MONITORING AND EVALUATING

THE IMPLEMENTATION OF

THE MASTER PLAN ON ECONOMIC RESTRUCTURING

ACKNOWLEDGEMENT

This book was prepared by the Central Institute for Economic Management (CIEM) to fulfil the task assigned by the Government to the Ministry of Planning and Investment (MPI) on monitoring and evaluating the implementation of the Master plan of economic restructuring. The book also forms the basis for the implementation of stronger reform of economic institutions in the period 2016 - 2020. The preparation of the Report and the publication of this book received financial and technical support from the Australian Government financed Restructuring for a more Competitive Vietnam (RCV) Project.

The preparation of this book has benefited from constructive comments by MPI Leaders; leaders of agencies, departments, institutes and centers under MPI; members of CIEM's Research Advisory Board, and participants to the workshop held on 21 May 2015 in Hanoi for comments on the draft Report. The draft Report was also presented to workshops held at CIEM.

CIEM would like to take this opportunity to express great appreciation to the RCV Project for its financial support to the preparation of this Report.

This book was prepared by the CIEM team and consultants of the RCV under the guidance and support of Dr. Nguyen Dinh Cung, President of CIEM. The team was led by Dr. Nguyen Tu Anh and with the participation of Dr. Le Huong Linh and Ms. Nguyen Hai Thanh, with support from other members of the CIEM Department of Macroeconomic Policy and Integration Studies.

All views, opinions and errors in this publication are solely the responsibility of the authors and do not necessarily reflect those of the sponsor and/or CIEM.

DR. NGUYEN DINH CUNG

Director of the Central Institute for Economic Management

National Project Director of RCV

List of content

List of figures

List of tables

Abbreviations

ADB	Asian Development Bank
ASEAN	Association of Southeast Asian Nations
CAR	Capital Adequacy Ratio
CDS	Credit Default Swap index
CECODES	Center for Community Development Studies
CIC	Credit Information Center
CIEM	Central Institute for Economic Management
CNY	China Yuan
CPD	Cumulative Probability of Default Index
DTF	Distance to Frontier
DTF	Distance to Frontier Index
FDI	Foreign Direct Investment
GCI	Global Competitiveness Index
GDP	Gross Domestic Product
GSO	General Statistic Office
HNX	Hanoi Stock Exchange market
HSX	Ho Chi Minh City Stock Exchange market
ICOR	Incremental Capital Ratio Output
IMF	International Monetary Fund
MEI	Ministerial Efficiency Index
MPER	Master Plan on Economic Restructuring
MPI	Ministry of Planning and Investment
NPLs	Non-Performing Loans
ODA	Official Development Assistance
OECD	Organization for Economic Co-operation and Development

OER	Overnight Exchange Rates
PAPI	Provincial Governance and Public Administration Public Performance Index
PCI	Provincial Competitiveness Index
PPP	Public-Private Partnerships
ROE	Return on Equity
SBV	State Bank of Vietnam
SCIC	State Capital Investment Corporation
SOEs	State-Owned Enterprises
SSA	Shift-Share Analysis
TFP	Total Factor Productivity
UNDP	United Nations Development Programme
USD	US Dollar
VAMC	Vietnam Asset Management Company
VND	Vietnam Dong
WDI	World Development Indicators
WTO	World Trade Organization

INTRODUCTION

1. BACKGROUND

Vietnam's policy on economic restructuring to change the growth model toward sustainable growth has stemmed from the urgent demands of the economy and is in line with global trends in economic restructuring. This policy was concretized as the Master Plan on Economic Restructuring (MPER) to transform growth model and the specific plans to restructure several major sectors of the economy. The MPER specifies five main contents/orientations of economic restructuring, including restructuring of the financial-banking system, with the focus on credit institutions; restructuring of investment with the focus on public investment; restructuring of enterprises with the focus on state groups and corporations; restructuring of economic technical industries and services; and restructuring of economic regions. The contents of economic restructuring must be linked to each other and mutually interact.

In recent years, the implementation of the MPER has brought numerous positive changes and profound impacts on Vietnam's economy. Macroeconomic stability has been maintained. Public investment activities and the operations of state enterprises and the banking system have become increasingly transparent under greater monitoring.

However, various aspects of economic restructuring have not been as expected. Restructuring of public investment has been limited to tightening public investment disciplines rather than focusing on solutions to improve investment efficiency. State enterprises equitization has made slow progress and unfair incentives for state enterprises continue to distort the market. The process of resolving non-performing loans (NPLs) has dragged on, and credit has not increased as expected. The risk of macroeconomic instability has remained, particularly with the rapid rise in public debt. Furthermore, there has been no substantive restructuring of regions and sectors.

In this context, this publication serves to provide an assessment of the economic restructuring, including the notable achievements in the contents of restructuring, and improvements and problems with those factors promoting economic restructuring and changes in the growth model. On that basis, policy adjustments are proposed to continue to strengthen and improve the efficiency of economic restructuring to contribute to the transformation of the growth model towards higher labour productivity, more effectiveness use of national resources, and increased economic competitiveness.

2. OBJECTIVES

The key objectives of the Report on "Monitoring and evaluating the implementation of the Master plan of economic restructuring" are: (i) to review the process of economic restructuring of Vietnam; (ii) to evaluate the changes in policies on economic restructuring and achievements; (iii) to assess the performance and administration of macroeconomic policies during the period of implementing the Master plan of economic restructuring, and; (iv) to provide recommendations on administrating policies on economic restructuring to change Vietnam's growth model.

3. METHODOLOGY

3.1. General method

The report starts by highlighting the present necessity and inevitability of economic restructuring to change to a new growth model towards higher labour productivity, more effectively using national resources, and increasing the competitiveness of the economy (including the concept and connotation of economic restructuring; the characteristics and consequences of the old growth model; and identifying the objectives, orientations, preconditions, and guidelines of the new growth model).

Subsequently, the authors assess the current situation of economic restructuring, including the main achievements in restructuring, the positive and negative factors in promoting economic restructuring and transforming the growth model. The authors also evaluate the macroeconomic changes induced by the implementation of economic restructuring, including achievements and the problems and causes of these problems.

On that basis, the authors provide policy recommendations to strengthen and improve the efficiency of economic restructuring to help the transition of the growth model toward higher labour productivity, more effective use of national resources and increased competitiveness of the economy.

To assess the economic restructuring process, the authors use and compute some economic indicators with a focus on:

+ *Macroeconomic indicators*, such as economic growth rates, inflation, money supply, credit, investment, savings, trade balance, etc...

+ *The gross profit rates of commercial banks:* the difference between deposit rates and lending rates of commercial banks.

+ *The Credit Default Swap index – CDS and the Cumulative Probability of Default index - CPD:* to assess the likelihood of default risk of a nation.

+ *The Incremental Capital Ratio output – ICOR*: to evaluate the investment efficiency of the economy.

+ *Productivity:* The Total Factor Productivity (TFP), labour productivity, technical efficiency and allocative efficiency.

+ *The Provincial Competitiveness Index – PCI:* to assess the business environment, the quality of economic management and administrative reform efforts of the provincial authorities of Vietnam, thereby to promote the development of the private sector in the country.

+ *The Provincial Governance and Public Administration Public Performance Index – PAPI:* the evaluation of people on governance capacity and the supply of public services by the provincial authorities.

+ *The Distance to Frontier index – DTF:* to assess the potential capacity to improve the business environment of Vietnam.

+ *The National Competitiveness Index of Vietnam:* to assess the competitiveness at national level based on 12 pillars divided into 3 groups: (1) Basic requirements: Institutions, Infrastructure, Health and primary education, Macroeconomic stability; (2) Efficiency enhancers: Higher education and training, Goods market efficiency, Labour market efficiency, Financial market sophistication, Technological readiness, Market size; and (3) Innovation and sophistication factors.

3.2. Scope of research

This publication assesses the major achievements of restructuring in association with changing the growth model, including: (1) Macroeconomic stability; (2) Public investment; (3) Restructuring of the banking system; (4) Restructuring of state enterprises; and, (5) Other restructuring programs (restructuring of economic regions, of agriculture, industry and commerce...).

In assessing the macroeconomic transformation of Vietnam in the process of implementing the Master plan on economic restructuring, the publication focuses on the following areas: (1) Economic growth; (2) Budget; (3) Productivity; (4) The stock market; (5) The institutional indices.

4. STRUCTURE OF THE REPORT

Following this introduction, this publication consists of four parts:

Part One: Overview of economic restructuring

Part Two: Policy changes and achievements

Part Three: Assessing the macroeconomy

Part Four: Conclusions

1 OVERVIEW OF ECONOMIC RESTRUCTURING

1.1 The concept and meaning of economic restructuring

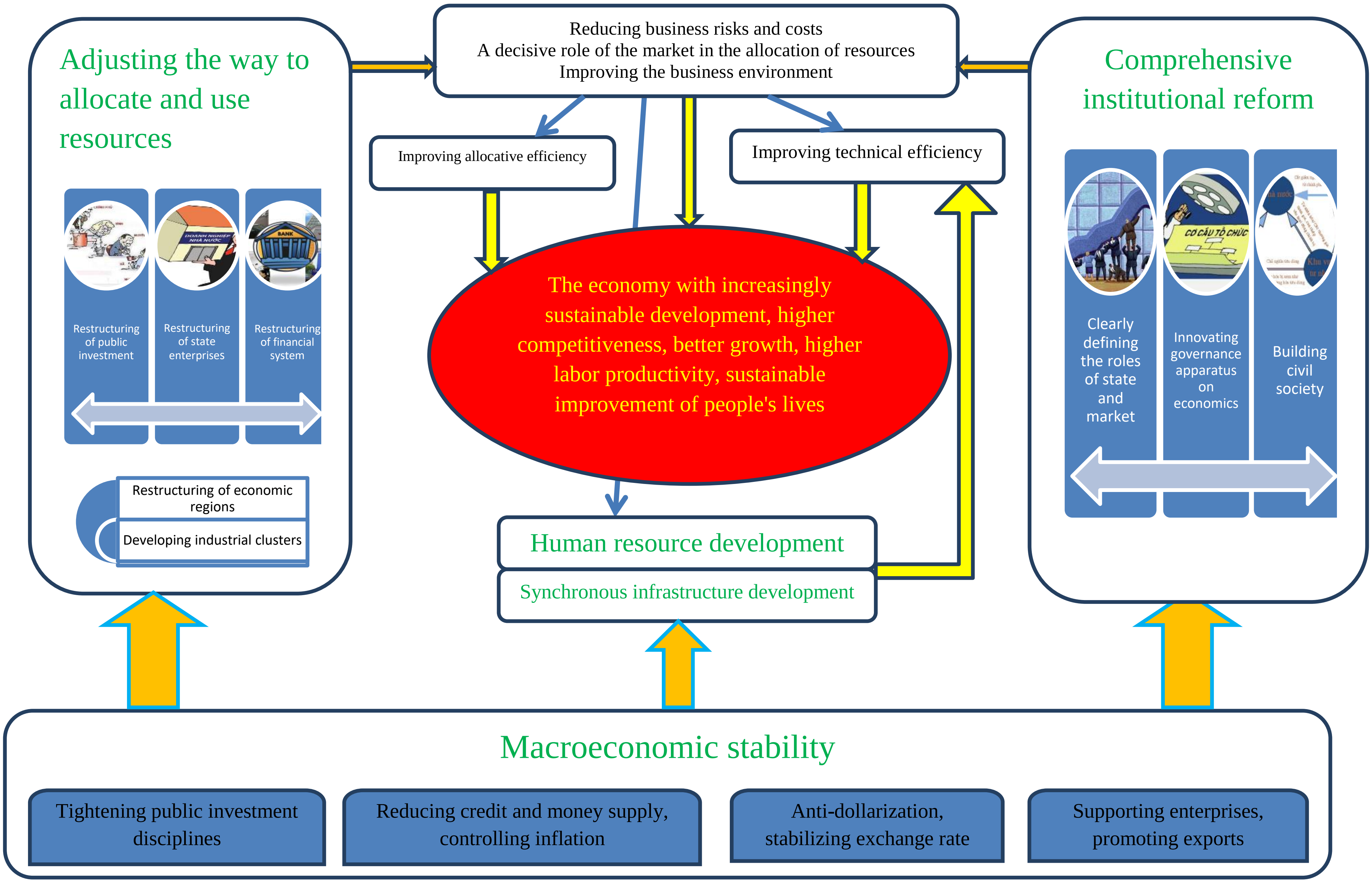
Different economies have different economic structures, as does one nation at different stages of development. Thus, economic structure as a whole is not simply a dichotomy of "underdevelopment and development", "advanced and backwardness", "agriculture and industry", but rather a "sequence" or a "series" of structural "points" forming a continuous and upward process. Shifting and changing economic structure is a long process in which economic structure gradually changes and shifts from resource extraction, less capital-intensive, labour-intensive, low level of technology, low value-added industries to more capital intensive industries with higher level of technology and value-added; from there, the economy moves from stage 1 to stage 2 and continues to stage 3 of the economic development process[1]. This movement process occurs due to the development of science and technology, change of market demand and changes in production costs of each enterprise, each sector and the whole economy.

