 finance companies, and
- 1 government-owned insurance company.

The creation of a fully fledged central bank, the State Bank of Viet Nam, and the development of a commercial banking system have made important contributions to macroeconomic management and facilitating the transition to a market economy. The central bank has played a major role in macroeconomic stabilisation, reinforced by the severing of the direct links between the budget and the SOE sector that termination of the monobank system brought in its wake. The emergence of a commercially oriented banking system as the major source of domestic business financing has introduced an element of financial discipline and performance monitoring into the operations of domestic enterprises.

The introduction of Treasury bill auctions, and interbank deposit and foreign exchange markets have been first steps towards development of money markets. And the evolution of a more modern banking system has had some impact on the confidence in holding the local currency, and an expanding mobilisation of domestic savings for investment. Total financial assets have tripled between 1990 and 1996 (World Bank 1997), and real interest rates have been strongly positive in recent years.

Despite these positive developments, Viet Nam's financial sector remains quite shallow with the ratio of broad money to GDP stabilising at around 25 per cent (down from around 27 per cent in 1989). Structural rigidities, limited competition and perceptions of fragility associated with high exposure to poorly performing SOEs continue to erode public confidence in the financial system. Thus, gold and foreign exchange, and precious stones remain the preferred medium for savings for many Vietnamese households.

Dominating problems in the sector are serious weaknesses in the banking system, which are in turn linked to the poor performances of the state enterprise sector. Aspects of the vulnerability of the banking system include the following (drawn from IMF 1999):

- large foreign exchange exposure, with about 30 per cent of total bank credit being extended in foreign currencies (of which over 70 per cent is extended to SOEs)
- a growing and under-reported problem with non-performing loans (Officially reported overdue loans amounted to 12.5 per cent of total loans at end-September 1998, while loan loss provisions amounted to less than 1 per cent of total loans.)
- a maturity mismatch – with most deposits being of maturity less than one year, while some 20 per cent of loans have maturity over one year
- inadequate capitalisation (The average capital asset ratio of the state-owned commercial banks remained at 3.8 per cent after a major recapitalisation

carried out in September 1998. This compares with a legal minimum of 5.6 per cent and a desirable ratio of 10.3 per cent.)

- low profitability (Two of the four state-owned commercial banks have reported zero profits over the last four years.)

Some of the important issues that need to be addressed to create a sound financial system capable of meeting the needs of a modernising industrial economy include:

- the large element of nonperforming loans on the books of the state-owned commercial banks (SOCBs) and their dominance of the banking system. SOCBs account for over 80 per cent of the systems assets and deposits and they are in serious need of recapitalisation
- high transactions costs, due to the fragmented and rudimentary nature of the payments clearing system, and
- the reliance on direct controls to achieve monetary targets, which work against the pursuit of efficiency and deposit mobilisation by banks. This is linked to:
 - the lack of depth and width of financial markets and the absence of a legal framework for the operation of bills of exchange;
 - the biases against longer term project lending in favour of short term trade finance, created by the existing level of non-performing loans in SOCBs and the underdeveloped state of the legal system and property rights in the economy, that erode the viability of security and collateral pledges;
 - the uncertain nature of enterprises' access to foreign exchange – the lack of free convertibility on the current account means that banks are cautious about offering foreign currency loans to local firms, because they cannot be sure that debtors will be able to acquire foreign currency to meet obligations over the life of a loan;
 - the heavy reliance of the joint stock banks on SOEs as a source of deposits and for lending. The operation of some of these banks is closer to that of a 'credit club' than a genuine deposit mobilisation and intermediation function, and there is a risk that 'capture' of banks will work against the channelling of savings to the most viable projects; and
 - the absence of significant nonbank lending. There has been some limited recourse to bond issues, but without injections of equity capital into enterprises the scope for extensive use of this source of financing is limited. Development of a stock market is largely going to be driven by a decision to proceed with equitisation of SOEs. The current private corporate sector is too small to support a stock market, and only with a larger scale equitisation process would the preconditions for a market be created.