A sound economic structure is a structure formed on the basis of effectively exploiting resources and competitive advantages of a country, increasing its productivity and competitiveness (compared to other countries at the same stage of development), creating a foundation for sustainable development. The converse is an unsound economic structure. The movement from an unsound economic structure to a more sound and efficient one is termed economic restructuring. Recent issues of our economy include not only economic restructuring but also how to transform our economic structure, improve technology, and enhance efficiency and competitiveness. Generally, economic crises are often motivating factors for economic restructuring to form a more sound, efficient, and competitive economic structure.

---

[1] Stage 3 is the highest stage of development. Currently, all of the industrialized countries are in stage 3 of the development process.

Figure 1: The framework of economic restructuring



In the process of economic restructuring, a new resource allocation system has yet to form while the old system is gradually being replaced, resulting in a short-term period of slower economic development. To ensure this economic volatility remains under control, the process of economic restructuring should be based on a foundation of macroeconomic stability. Additionally, in the economy where the market plays a decisive role in the allocation of resources, an essential condition for effective market operations would be a stable macroeconomic environment maintained by the State. Therefore, macroeconomic stability is not only a necessary condition for the restructuring process, but also a central goal of the whole process of economic development.

Important factors of the development process include capital, people, land and infrastructure. These factors must be distributed and shifted from sectors and business activities with low labour productivity to those with higher labour productivity. Capital will be distributed and transferred to sectors and business activities making higher profit; labour will be distributed and shifted to sectors, regions and enterprises providing higher wages; and land and resources must be distributed to investors and projects operating efficiently. The capital allocation system impacts on the dynamic system of the economy and has a decisive effect on the system for allocating human capital, land and infrastructure. Consequently, when the economy is unstable and in need of restructuring, the capital allocation system, including financial market (credit institutions, stock markets), public investment, state-owned enterprises (SOEs), becomes a top priority in the restructuring process.

Not only does the financial sector need to restructure, the real economic sector also needs to change in the context of global competition. Currently, enterprises have to compete through value chains of production; thus, enterprises operating alone will find it almost impossible to survive in today's competitive environment. Therefore, the real economic sector should be reorganized by strengthening the linkages between enterprises and suppliers. This is the guideline for restructuring economic regions and developing industrial clusters.

The current resource allocation system is a result of the institutional system guiding current economic activities. To use an analogy, the institutional system is like a computer operating system (OS), whereby policies serve as software that run on this OS. In other words, the economy operates similar to a computer, through two institutional systems: *(i)* operating system, which is the institutional system specifying functions, tasks and interactive environment of the state apparatus, and *(ii)* software system running on the OS, which is legal documents, regulations etc. If we maintain the old operating system and only innovate the software system running on the OS, efficiency will be limited. Furthermore, new and modern software (the best practices of the world, the new rules of agreements on economic, trade and investment, etc..) would not be able to run on the old OS. Institutional breakthrough in socialist-oriented market requires the renewal not only of policies and legislation system, but also the apparatus operating that policy system. A process of economic restructuring focusing only on the renewal of resource allocation system, without changing institutional system, is similar to upgrading software which runs on an obsolete OS. As a result, the fundamental barriers in the old resource allocation system will remain unchanged, with insubstantial innovations in the resource allocation system. Thus, the process of economic restructuring must be accompanied by restructuring of the institutional system, or upgrading the operating system of the economy.

The contents of institutional reform should focus on three main pillars: (i) clearly defining the role of the market and the state, the state should play a role of developing and supporting the market to perform its functions; (ii) renewing the economic administrative apparatus of the state towards a law-based developmental state; and (iii) building an institutional system to ensure the healthy development of civil society.

1.2 Features of Vietnam's economic growth model before 2011

- Pursuing the objectives of continuous and rapid economic growth based on ever-increasing investment through the three channels: private, foreign and state investment, of which the latter always accounted for the largest proportion.

- Capital was distributed primarily through three main channels: banks, the stock market, and public investment. The latter was mainly allocated to state enterprises and often not based on competition principles.

- The economy operated according to the mechanism of socialist-oriented market, multi-sector, with diversified forms of ownership, in which the state economic sector played a key role. The non-state economic sector (private and foreign sectors) competed under the market mechanism and mainly accessed capital through the banking system and stock market. The State economic sector operated under both competition of the market mechanism and the control of the state; therefore, the access to resources and distribution of goods of the State sector were influenced by various non-market factors.

- The economy operated in the direction of increasing openness and international integration both in breadth and in depth. Competitiveness in the international market mainly based on static comparative advantages: namely low labour costs, and cheap natural resources and fuel.

Transformation of economic growth model means changing the dynamics of economic growth from increasing the amount of inputs to enhancing efficiency, labour productivity and total factor productivity, while at the same time ensuring that the benefits of growth are distributed more rationally and equitably across regions and social classes. Therefore, our targeted economic growth model should be the model in which growth will be based primarily on resource use efficiency and labour productivity; people will have stable and better jobs with higher wages as a result of increasing labour productivity; and there will be sufficient resources to provide universal and sustainable accessibility to health care services and education. Thus, economic restructuring is a prerequisite or precondition to transforming the growth model; at the same time, it is also a component of the process of transforming economic growth model.

1.3 Consequences

In the first stage of development with scarce resources and excessive labour, the broad growth model proved its effectiveness, generating continuous and fast growth, rapid improvement of people's lives, and rapid reductions in poverty.

However, the ever-increasing accumulation of total capital in the economy, coupled with the slow improvement in human resource quality, has resulted in a declining productivity of capital under the law of diminishing marginal returns. To pursue the goal of high growth, even larger investments were made. Large investment in the context of capital flows continuously pumped into the economy reduced the efficiency of investment in the manufacturing sector and increased profits in the financial and speculative sectors. As a result, scarce resources such as capital, land, skilled human resources were sucked into the financial sector, speculative and commercial activities. The manufacturing sector was increasingly shrinking and dependent on foreign-invested enterprises. The economy quickly fell into a bubble and unstable situation.

The massive demand for capital facilitated the rapid development of the stock market and banking system. Meanwhile, the system of institutions, laws, management and monitoring mechanisms were in the process of development and did not keep pace with the rapid development of these two capital markets. A series of weaknesses, gaps and inadequacies in the system of institutions, laws, and monitoring mechanisms had been abused for a long time without being detected. Only when some banks lost liquidity, interest rate hiked, NPLs escalated, etc., which potentially caused mass disruption, were these weaknesses, gaps and inadequacies clearly revealed.

1.4 New model

The new economic growth model pursues the target of rapid and sustainable growth based on the continuous improvement of productivity. Economic growth dynamics changed from primarily relying on higher amount of inputs to gradually increasing the efficiency, labour productivity and total factor productivity.

The XI National Party Congress determined to "*transform the growth model from mainly relying on growth by breadth to relying on growth both by breadth and by depth, expanding the size while also focusing on improving the quality, efficiency and sustainability*".

New models must operate with less cost, higher growth, more stability and sustainability, and scarce resources being allocated in the most effective sectors.

Economic theories indicate that our targeted model should minimize unnecessary intervention of the government which is distorting the market, and at the same time develop monitoring institutions which are strong enough to ensure a well-functioning market and to redress market defects.

1.5 The overall objectives, orientations and precondition of economic restructuring associated with the transformation of growth model

1.5.1 The overall objectives

The master plan on economic restructuring associated with transforming the growth model during 2011-2020 sets out the following specific objectives:

Generally, the goal of economic restructuring is to establish a sound economic structure towards effectiveness and competitiveness by gradually and continuously improving the efficiency of using social resources, increasing labour productivity, total factor productivity and competitiveness of the economy, so that labour productivity, total factor productivity and efficiency of resource use will gradually become the driving forces of economic growth with reasonable growth rates for the period of 2013-2015, and with higher growth rates afterwards.

Regarding economic structure, the objective is to transform the structure towards decreasing the share of agriculture sector, and increasing the share of industry and service sectors. About this orientation of restructuring, the Socio-economic development strategy for 2011-2020 has identified that by 2020 agriculture sector accounts for a maximum of 15% and industry and service sectors account for at least 85% of GDP. Within economic sectors, restructuring is implemented in the direction of high-tech, high productive and high value-added products gradually replacing low-tech, labour-intensive and low value-added products, becoming key products of the economy; thus, gradually and constantly improving and upgrading the level of development of economic sectors in particular and the whole economy in general.

Regarding economic regional structure, the objective is to establish a reasonably balanced development among localities, regions on the basis of utilizing the advantages of each locality, region; collaboration, coordination and complementarity among localities in a region; as well as the selective and efficient support by the Central government.

Regarding market structure, the objective is to continue to expand and diversify export markets, to select and prioritize strategies of participation in institutions of trade liberalization; and concurrently, to develop domestic markets, especially rural markets.

Finally, the objectives are to contribute to building and strengthening the national position in international relations; to firmly protect national independence, sovereignty and unity and territorial integrity; to preserve political security and social order and safety; to create the foundations for Viet Nam to become a basically modern market-oriented industrialized country by 2020.

1.5.2 Preconditions of economic restructuring

To conduct economic restructuring in association with changing the growth model, there must be at least three following preconditions:

Firstly, to steadily maintain macroeconomic stability with low inflation and strong macroeconomic foundations.

Secondly, to form and develop comprehensive modern market economy institutions that establish an equal, fair and transparent business environment with low levels of costs and risks.

Thirdly, to develop high quality human resources and synchronized infrastructure systems.

The three conditions above-mentioned will influence each other to ensure maximum mobilization of available resources for development investment; while at the same time, pushing and pulling resources to sectors and regions of the country based on market signals around the average rate of return, thus ensuring the harmonious and balanced development of the economy. As a result, investors and enterprises can access and take advantage of the opportunity to expand and develop their business. This in turn promotes enterprises to develop human resources, to apply, renovate and develop manufacturing technologies, new organization and management techniques and to create dynamic competitive advantages to maintain competitiveness and development capability. All of these together will accelerate the relatively continuous transfer of investment and production structure, creating an economy with high creative ability and new products with higher productivity, efficiency and competitiveness.

1.6 The guiding principle of economic restructuring associated with the transformation of growth model

Economic restructuring, together with the transformation of economic growth model, is a massive, difficult and complex task, and must be implemented uniformly in all sectors, levels and areas on a national scale and in each locality and base unit for many years. Therefore, the guidance and implementation of economic restructuring should comply with the following principles:

Firstly, to implement a sound and sustainable growth, prioritize the quality of growth.

Constantly improving the income and people's material and spiritual life is the highest goal in the policies of the Party and the State. The soundness and continuity of growth are the most important tool to achieve the above goal. Therefore, while the first guiding principle emphasizes the importance of sound and rapid economic growth, it does not encourage pursuing short-term growth at all costs, but rather growth that meets the following criteria:

- Inflation fell steadily to around 9% in 2012, and continued to decline in the following years to levels of less than 5-7% annually;

- Balanced growth, that is, growth accompanied by stable macroeconomic balances;

- Growth which brings benefits to all social classes; particularly, growth must go hand in hand with reducing income inequality, sustainable hunger eradication and poverty alleviation, especially for ethnic and other vulnerable groups;

- Growth mainly comes from the increase in efficiency, productivity and value created by knowledge and skills of workers;

- Finally, growth must be environmentally-friendly, encompassing the economical and efficient use of energy.

In managing and regulating the economy, it is important to always strive to achieve all the above criteria. However, in case this cannot happen, the quality of growth must be prioritized, especially growth with low inflation, stable macroeconomic balances, accompanied by poverty reduction, social security insurance and environmental friendliness.

Secondly, to implement a uniform and unified system of measures to control inflation, maintain macroeconomic stabilization, restructure the economy and ensure social security.

In the current context, we are not only restructuring the economy and transforming the growth model, but also curbing inflation, stabilizing the macro economy and ensuring social security. All these activities must be carried out simultaneously, be linked together and complement each other. Therefore, the measures of inflation control, macroeconomic stabilization, economic restructure and social security insurance should be integrated and unified together, complementing each other in short term as well as medium and long term.

Thirdly, to continue to implement the open-door policy and actively and proactively engage in international integration.

Economic restructuring will be successful and achieve its intended objectives if the people and all economic sectors, especially domestic and overseas private investors, actively respond and participate in this process in order to mobilize to the utmost and utilize more effectively resources for socio-economic development. Therefore, it is necessary to further revise the way of thinking, to clearly delineate the roles of the State and the market; to continue to expand the scale and improve the operational efficiency of all types of markets, where the freedom and opportunities of doing business of people and enterprises are better ensured, the transfer and allocation of production factors are based mainly on market signals. Along with building national governance capacity and effectiveness, the State should focus on the role of creating and supporting development through economic mechanisms, policies and leverages, gradually minimizing State investment in businesses and the use of administrative measures to interfere with the market; administrative measures, if any, must have time limits and be used only when necessary.

Fourthly, to conduct economic restructuring sequentially, step by step and systematically based on exploiting current competitive advantages as well as accelerating and "leaping forward" in certain industries and sectors. Economic restructuring associated with growth model transformation is a complex and long-lasting process with many difficulties and challenges which must be implemented simultaneously and synchronously in multiple sectors of the economy, at different governmental levels and in different sectors. There should be breakthroughs where necessary. Thus, the solutions of economic restructuring must be arranged systematically and sequentially over time, based on the nature of issues and the relations among the issues to be resolved. Accordingly, the implementation must be sequential, gradual and steady with prioritized order and breakthroughs; implementation should be done in tandem with evaluation and learning lessons in order to make necessary adjustments.

1.7 Orientations and solutions

The new economic growth model pursues high and sustainable growth based on continuous improvement of productivity. Economic growth dynamics change from primarily relying on increasing the amount of inputs to gradually increasing efficiency, labour productivity and total factor productivity.

This requires restructuring of the financial and land allocation system and improving the quality of human resources compatible with the requirements of the market.

Vietnam determined that the breakthrough of the restructuring process is the system of capital allocation and use, including the stock market, the banking system, public investment, and the state-owned enterprises, with a focus on institutional reform and changing the way of interaction between the State and the market, between the state sector and the private sector (including overseas investors).

Financial market

The focus is on restructuring the system of commercial banks: first of all, to remove the risk of insecurity on the financial system in particular, and the economy in general, and at the same time, to create conditions for the sustainable development of the financial system and to better implement financial intermediation function and convey the impact of monetary policy to the enterprise and household sectors; and to serve as the foundation to promote restructuring in other sectors of the economy.

The stock market must be an important channel to provide capital for the manufacturing sector, hence, it is necessary to maintain macroeconomic stability, strengthen market supervision, and prevent illegal trading acts and market manipulation to minimize speculative activities on the stock market.

Public investment

Vietnam is a country with a low level of development, poor infrastructure, obsolete education and training, low accessibility of health services for the majority of people... Investments in these fields are basic investments to create the foundation for long-term development of the economy. In the new economic growth model, public investment remained a major role in these fields. However, other economic sectors are encouraged and provided incentives to engage in these fields to share the burden of public investments. Investment restructuring will focus on fundamentally innovating the mechanisms and ways of mobilization, distribution, management and use of social capital under the following orientations. *Firstly*, to ensure the key balances of the economy, including the balance between savings and consumption, between domestic savings and investment, budget balance, balance of payment, public debt and foreign debt. *Secondly*, to mobilize investment capital of other economic sectors, expanding the scope and opportunities for private investment. *Thirdly*, to determine the specific investment prioritized areas of the State; first of all, focusing on the important and public areas and buildings without capital recovery that private sector does not invest or not allowed to invest (the fields of security and defense) and on the socio-economical infrastructure system for the remote, ethnic minorities with exceptionally difficult conditions; providing counterpart funding for the ODA and public-private partnership projects.

State enterprises

Focusing on the simultaneous implementation of the following three contents:

Firstly, to clearly define the roles and functions of each type of state enterprises (public utility, national defense and security, regulatory of macroeconomic stability and in areas of national development in which other economic sectors do not engage); thereby, to sort, classify and restructure investment portfolios and business lines, focusing on their core business lines; to equitize and diversify the ownership of enterprises in which the State does not need to hold 100% shares; to divest state capital from enterprises in which the State does not need to hold dominant shares.

Secondly, to renovate, develop and apply modern governance framework according to international practices at state economic groups and corporations.

Thirdly, to strictly impose state discipline and market discipline forcing SOEs to fully comply with the market mechanism and fair competition as other types of enterprises.

Institutional innovation

1. To fully protect legitimate interests, particularly people's legal rights to do business through the development, amendment and supplement of the following laws and codes: the Civil Code, the Criminal Code, the Law on Enterprises, the Commercial Law, the Foreign Trade Administration Law, the Law on Real Estate Trading, the Law on Employment, the Law on Bankruptcy...

2. To promote administrative reforms, removing barriers, creating sufficiently attractive and feasible incentives for investment. To amend and supplement the following laws in the direction of encouraging non-state investment: the Law on Bidding, and laws and legal documents relating to tax, fees, credit, enterprise access to land...

3. To change the way of interaction between the State and the market, between the state sector and the private sector. To open up markets in sectors and business lines of natural monopoly or in which state economic groups and corporations are holding monopoly or dominant positions. To build strong institutions and apparatus capable of efficiently controlling a monopoly position or market dominance of enterprises in these sectors and business lines. The laws will be developed, modified and supplemented including: The Law on the promulgation of legal documents, the legal documents relating to the management, ownership and supervision of state enterprises, the Law on Public Investment, the Law on State Budget...

4. To improve the quality of law-making, to redress the self-invalidation of legal documents which are impractical with regards to real-life conditions of the majority of the people, or which have much higher enforcement costs compared to benefits, or which detriment the legitimate interests of the people.

5. To implement the mechanism of supervising law enforcement which enhances the responsibility of the ministers, heads of ministerial-level agencies and chairpersons of provincial-level People's Committees.

2 POLICY CHANGES AND RESULTS

2.1 Macroeconomic stability

2.1.1 Policies and consistency

In early 2007, there were signs of macroeconomic instability as massive external capital poured into the economy (more than 18 billion US dollars on the capital account, approximately 20 per cent of GDP). The State Bank of Vietnam (SBV) maintained the exchange rate, resulting in a substantial increase in money supply in this year to obtain this capital flow. As consequences, there was an increase in money supply M2 of more than 46 per cent, credit of over 54 per cent and escalation of inflation in late 2007 and 2008. The global economic slowdown in 2009 directly affected Vietnam's economy; thus, Vietnam implemented a $9 billion stimulus package in order to combat the economic downturn. The reduction in confidence in the domestic currency encourages people to hoard foreign currencies, leading to high pressures on the exchange rate, and the SBV had to continuously adjust the overnight exchange rates (OER). Additionally, due to lower commodity prices in the world market, import demand soared while exports were in difficulty. As a result, in 2009 trade deficit of Vietnam accounted for more than 12.8 billion US dollars, the largest amount ever. This added more pressure on the exchange rate, expectations on devaluation rose, and people continued to accumulate US dollars. Inflation began to rise in late 2009 and continued in 2010. In order to achieve growth targets, Vietnam once again continued to loosen monetary and fiscal policies and consequently, the economy fell into a serious volatile situation in early 2011. Exchange rate in the free market continued to rise, inflation escalated, commercial banks lacked liquidity and constantly increased interest rates. The vicious cycle of higher inflation, higher interest rates, and higher exchange rates continued to worsen.

In order to reverse this vicious cycle, the Government consistently set a target of macroeconomic stability to the top and considered the target as a foundation for the process of economic restructuring. On 24th of February the Government issued Resolution No. 11/NQ-CP providing a package of measures on "containing inflation, stabilizing the macro economy, guaranteeing the social security", which emphasize the role of cutting public investment and tightening monetary policy; on March 16, 2011 the Politburo adopted Conclusion No.02/KL-TW and in March 29, 2011 the National Assembly also issued Resolution No. 59/2011/QH12 reaffirming the determination and measures that the Government approved in Resolution No. 11/NQ-CP.

In the monetary market, on February 2, 2011 the SBV devalued the VND by 9.3 per cent - the highest level ever. This devaluation approached the expectation threshold of the market, providing a clear message that, at least in the short term, the exchange rate will not be broken again, mitigating devaluation expectations in the first step, temporarily reducing pressure on the exchange rate. On March 7, 2011 the foreign exchange free market was closed, leading to increasing difficulties and risks of foreign exchange speculation, which in turn reduced pressure on the exchange rate. Deposit rates and lending rates were pushed up to an extremely high level to attract money into the banking system, anti-dollarizing, gradually solving the liquidity crisis in some commercial banks. Besides, the credit limit in some non-manufacturing sectors was controlled to reduce the excessive speculative activities in these areas.

In the fiscal and public investment fields, investment activities from state budget capital were tightened under the Directive 1792/CT-TTg of the Prime Minister dated October 15, 2011. Rampant and unidentified investment activities were blocked.

Although during the process of implementing restructuring, many enterprises and banks had suffered, and the pressure on loosening fiscal and monetary policies to support these enterprises increased, the Government has been steadfast and consistent in maintaining macroeconomic stability, thus consolidating the confidence on resources reallocation of the market.

Subsequent months experienced the gradually improved macroeconomic stability: the exchange rate stabilized from March; inflation reached a peak in April 2011 and gradually decreased by August 2011; in 2011, the inter-bank interest rates declined, although still remained at high level; people began to sell foreign currencies to the state bank and deposit Vietnam dongs for the large interest differences (about 14-15 per cent); foreign exchange reserves increased to 5 billion US dollars; trade deficit gradually decelerated in the first 9 months to only about 6.9 billion US dollars.

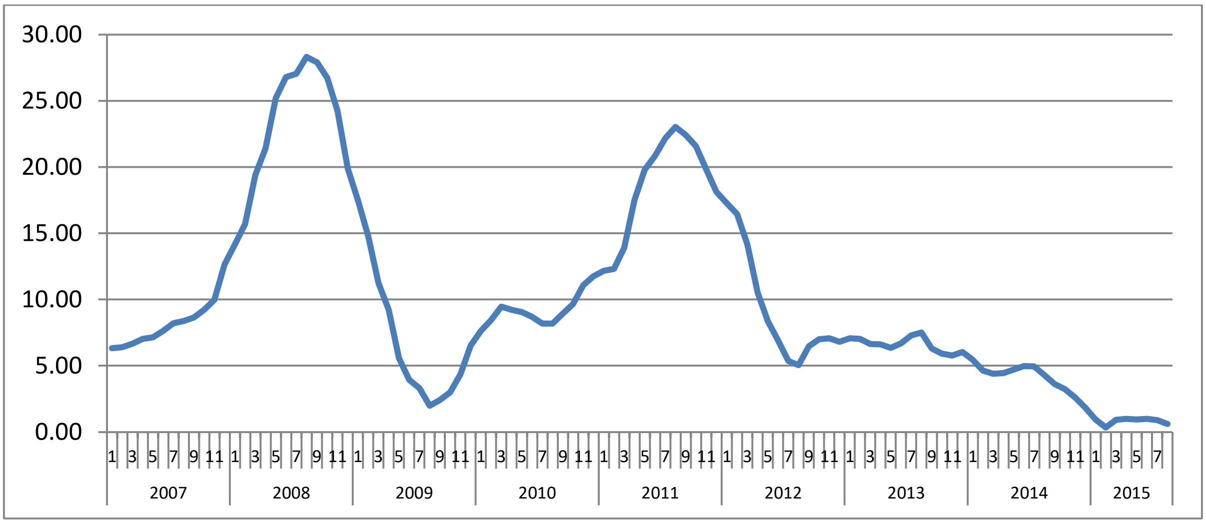
Stabilizing the macroeconomy has been implemented in parallel with economic restructuring by the Government, which has created a solid foundation and confidence of the market on the restructuring process. Macroeconomic stability, the prevention of the slowdown of the economy and the avoidance of mass disruption in the banking system and enterprises have been the outstanding achievements of the economic restructuring process.

2.1.2 Macroeconomic stability performances

2.1.2.1 Prices and inflation

The evolution of inflation in the Vietnam's economy showed signs of macroeconomic instability of the economy from the last months of 2007. Inflation continued to climb in the first half of 2008 and hit a top at 28.32 per cent in August 2008. This was an extremely high inflation rate and became a clear sign of serious troubles in the Vietnam's economy. Unfortunately, at that time we were too mesmerized by the achievements of growth and overlooked economic structural issues. At that time, we believed that inflation was mainly due to the impact of external factors. Internal factors had been neglected. Because of this viewpoint, when the world economy fell into a crisis and commodity prices in the world market dropped, we hastily implemented the stimulus packages and did not taking the opportunity to restructure the economy. The implementation of the stimulus packages could restrain growth but exacerbate problems such as bad debt, inefficient and rampant public investment, and soared speculation.

Figure 2: Year-on-year inflation



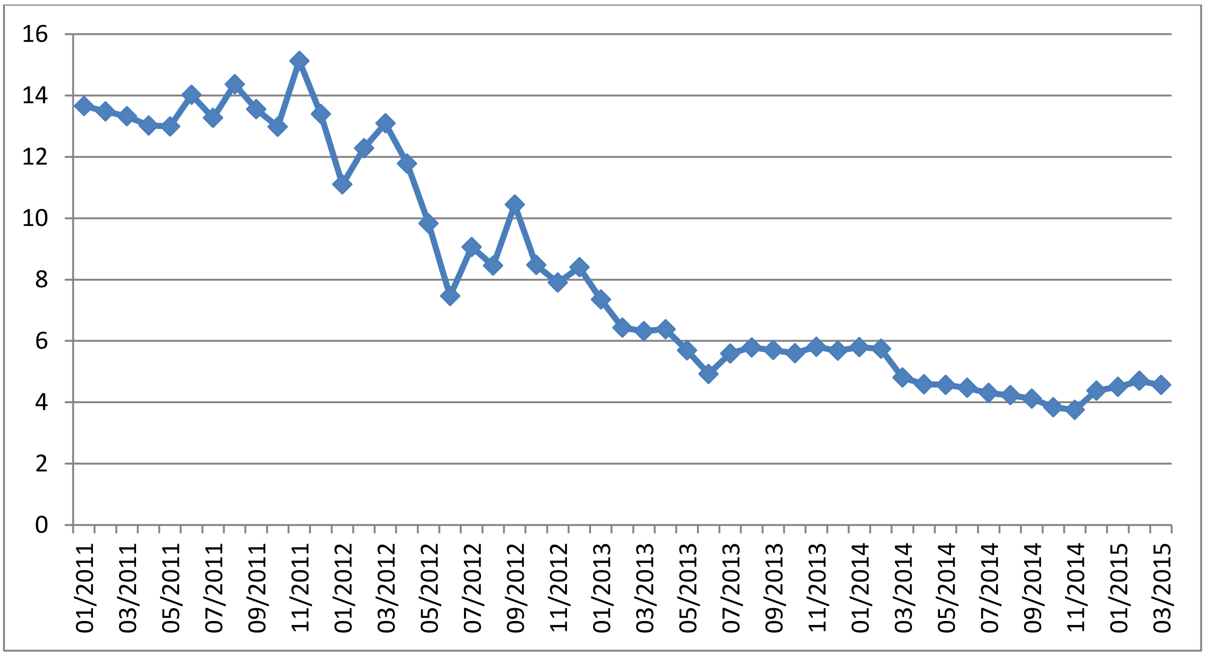
Source: GSO.