Donor activities and prospects for Australian assistance

Viet Nam is receiving extensive donor support for its efforts to develop new and more efficient systems of economic and financial management. The ADB, the IMF and the World Bank are supporting reforms in the financial sector, trade policy, state enterprise management and public expenditure management through balance of payments, support loans and/or technical assistance operations. The UNDP has an extensive program of technical assistance in economic and financial management, covering, among other things, support for design and implementation of state enterprise reforms, reviewing public expenditure, public investment programming, strengthening aid and debt coordination and management, and promoting international integration.

Regional and bilateral development cooperation agencies are also heavily involved in capacity building with respect to economic and financial management, with programs and projects supporting: policy research in economic management; tertiary training of economists; developing the insurance industry; strengthening auditing and accounting; developing policies towards intellectual property rights; reforming tax policy and administration; building up national statistics; planning for the transition to a market economy; improving expenditure monitoring and control; banking sector reform and development; capital market development; accession to the WTO and developing the legal framework for BOT projects (CIE 1998c).

Despite the wide range of existing donor activities, there are many areas where there is scope for well-targeted Australian expertise. One important area where Australia has already been active, through regional programs and trust fund facilities with the World Bank, is concerned with economic integration. A number of donors are supporting Viet Nam with respect to international aspects of integration – such as negotiating accession to the WTO and addressing implications of membership of AFTA. However, there is considerable demand for support in dealing with the *domestic* policy and institutional dimensions of integration – for example, developing and implementing strategies for trade and investment liberalisation, devising non-discriminatory forms of public regulation to replace non-tariff barriers, rationalising incentives for foreign investment, and addressing the revenue consequences of tariff reform by strengthening indirect tax policy and administration. The Ministry of Trade has proposed establishing a long-term cooperation agreement with AusAID for support across a range of trade policy and administration issues, targeting a selection of ministries and departments working on trade reform.

Another area, which is linked to both integration and private sector development, concerns domestic deregulation and competition policy. The implementation of the new Enterprise Law is creating a requirement to develop alternative approaches to achieving regulatory objectives (such as public health and safety) which do not act as barriers to entry or impose undue restrictions on the development of private enterprises. Australian advisers have already worked

with Vietnamese agencies on approaches to competition policy and regulatory review (Cuthbertson, Nguyen and Thai 1999), and Australian agencies such as the Australian Competition and Consumer Commission have established links with Vietnamese agencies. There is a rich and relevant Australian experience in regulatory review, which could be tapped to assist with this work.

AusAID is already working on micro-enterprise development, and there is scope to expand efforts in business skills training at provincial as well as national levels, perhaps in collaboration with NGOs which are active in this field in Viet Nam (such as Friedrich Ebert Stiftung, which has a long established program targeting practical and political dimensions of SME development in Viet Nam). This work could also be complemented by carefully constructed efforts to encourage business and professional associations representing private sector interests.

Australia also has a strong record in public expenditure management reform and is already involved – or about to be involved – in aspects of expenditure monitoring and debt management. It has been suggested that AusAID could support the work of the Economics and Budget Committee of the National Assembly. This could provide a basis for developing greater insights into budgetary and financial management processes in Viet Nam, and a platform for further technical assistance in the area. There may also be scope to build on current assistance with SOE reform. AusAID is currently supporting pilot studies on methods of divesting enterprises that are too small to equitise. There may be scope for drawing on Australian – especially state government – experiences in commercialising and corporatising government business enterprises, particularly with regard to corporate governance and performance monitoring.

Finally, there may be scope to assist in developing institutional capacities involved in collecting and disseminating information needed for economic management and economic development. As discussed in Working Paper 2, there are possible opportunities to work with the General Statistics Office and the Ministry of Agriculture and Rural Development to improve institutional capacities for gathering and disseminating information.

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