When the world economy began to recover in 2011, Vietnam's economy fell into a serious downturn, where macroeconomic instability increased, inflation gradually rose from August 2009 and continuously escalated, reaching a peak of more than 23 per cent in August 2011. The greatest achievement of the restructuring process has been the prevention of the momentum of inflation and macroeconomic instability, creating the basic foundation for the subsequent recovery process (Figure 2). Since July 2012, inflation in Vietnam has officially returned to the normal level and remained stable ever.

2.1.2.2 Interest rates

Macroeconomic instability before the implementation of restructuring was reflected not only in the hyperinflation but also in the escalation of interest rates (Figure 3). The economy fell into a displeasing situation of stagflation, in which it had to not only control inflation but also to reduce interest rates. The escalation of the average interbank offered rate showed a serious problem in liquidity situation of the banks. The lack of liquidity was also expressed in the primary market where interest rates skyrocketed (Figure 3).

Figure 3: The average interbank offered rates (term of 3 months), %/year



Source: SBV.

The evolution of interest rates in the primary market since 2008 has shown some signs of instability of the banking system. The problems of debt structure and the vulnerability of the banking system had existed long before. The restructuring process could be faster and more effective if we detected the problems earlier and implemented restructuring as early as 2009.

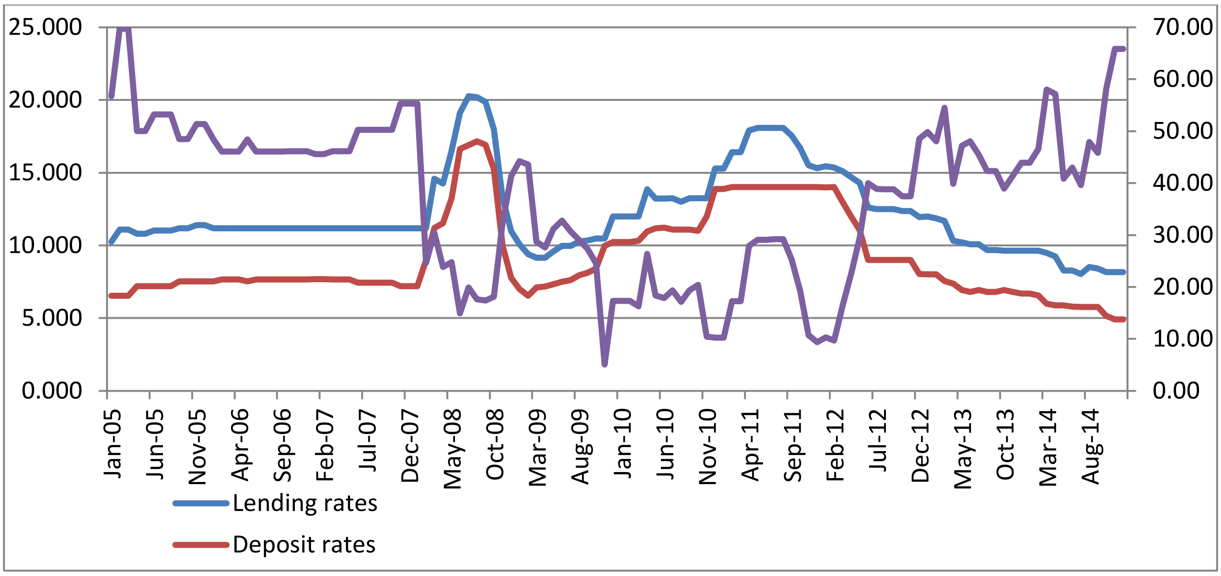
The solutions of restructuring the banking system began to take effect from the beginning of 2012. Since February 2012, interest rates on the interbank market and deposit interest have been on a clearly downward trend and basically stable around June 2013. For the term of 3 months in VND, the average interbank offered rate in 2014 was common at 3.8-4.5%/year and in 2013 at 5- 6%/year, which were at relatively low and stable levels compared to those in the previous years (around 13-15% and 8-13% in 2011 and 2012, respectively). In the first 6 months, the economy began to pick up steam with growth rates being higher than expected, credit demand starting to rise, interest rates stopping the downward trend and slightly increasing in the first 3 months before stabilizing at the level of 4.25%.

Similar trends were seen in commercial banks' lending rates and deposit rates with term of one month. Lending rates and deposit rates of commercial banks gradually increased, noticeable from the beginning of 2009 to mid-2011 and reached its peak of more than 18%[2]. Since then, both the lending and deposit rates declined regularly and steadily. Thus the efficiency of restructuring the banking system has been indicated in the gradual normalization of lending and deposit rates of commercial banks.

The stabilization of interest rates and the rescue of the serious lack of liquidity of commercial banking system have been considered a key success of the bank restructuring process. Additionally, the restructuring process has prevented a mass collapse of the banking system.

Figure 4: Average deposit and lending rates of commercial banks with term of 1 month

[2] It should be noted that this is the official reported rates of SBV, in reality borrowing interest rates of customers for this term reached up to 30%.



Source: IMF[3].

However, the process of restructuring the banking system has yet to completely settle NPLs and is still having to deal with weak banks. The establishment of VAMC is a way of allowing commercial banks to freeze NPLs and amortize them over 5 years. Depositors and borrowers are suffered from the amortization expenses. This is shown in Figure 4, where d_r is a difference between lending rate (R) and deposit rate(r). Total profit of banks, excluding operating expenses, is:

$$\pi = \frac{R-r}{r} = \frac{d_r}{r}$$

Figure 4 shows that along with the downward trend of deposit and lending rates, total profit rate π of commercial banks has increased dramatically from under 10.3% in February 2012 to 65.85% in December 2014. Obviously, the banking system has been maintaining a substantial gap between deposit rates and lending rates to cover high costs of bad debt treatment on their own. This large difference was partly covered by depositors because of low deposit rates and partly covered by borrowers because of high lending rates. This was an important reason that credit did not increase as expected to bring the economy back to growth.

2.1.2.3 Exchange rate

Similar to interest rates and inflation, exchange rate also showed great instability since 2008. The average interbank offer rate continuously increased

[3] IMF has not updated data for the first 6 months of 2015 yet. However, according to the authors' observations, the gap between deposit rates and lending rates of Vietnam's banking system so far has not changed much.

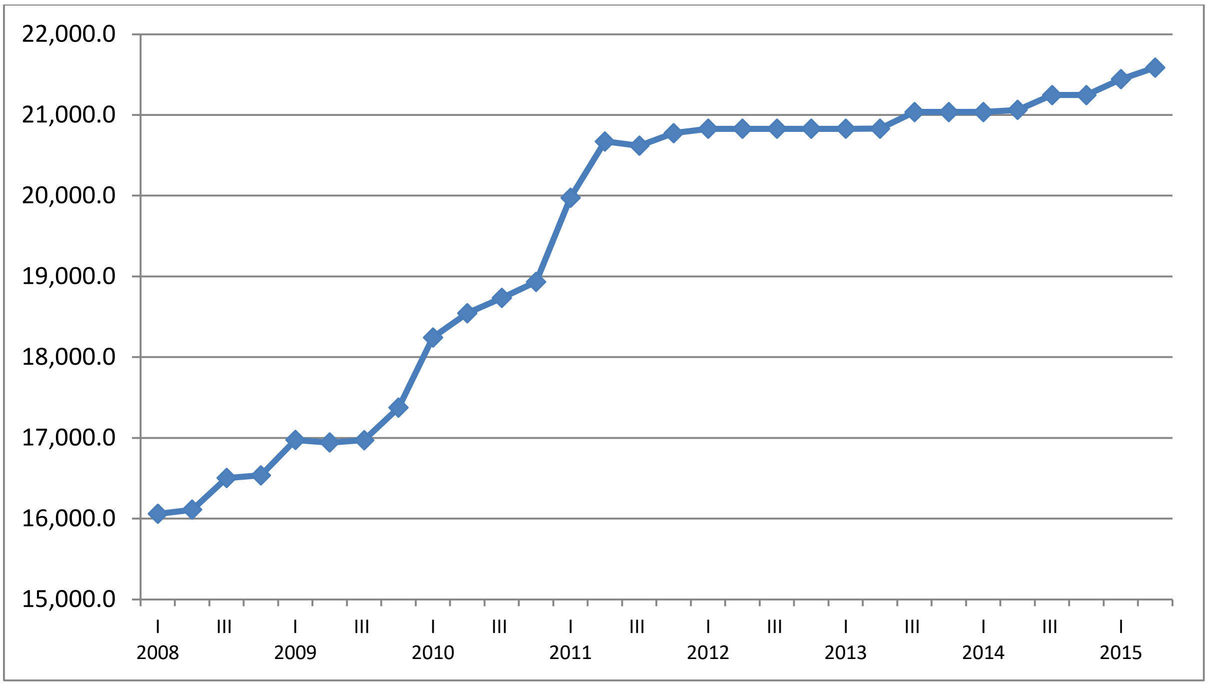
from Q1/2008 to Q1/2011. The continuous and substantial increase in exchange rate during this period was an indication of sharp decline in confidence in Vietnam dong. Once again the market has given an early sign of the instability of the economy.

The process of restructuring began with the implementation of Resolution 11/NQ-CP of the Government dated February 24, 2011 which included the February 2011 major devaluation of the Vietnam dong by 9.36%. The devaluation that exceeded expectations of the speculative market, the measures to tighten foreign exchange markets as well as the increase in VND-denominated savings rates and the decrease in foreign currency-denominated saving rates, etc. have quickly stabilized exchange rates and reduced the dollarization of the economy.

Since April 2011, the foreign exchange market has remained stable, the average interbank exchange rate in the period Q2/2011 - Q2/2015 increased by an average level of 0.196%, lower than the level of 1.96% in the period Q1/2008 - Q2/2011 (Figure 5). In other words, the growth of exchange rate during Q2/2011 - Q4/2014 was equivalent to only one tenth of that during Q1/2008 - Q2/2011. Since Q3/2014, USD has appreciated against most other currencies, the VND/USD fixed exchange rate policy has been detrimentally affecting exports and encouraging imports. Therefore, since Q3/2014 exchange rates have been adjusted to increase slightly.

The stability of exchange rate has been the result of many factors, including inflation being controlled at a low level, which strengthened confidence in the VND, and the abundant supply of foreign exchange due to surplus of trade balance and capital account. Various solutions to empower VND have been implemented, especially the solutions of strict management of foreign currency credit, maintenance of foreign deposit ceiling at a low level, regulatory of excess liquidity of VND on the open market, maintenance of required reserve ratio at a high level for foreign currency deposits, management of the gold market in the direction of removing gold as a unit of payment.

Figure 5: Average interbank exchange rate, 2008-2015

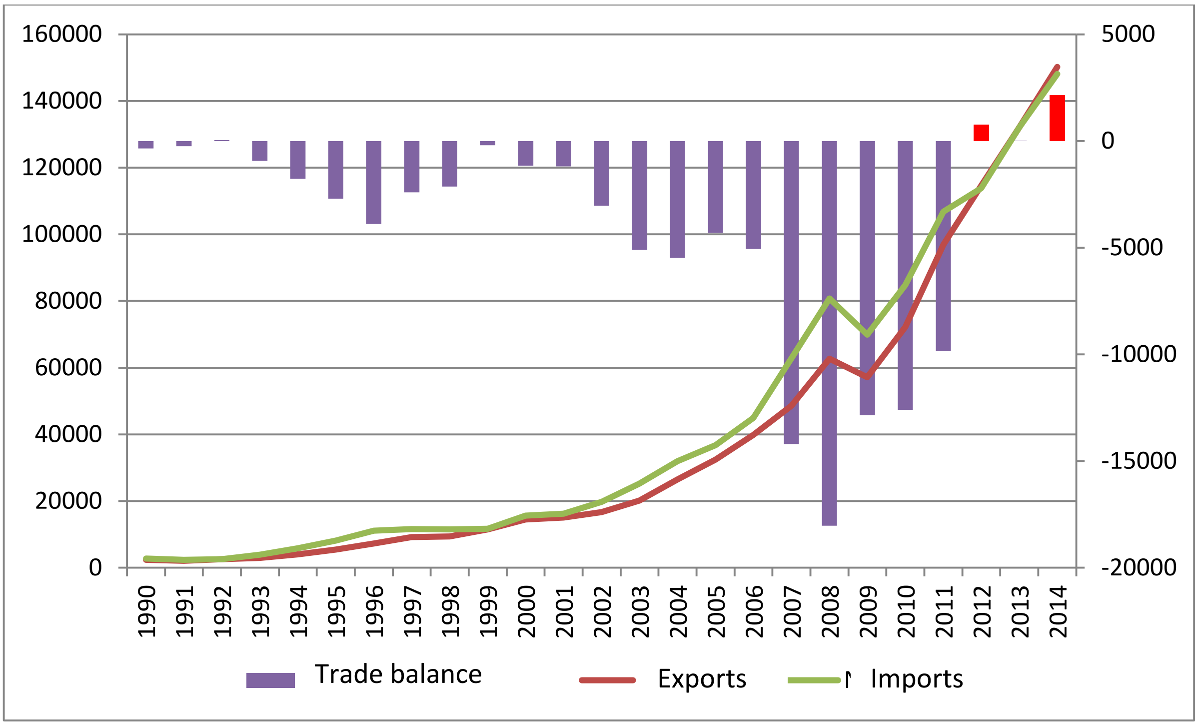


Source: SBV.In the short and medium term, the exchange rate of VND/USD is not likely to increase suddenly thanks to relatively strong foreign exchange reserves of Vietnam. On November 8, 2015 the People's Bank of China changed the operating mechanism of exchange rate, resulting in CNY devaluation in three consecutive days up to 4.6%. The State Bank of Vietnam has responded by widening the foreign exchange transaction bands to ± 3% and depreciating VND/USD reference rate by 1%. Initially, the adjustment of the State Bank of Vietnam and the sudden fluctuations of the CNY put a significant pressure on the exchange rate. As of now, under the adjustment of the market, the pressure on the exchange rate has fallen, leading to the movement of exchange rate still below the ceiling level. Till the end of the year, the abundant USD supplies will lessen pressure on exchange rate adjustment. Adjustment, if any, will be temporary and at certain points in year.

2.1.2.4 Trade balance

There have clearly been signs of the dichotomous economy of Vietnam during the current restructuring. The export sector has been almost unaffected by the internal problems of the economy; exports grew strongly during the domestic economic slowdown. It could be said that thanks to the steady growth of the export sector, the growth rate of our country has not fallen into recession.

Figure 6: Imports, exports and trade balance (million USD)



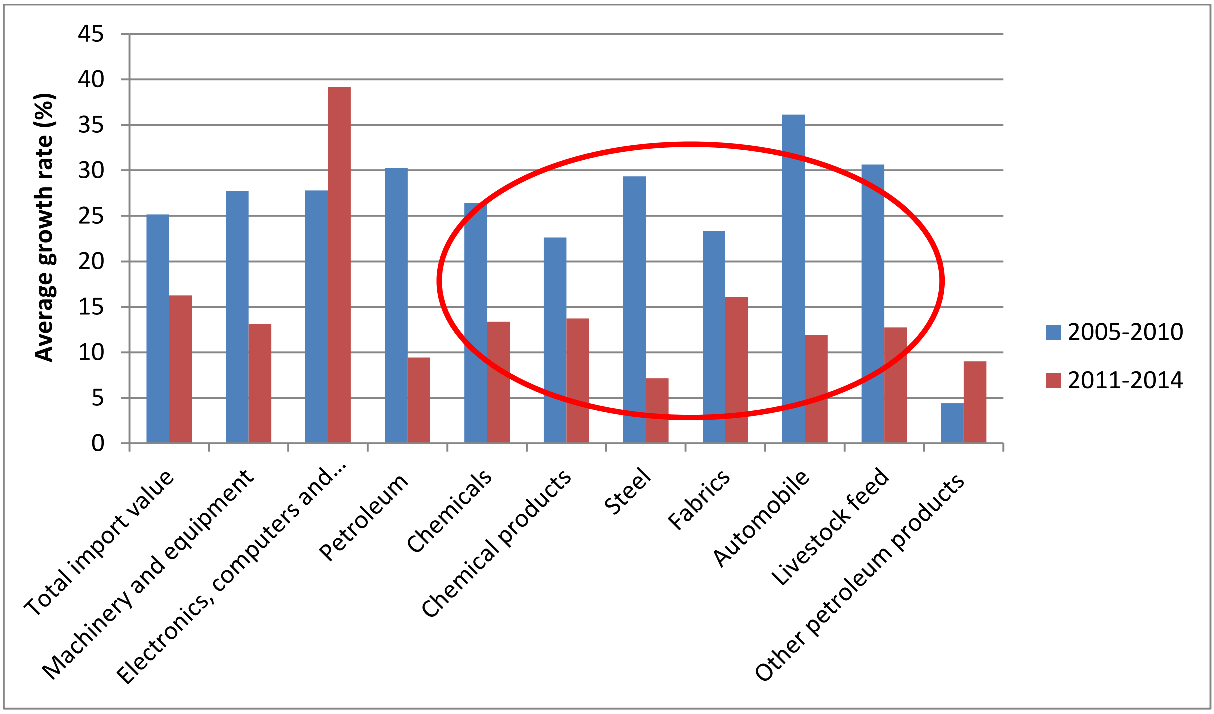
Source: GSO. Trade balance is on the right axis.

The significant increase in export growth and the sharp decrease in import growth due to falling domestic demand have contributed positively to the improvement of the trade balance of Vietnam. Figure 6 shows that in the process of development, Vietnam's economy experienced a persistent trade deficit during 1990-2011 with the highest deficit level in the period of 2000-2011. Surprisingly, when the trade deficit reached a peak in 2011, the decisions on tightening public investment, credit, anti-dollarization and economic restructuring completely reversed the trade balance of Vietnam.

The trade balance surplus, though modest, helped improve Vietnam’s current account significantly. In 2002-2010, Vietnam incurred continuous current account deficits at high levels, especially in 2007 and 2008; the current account deficit amounted to over 10% of GDP. In 2009 the deficit still remained at nearly 4% GDP. However, from 2011 to 2014, the current account was always positive and from 2012-2014 the current account surplus was more than 5% of GDP. The current account surplus and capital account surplus have contributed significantly to the rapid increase in foreign exchange reserves of Vietnam and thereby stabilized the exchange rate.

The turnaround in the trade balance partly resulted from the reduction in aggregate demand which led to a decline in import demand. When comparing the average import growth in the two periods of 2005-2010 and 2011-2014 as indicated in Figure 7, the dependence on imported goods tends to fall.

Figure 7: The average import growth of goods in the two periods 2005-2010 and 2011-2014

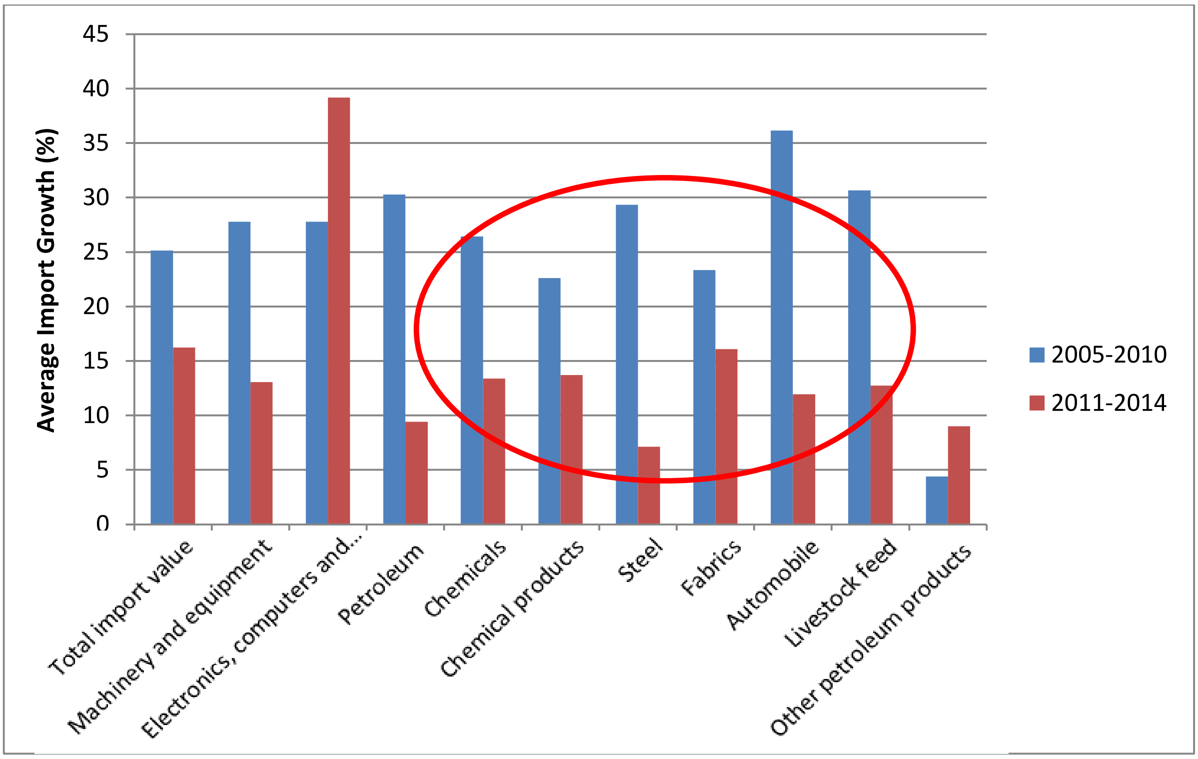


Source: GSO.

Of the 10 product groups, the import growth of seven groups in 2005-2010 outpaced the average import growth of the country, but in 2011-2014, the situation was reversed. These seven product groups include: machinery parts, chemicals, chemical products, steel, fabrics, automobile, and livestock feed. Of the three remaining groups, although the import growth of petroleum was always lower than the average growth of the economy, the import growth of petroleum fell more sharply in 2011-2014 than that in 2005- 2010. This is partly due to the fact that the production of Binh Son Refining and Petrochemical Company Limited since 2009 has reduced demand for imported petroleum. Other petroleum products have only been imported since 2009 and accounted for a negligible proportion of total imports. Only for the group of "electronics, computers and components", the average growth in the second period outpaced that of the first period. This is resulted from the surge in imports and exports from Samsung and some other TNCs.

It should be noted that in 2005-2010, including 2009, with the downturn of the world's economy, the average demand for imports and exports of almost all countries decreased. When excluding 2009, the import growth of these product groups in 2010-2014 was much lower than the previous period (Figure 8).

Figure 8: The average import growth of goods in the two periods 2005-2010 (excluding 2009) and 2011-2014

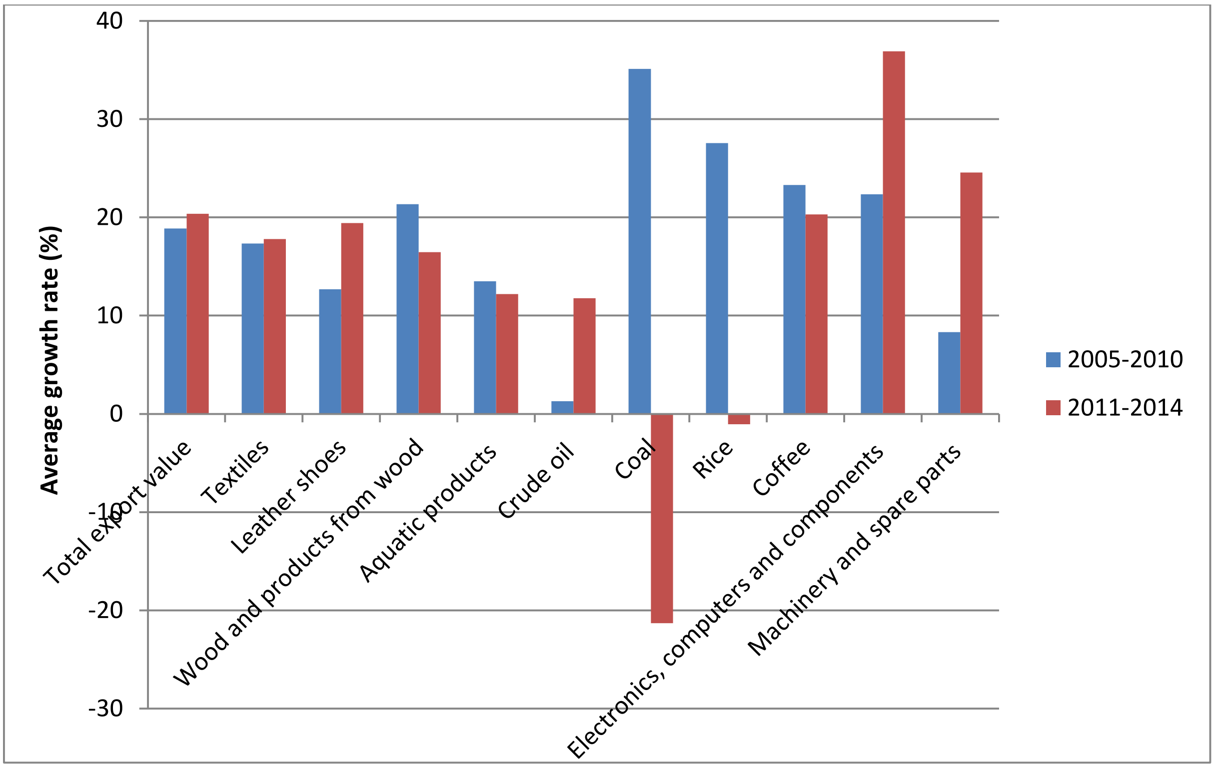


Source: GSO.

Therefore, it can be seen from the structure of import growth that Vietnam's economic autonomy tended to improve in 2011-2014 compared with 2005-2010.

The pattern of exports shows that in 2011-2014 the Vietnam's economy still maintained a high growth rate, which was higher than that in 2005-2010 for the products at which Vietnam has comparative advantages and do not face resource limitations, such as textiles and leather shoes. Vietnam has been still exploiting other goods, at which Vietnam has comparative advantages but with limitation of resources, such as fisheries (limits on the area of aquaculture, fishing capacity), coffee (limits on farmland), wood and products from wood, and the export growth of these products in 2011-2014 was 10%, even lower than the average growth in 2005-2010 (Figure 9). Especially, when rice has reached the limitation of exploitation, it could be difficult to increase its export growth. When the growth of goods with traditional advantages tended to slow down, there have emerged new products with high technological content and no resource limitation, such as electronic goods, computers and machinery. It should also be emphasized that prior to 2010 Vietnam did not export machinery. This is a remarkable transition because the mentioned two product groups have high growth rates in recent years and in 2014 they accounted for 12.5% of total exports, nearly equal the share of the textile sector and 3 times the proportion of crude oil exports.

Figure 9: Average export growth of product groups in the two periods 2005-2010 and 2011-2014



Source: GSO.

It should also be added that trade surplus of Vietnam in 2012 and 2013 had been significantly contributed by the foreign sector, particularly, by the multinational corporations leading by investors in global value chains such as Canon, Sony, Nokia, Samsung. Export value of phones and components grew by 98.9% (in 2012) and 67.1% (in 2013).

However, in 2014 the growth of products including electronics, telephones had signs of slowdown due to the saturation of the computer and electronic market and the heavy dependence of telephone export on the investment and business situation of Samsung. The cash flow of trade surplus in recent years has mainly come from FDI enterprises, while domestic enterprises have been in deficit for many years. In 2014, FDI enterprises' surplus accounted for approximately USD 9.8 billion, while the domestic enterprises experienced trade deficit of about USD 7.6 billion. Therefore, in order to maintain the momentum of trade balance surplus, the process of restructuring of domestic enterprises should be accelerated, production capacity should be enhanced, and the trade deficit of domestic enterprises should be reduced.

The first 8 months of 2015 experienced a reappearance of trade deficit (USD 3.6 billion). However, according to the situation of import and export during this period, product categories of imports and exports remained unchanged. The reappearance of trade deficit in the first 8 months in 2015 resulted from lower export growth at only about 9% (on YoY basis). Particularly, natural resource exports such as crude oil, coffee, rice, aquatic products fell sharply. In the first 8 months of 2015, exports of seafood reached USD 4.2 billion, a decline of 16.6%; exports of rubber reached USD 921 million, a decline of 10.3%; exports of coffee, rice and coal fell by 32.8%, 11% and 64.2%, respectively; especially, exports of crude oil fell sharply by 48.7% due to a substantial drop in its world price. Meanwhile, export growth of the products with competitive economies of scale and without limitation of natural resources has remained significant: Exports of telephones and components attained approximately USD 20 billion, increased by 31.1%; exports of textiles reached USD 15 billion, a rise of 10.9%; exports of electronics, computers and components reached USD 9.9 billion, increase of 51.8%; exports of footwear reached USD 8.1 billion, increase of 20.9%; and exports of machinery and spare parts reached USD 5.2 billion, increase of 10.1%.

On the import side, the demand for imported machinery, equipment and inputs rose sharply thanks to the recovery of the economy, leading to import growth outweighing export growth. In the first 8 months, imports increased by 16.4% (on YoY basis): Imports of automobiles reached USD 3.8 billion, an increase of 80.2% (automobiles increased by 132.1%, in which automobiles with less than 9 seats rose by 63.3%); imports of machinery, appliances or other parts accounted for 18.9 billion, rose by 33.4%; imports of electronics, computers and components were USD 15.1 billion, an increase of 35.3%; telephones and components reached USD 7.1 billion, increase of 36.3%; imports of fabric were USD 6.8 billion, increase of 11%; imports of steel reached USD 5.2 billion, increase of 10.8%; imports of textile materials, footwear reached USD 3.4 billion, increase of 10.5%; and imports of plastic products reached USD 2.5 billion, increase of 23.9%.

Besides, the severe decline in aggregate demand of the Chinese market has had a negative effect on the trade balance of Vietnam. Import demand from

China has fallen substantially (rice, rubber, crude oil, vehicles and spare parts); while the redundant goods due to lack of demand from China have been seeking to pour into Vietnam at low prices, for example, transport automobiles.

Finally, an appreciation of the USD to which the VND pegged has resulted in cheaper imports and less competitive exports, and to some extent, has affected the trade balance. However, the positive shift of export and import structure remained a more important matter.

2.1.2.5 Foreign reserves

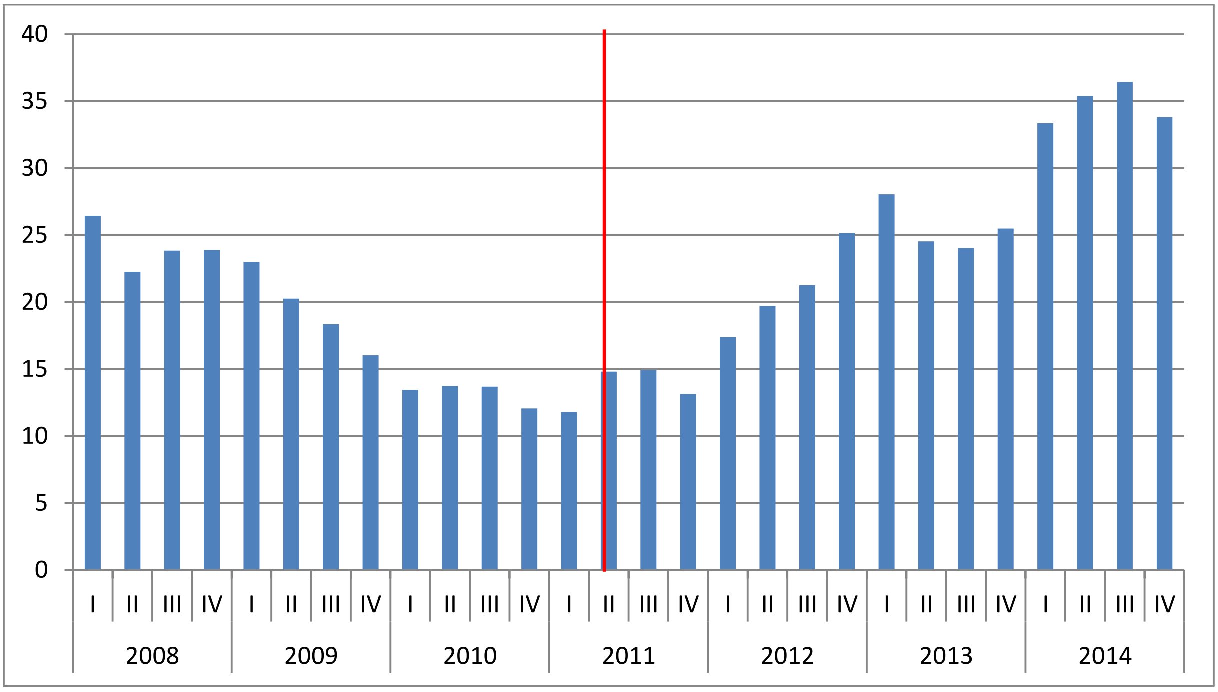
After joining the WTO, foreign reserves of Vietnam have continued to increase, reaching USD 23.9 billion in 2008. However, due to the negative impact of the global financial crisis, foreign capital inflows and remittance inflows into Vietnam plummeted. At the same time, the macroeconomic instability in the country exacerbated the dollarization of the economy; that is, people held foreign currencies and did not sell them to banks.

This created a paradox in which the sum of the capital account and the current account were in surplus but foreign reserves declined. Additionally, when the global psychological unrest about the economic turmoil spread to Vietnam, inflation increased, but SBV maintained a low exchange rate which enabled foreign currency speculation. SBV was forced to sell foreign reserves to maintain the exchange rate. This again resulted in a sharp decline in foreign reserves. In 2010 foreign reserves only met the demand of about six weeks of imports.

Since 2012, foreign reserves have resumed to increase, reaching USD 25.2 billion (in 2012), USD 25.5 billion (in 2013) and USD 33.8 billion (in 2014). This is a favourable condition to maintain confidence in the ability to fulfil foreign debt payment obligations of the economy, the ability to support the value of VND and in the financial ability of country, which help attract foreign direct and indirect investment. In addition, it also helps protect the value of the domestic currency, limiting the excessive volatility of exchange rates, meeting the demand for foreign currencies of the economy, and reducing the economy’s vulnerabilities to economic and financial crisis.

Figure 10: Foreign reserves of Vietnam 2008-2014

Unit: Billion USD



Source: International Financial Statistics, IMF.

Figure 10 shows that the foreign reserves have reached a bottom in late 2010 and early 2011. The implementation of Resolution 11/NQ-CP of the Government in early 2011 has been a key element for the recovery of foreign reserves of Vietnam. The measures on anti-dollarization (to reduce interest rates on deposits in foreign currencies, to increase interest rates on deposits in local currency, to ban foreign currency exchange in the free market, to raise the required reserve ratio for foreign currency to 4 percentage points in 2011, etc., and the measures on depreciation to reduce speculative pressure have reversed the flow of foreign exchange from the public to the banking system, thereby increasing foreign reserves. The other important factors contributing to the increase in foreign reserves of Vietnam included the improvement of trade balance and the end of two-decade trade deficits. The strong recovery of foreign reserves has significantly contributed to reduce national financial risks, stabilizing the environment of investment and trade.

2.1.2.6 National Risk

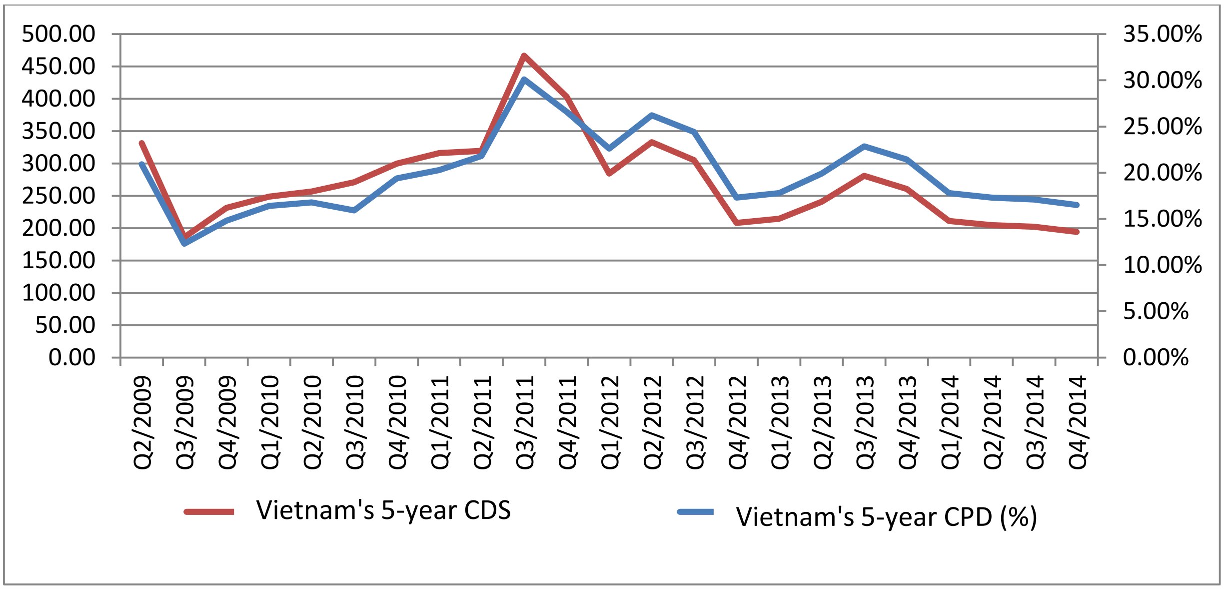
Vietnam's economic developments were also reflected in the national risk index of Vietnam. The CDS[4] (Credit Default Swaps) index for 5-year bond of

[4]The increase of this index by 100bp shows that the additional costs for credit risk insurance of Vietnam in the international financial marketincreased by 1 percentage point.

Vietnam, rated by S&P from 2009 to the present, shows that the national risk of Vietnam increased steadily since Q3/2009, reaching a peak in Q3/2011.In Q3/2009 Vietnam's CDS was 185.8bp and the cumulative probability of default for the 5-year bond, CPD, was 12.3%. In Q3/2011 these indicators were 466.8bp and 30.10%, respectively.

The solutions on macroeconomic stabilization and economic restructuring, especially the restructuring of credit institutions, were assessed as heading in the right direction by international financial organizations. CDS and CPD fell sharply from Q3/2011to Q4/2012 (Figure 11). However, due to the unfinished settlement of NPLs in the system of commercial banks, the reports of bad debt still increased in 2013, resulting in the rise of national risk. The recovery of economic situation since 2014 has contributed to the reduction of CDS and CDP. By the end of Q4/2014 CDS of Vietnam was approximately equivalent to that in Q3/2009.

Figure 11: Credit default swaps (CDS) and cumulative probability of default (CPD)



Source: S&P Capital IQ, https://www.capitaliq.com.

It should be noted that as early as Q1/2012, CDS has fallen below CPD, meaning that the decrease of CDS resulted partly from the reduction of national risk and partly from the higher valuation of the ability to recover those risks. In other words, the potentials of the country since 2011 were increasingly estimated, and therefore the ability to overcome the risks (of default) of the country has become higher.

Although the national risk has strongly decreased, it still remained at a high level compared with other countries in the region. The evolution of CDS of

Asian countries shows that Vietnam is amongst the riskiest. Indonesia's CDS fluctuated around 150bps, Thailand's and Malaysia's around 100bps, Philippines's around 90bps, while Vietnam's remained over 190bps. Thus, in Vietnam, the economic restructuring is uncertain and the investment environment is still riskier than in other countries in the region.

2.2 Public investment

2.2.1 Objectives and orientations of restructuring of public investment

The objectives of restructuring investment are to guarantee an appropriate mobilization of total social investment capital and to allocate and use capital in the sectors, branches and investment projects with the highest economic efficiency, which contribute actively to improve productivity and overall efficiency of the economy. Hence, the orientations of restructuring investment should focus on:

Firstly, to appropriately mobilize total social investment in relationship with macroeconomic balances, including balance between savings and consumption, balance between domestic savings and investment and balance of payment.

Secondly, to ensure a reasonable proportion of public investment in total social investment and budget expenditure framework, ensuring a reasonable balance with the budget deficit, public debt and external debt.

Thirdly, to strengthen investment discipline, to avoid any possible losses and mismanagement and to improve the efficiency and spillover of public investment.

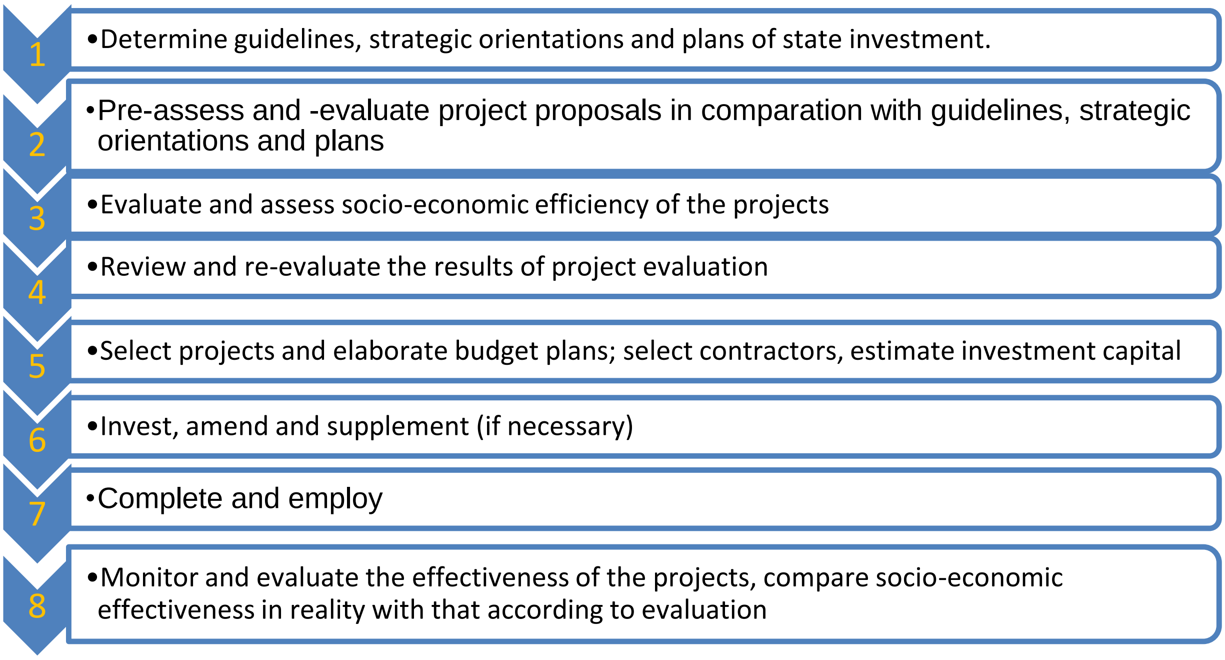
Fourthly, to distribute investment funds according to market mechanisms and to implement the freedom of doing business in all sectors and branches not prohibited by law; to prioritize and allocate state investment capital, especially state budget capital, government bond capital and ODA "to construct system of synchronous infrastructure with some modern buildings, focusing on transportation system and major urban infrastructure", and to develop human resources, especially quality human resources.

Fifthly, to implement investment restructuring at the same time with other relevant policies, especially policies on land, land clearance, SOE restructuring, development of private enterprises and financial market restructuring.

2.2.2 The implemented solutions

A process of public investment following international best practices is often conducted through eight steps (Figure 12):

Figure 12: The process of public investment



Source: Authors.

First, the Party and the State approve broad policies and guidelines as well as strategies on the socio-economic development of the whole country for each period. Based on these policies, guidelines and the socio-economic development strategies, the ministries, branches and localities formulate development plans, 5-year and annual plans, which are basis to perform public investments.

Second, upon a proposed public investment project, the authorities (the National Assembly, the Ministry of Planning and Investment and the units using public investments) conduct a pre-assessment of this proposal's appropriateness with the guidelines, strategies, and plans on socio-economic development. Inappropriate projects will be excluded. According to good practices, at this step the competent authorities will review and assess the capability of the private sector involvement in the project. The state sector should only be considered to perform the project if it can't be undertaken by the private sector.

Third, the competent authorities will assess, evaluate the socio-economic efficiency of each project. This is the weakest step of the public investment process in Vietnam because of short-time evaluation period (except for national projects approved by the National Assembly) and lack of specialized, independent and qualified agencies.

Fourth, to strengthen the evaluation results on socio-economic efficiency of the project, an independent agency will review and re-evaluate the evaluation results at the third step. In Vietnam, this step in most cases has not been taken.

Fifth, after the reassessment results, the national important projects must be approved by the National Assembly regarding the proposal of investment and selection of contractors. Some other important projects within the competence of the Prime Minister must be approved by the Prime Minister regarding funding, scale and the contractor selection for the project. The remaining projects are often approved through open competitive bidding based on the criteria of socio-economic efficiency, implementation costs and the project's spillover impacts.

Sixth, project implementation must be monitored in order to propose amendments and supplements if needed.

Seventh, the project is completed, and brought into use; the project is finalized.

Eighth, monitoring and evaluation of the project's effectiveness, comparing socio-economic efficiency in reality with the a priori assessment. If the project's effectiveness is different from a priori assessment, a committee will review the process of appraisal and implementation of the project to find out the cause of this discrepancy.

Overall, public investment in Vietnam has not strictly followed this process. Public investment has gradually been restructured to the medium-term public investment basis, which is an initial step of the process applying a standardised public investment process. Currently, Vietnam has been focusing only on reinforcing the old process through the following changes.

2.2.2.1 Tightening discipline on public investment

Under the policies and guidelines on investment restructuring, in the period 2011 - 2013, some important institutions have been issued related to the orientation of investment, decisions on investment policy, investment preparation, approval, and implementation and monitoring.

- Firstly, the restructuring of public investment are mentioned in the Conclusion of the Resolution of the 3th Plenum of the Party Central Committee, term XI. The basic contents of this Conclusion are about restructuring investment, especially public investment. The basic idea of public investment restructuring is to immediately rectify the situation of scattered investment beyond the capacity of fund mobilization, to reduce total investment to one third of GDP, in which public investment is about one third of total investment.

This was followed by Directive 1792/CT-TTg dated October 15, 2011 by the Prime Minister on strengthening investment management from state budget capital and government bond capital. This Directive was issued in the context of limited public investments, with demand substantially exceeding supply and huge unsettled debts derived from infrastructural development. This Directive aims at three issues. *Firstly*, administrative authorities can only decide public investment portfolio within their scope of power and public investment projects in which sufficient funds can be mobilized. *Secondly*, the localities at the request of the central government to balance public investment must obtain central consensus (the agreement of the Ministry of Planning and Investment and the Ministry of Finance). *Thirdly*, the persons making public investment decisions must take responsibility for their decisions. This Directive for the first time tightened discipline on public investments, strictly controlling scattered investment and investments beyond capacity to balance, which led to higher public debts. Without hard budget limitation, authorities using public investment did not consider to choose the most useful projects with positive impacts on the economy, resulting in low investment efficiency. Obviously, Directive 1792/CT-TTg has made a fundamental change in developing projects, ratification and implementation of public investment projects in Vietnam.

Along with tightening discipline on public investment, the Government has taken measures to overcome the previous consequences of scattered investments. Due to public investment approval that was beyond the capacity to balance budget, there has been a hike in outstanding debts in capital construction which government agencies owed to contractors. According to the report of the State Audit of Vietnam, by the end of 2011, unsettled debts derived from infrastructural development had reached more than 91,273 billion VND.[5] Especially, there were 15/63 localities with debts in capital construction at over

[5] This figure includes the debts that investors located beyond the state budget and the approved government bonds, excluding unsettled debts derived from infrastructural development in the ministries and branches. If only counting the debts of the projects invested by the State, according to the Ministry of Planning and Investment, the figure was equivalent to VND 42,000 billion.

100% of infrastructure investment plan, such as Ha Tinh with VND 9,696 billion, Dong Thap –VND 3,335 billion, Nghe An – VND 6,316 billion and Bac Ninh – VND 2,856 billion. This situation has caused many companies to be on the brink of bankruptcy, thousands of workers to lose their jobs and have their wage payments delayed. Within the 9 months from October 2012 to June 2013, the Government issued three directives concerning the settlement of unsettled debts derived from infrastructural development for enterprises.

On October 10, 2012 the Government issued Directive No. 27/CT-TTg on the key solutions to overcome arrears in capital construction at localities, requiring that the settlement of the arrears must comply with Directive No. 1792/CT-TTg. At the same time, it defines the responsibilities of each level, each agency (linked to individual responsibility) in incurring the arrears. Localities must balance capital sources to resolve completely the issue of outstanding debts in capital construction, to determine the causes and elaborate plans and roadmaps so as to completely handle all arrears in capital construction by 2015. Localities are responsible for the 6-month periodic reports on the situation and the results of handling arrears submitted to the Ministry of Finance, Ministry of Planning and Investment to synthesize and report to the Prime Minister.

Specifically, for newly-started projects, to only allocate capital to those which are really urgent and satisfying the following conditions: (1) in line with approved master plan; (2) with clearly defined capital sources and ability to balance budget at all levels; (3) to complete all investment procedures in accordance with the law prior to October 31 of the budget year; (4) to allocate sufficient capital to handle arrears in capital construction under the provisions of Directive 14/CT-TTg and Directive 27/CT-TTg mentioned above; (5) to not allocate investment capital from the State budget to projects not included in investment spending tasks in accordance with the Law on State Budget.

The implementation of the solutions in the above-mentioned directives has achieved important results; unsettled debts derived from infrastructural development have experienced almost no increase in 2012, even though not all objectives have been fully achieved. Therefore, on May 24, 2013, the Prime Minister issued Directive 09/CT-TTg on strengthening the direction and management in implementing state budget - financial tasks in 2013, requiring "to strengthen the handling of unsettled debts derived from infrastructural development" and Directive 14/CT-TTg dated June 28, 2013 on strengthening investment management and handling unsettled debts from infrastructural development from state budget capital and government bond capital.

The consecutive directives of the Prime Minister towards the issue of handling arrears in capital construction have also created a number of encouraging results. The amount of outstanding debts in the projects of capital allocation planning of the State by the end of 2013 was about VND 28,000 billion.[6]

It can be said that the process of restructuring public investment has made great strides in tightening discipline in public investment management. However, results have not fully met expectations, and violations have not been firmly handled.

2.2.2.2 Legislating investment activities

The Law on Public Investment No. 49/2014/QH13 promulgated by the National Assembly dated June 18, 2014, coming into effect on January 01, 2015, provides for the management and use of the capital budget for public investment; the state management of public investment; the right, obligation and responsibility of agencies, organizations and individuals involved in public investment activities. Hence, it is considered to be one of the most important documents of the institutionalization of public investment, facilitating the implementation of the restructuring of public investment and economic restructuring. One of the important revisions in the Law on Public Investment is the change in public investment planning from annual planning into medium-term planning of 5 years, in accordance with the 5-year socio-economic development plans. The Law on Public Investment specifically regulates the entire process from planning to evaluation, approval and delivery of medium-term and annual investment plans.

For the effective implementation of the Law on Public Investment, the Ministry of Planning and Investment has hosted a study to develop a Decree on mid-term and annual public investment plan. The drafted Decree with 6 chapters and 45 articles adjust principles, content and processes to plan, implement, monitor and evaluate the implementation of the medium-term and annual national investment plans of the country, sectors and branches and localities. The promulgation of the Decree aims at completing the legal basis and guiding ministries, branches and localities to implement the annual and

[6] http://www.thesaigontimes.vn/108184/No-dong-xay-dung-co-ban-trung-uong-giam-dia-phuong-rat-phuc-tap.html

medium-term public investment plans on time and in accordance with new regulations in the Law on Public Investment; contributing to improve the efficiency of investment, ensuring the programs and projects being approved would be implemented with sufficient capital, controlling the situation of scattered and fragmented investment, ensuring the national macroeconomic balances and creating transparency in the allocation of state resources.

The Law on management and utilization of state capital invested in the enterprise's manufacturing and business activities dated November 26, 2014 and coming into effect since July 1, 2015 has created a solid legal basis for the investment and management of state capital invested in enterprises and for the determination of the functions, rights and responsibilities of representatives of the state owners, representatives of the enterprise owners in the investment and management activities of State capital invested in the enterprises. At the same time, for the purpose of controlling the situation of scattered and fragmented state capital investment in enterprises. The law was seen as a step forward in the management of state capital investment in manufacturing and business activities through enhancing efficiency of state capital invested in the enterprises, avoiding mismanagement and losses and contributing to the process of restructuring SOEs in particular and the economy in general as well as to the prevention and combating of corruption in economic management.

The Law on Investment has been promulgated by the National Assembly on November 26, 2014, replacing the Law on Investment dated November 29, 2005. Compared to the Law in 2005, the Law in 2014 is more open and clearer in the regulated scope. The Law in 2014 substantially reduced formalities, paperwork for investors and made conditional business lines more transparent. Specifically, the content of business registration of enterprises was taken out of Certificates of Investment Registration (nowadays the Certificates of Investment). Certificates of Investment are only applied to enterprises and investment projects with more than 51% foreign-owned capital, while the establishment of enterprises is adjusted by the Law on Enterprises. The prohibited and conditional business lines are specified clearly and the use of exclusion method in selecting these business lines have substantially contributed to innovate the application of legislation. Particularly, investors no longer have to invest only in sectors allowed by laws, but rather can freely invest in all sectors which are not prohibited by law or subject to conditions.

Currently, investors are acquainted with which sectors and lines are allowed and which sectors and lines require certificates without asking public agencies, thus, implementing the rights that the Constitution regulates "Everyone has the right to freedom of enterprise in sectors and trades that are not prohibited by law" (Article 33). In addition, the Law on Public Investment has also "unleashed" domestic enterprises since investors now no longer need to acquire investment license, but only need business registration certificate. FDI projects with less than 51% foreign-owned capital are not subject to investment license but only business registration certificate.

The (amended) Construction Law, with many important renewed provisions on the formulation, evaluation and approval of investment projects, cost management and quality of construction, was studied, drafted, and promulgated by the National Assembly on June 18, 2014.

2.2.2.3 Expanding Public Private Partnership

The Resolution of the 4th Plenum of the Party Central Committee of the Xth Congress mentions a review of overall investment in infrastructure development. The resolution focuses on solutions to address the imbalance between the demands for infrastructure investment in the period 2011-2020 with the ability to mobilize capital. Some solutions include expanding the fields for Public Private Partnership (PPP), developing mechanisms of investment in infrastructure for the non-state sector, including the foreign sector. In order to concretize this policy, in November 9 2010, the Prime Minister issued Decision No. 71/2010/QD-TTg on promulgating the Regulation on pilot investment in the public-private partnership form for implementation of a number of projects. Although the Decision has little effect in developing the PPP form and sharing the investment burden of the state sector to the private sector, it indicates the government's desire to expand investment opportunities for the private sector, including the foreign sector.

The Government promulgated the Decree No. 15/2015/ND-CP dated February 14 2015 on investment in the form of Public-Private Partnerships, replacing the Decision No. 71/2010/QD-TTg, and the Decree No. 30/2015/ND-CP providing guidelines for some Articles on investor selection of the Law on Bidding. Both decrees have taken effect since April 10, 2015. Decree No. 15/2015/ND-CP has widely opened the door to attract investment from non-state sector and foreign investment into current "bottlenecks" of the economy, such as: infrastructure, public service, science and technology, meteorology, industrial parks, high-tech zone, etc. The new highlights of this Decree include:

(i) To add new forms of PPP, not only traditional forms, including BT, BOT, BTO, but also 4 new forms, including BOO, O & M, BTL, and BLT. The State also allows investors and competent authorities of the State to propose other forms.

(ii) To expand the list of public-private partnerships in the Decision 70. Additionally, projects are classified in groups A, B, C. The small projects have simplified procedures, for example, certificates of investment registration shall not be required for the projects of group C;

(iii) The state capital invested in projects will be used primarily to support the construction of auxiliary facilities, for compensation, land clearance and resettlement. Thus, the state capital is used mainly in performing a supporting role, not too deeply involved in the projects;

(vi) To allow establishing project enterprises and transferring rights and obligations under the project contracts or transferring partly or the whole project. This is a necessary condition for implementing securitization of projects, creating an efficient liquidity channel for investors' capital, and mobilizing maximum resources of the community invested in the projects;

(v) To allow the contracting parties to be entitled to agree in the contracts on the application of foreign laws to adjust the project contracts with one party being a foreigner or when the contracts are guaranteed by the Government to be implemented. This is a substantial change and allows international financial consultants to be deeply involved in a project.

The Decree No. 15/2015/ND-CP is expected to strongly support the process of restructuring public investment through reducing pressure on state capital invested in public projects, while at the same time helping to settle unfinished public projects, which were postponed in the previous period. The forms of BTL, BLT are an important legal framework for conversion of organizational form of public utility enterprises to the form of state purchasing public services from enterprises in accordance with BTL or BLT. Thereby, the State will take advantage of market mechanisms in the provision of public services through bidding under the form of PPP (BTL or BLT).

However, to date there has been no circular guiding the application of this Decree, new forms of PPP as prescribed by the Decree have yet to be implemented. The regulation that BT projects can only be paid by land areas was an unnecessary restriction and limits the ability to select of cities/provinces like Ho Chi Minh City and Hanoi. For these two cities with large budget revenues but limited land areas, allowing only payment by land for BT projects will limit these cities in implementing necessary BT projects.

2.2.2.4 Solutions to improve the efficiency of investment

On December 7, 2012 the Prime Minister issued the Directive No. 32/CT-TTg on the removal of barriers and the completion of mechanisms and policies on improving the investment efficiency. The Directive requires the ministries, branches and localities to conduct an annual review on the administrative barriers and institutions, then to propose to remove and modify these barriers. At the same time, in the context of limited capital investment, the Directive also asks to review the list of national infrastructure projects; on this basis, to compile a list and priority of the key national infrastructure projects that must be finished soon, including the routes that connect key economic regions, arterial routes, airports, ports and railways that are important for international economic integration. To prioritize to allocate central budget for investing in national strategic projects, and the economic regions with low profit or without profit.

To gradually change public investment monitoring from compliance-based to output-based, the Directive requires ministries, branches and localities to construct a system of evaluation criteria of efficiency of state investment, forming a basis for the annual assessment of implemented results and state investment performance in each locality, territory and to submit to the Government in the second quarter of 2013. This task has not completed yet.

At the same time the Prime minister also demanded transparency of the investment activities of the State through building national information system with electronic databases and national information network on the state investment projects.

Since the efficiency of economic activity comes from competition, public investment therefore must also be based on competition principles. The Law on Bidding No. 43/2013/QH13 promulgated by the National Assembly on November 26, 2013 approves the state's regulations on bidding; to enhance openness, transparency, simplification of procedures, to strengthen competition capacity among domestic contractors and to strengthen sanction mechanisms against violations.

These legislation documents were enacted to create a legal framework, resulting in a comprehensive change in the management and implementation of investment.

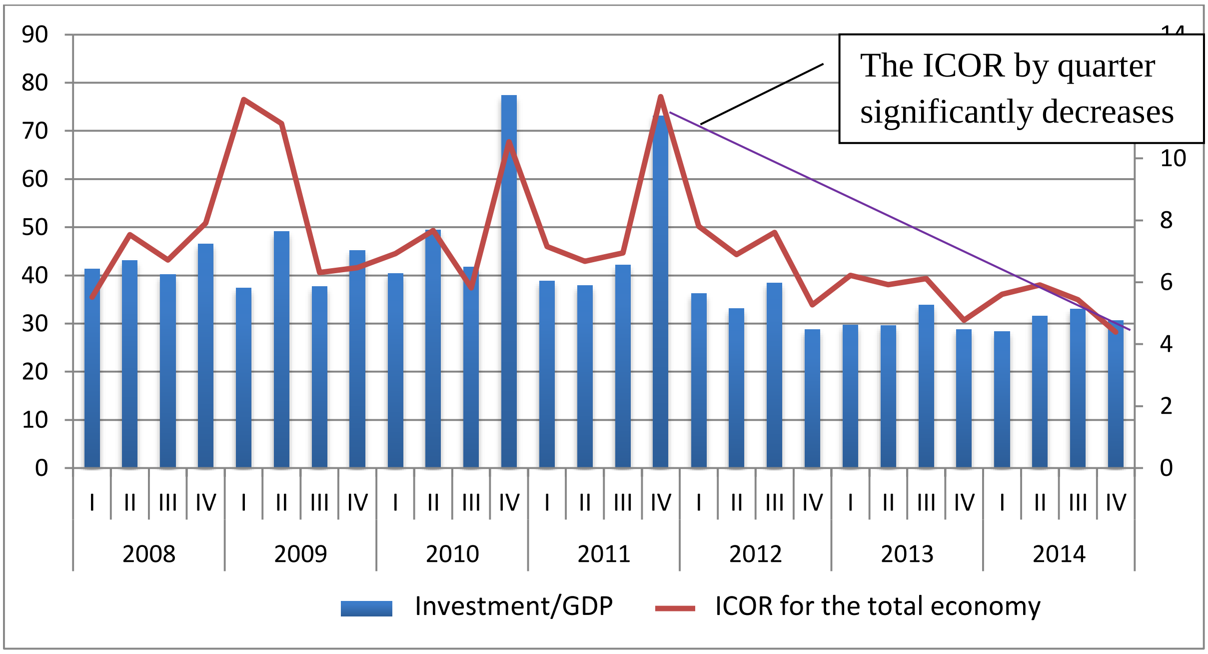
2.2.3 Some preliminary results

2.2.3.1 Investment efficiency of the economy

Investment efficiency of the economy is expressed through the Incremental Capital Output Ratio – ICOR, which is defined as the ratio between investment in some previous period(s) and the growth in output in the subsequent period. ICOR calculation is based on the assumption of all other factors remaining unchanged and only the increase in capital leading to the increase in productivity. Thus, ICOR should only be applied in the short-term economic planning (quarter, half year or a year).

The higher the ICOR is, the lower the productivity of capital or the marginal efficiency of capital. In developed countries this ratio typically ranges between 3.5 and 4, that is, a 1 per cent increase in output requires a 3.5 to 4 percent increase in investment capital. According to the World Bank, for a developing country, an ICOR of 3 means that the productivity of capital is high and the economy is developing in a sustainable way.

Figure 13: The ratio of investment to GDP and ICOR for the total economy by quarter, 2008- 2014



Source: GSO.

According to the ICOR, Vietnam has been increasingly using resources more effectively (Figure 13). From 2012 onwards, the national ICOR gradually declined by quarters. In Q4/2014, the ratio was only about 4.5, while the highest level of Q4/2011 was approximately 12. The ICOR has become not only lower, but also stable across the quarters.

In 2007, when Vietnam's ICOR stood at 5.1, warnings were made about the waste of investment and low efficiency in the use of resources of Vietnam. However, in 2008 and 2009, the ICOR continuously set new records with 6.7 and 7.3, respectively, high levels compared to other countries in the world. High and rising ICOR, i.e. low and reducing investment is one of the underlying factors of high inflation. The repetition of this situation is a key reason causing budget deficit, increasing public debt and rising trade deficit, etc.

Table 1: The ICOR for the total economy and for the public sector

Year	The ratio of investment/GDP (%)		GDP growth rate (%)		ICOR	
	Total economy	Public sector	Total economy	Public sector	Total economy	Public sector[7]
2008	38.16	36.88	5.66	4.36	6.7	8.46
2009	39.18	45.78	5.40	3.99	7.3	11.47
2010	38.48	43.81	6.42	4.64	6.0	9.44
2011	33.26	37.60	6.24	4.46	5.3	8.43
2012	31.12	38.46	5.25	5.68	5.9	6.77
2013	30.44	38.17	5.42	4.84	5.6	7.91
2014	31.00	38.79	5.98	4.8 6	5.18	7.98

Source: Authors' calculation from GSO database.

In this context, a number of restructuring measures, with focus on public investment, has been implemented. Investment efficiency in terms of ICOR has greatly improved. In 2012, 2013, 2014, the ICOR was 5.9, 5.6 and approximately 5.18, respectively (Table 1). The decreasing ICOR signalled an improvement in investment efficiency of the economy. Although economic growth has not recovered to its level before the downturn, achieving 1% growth now requires less capital stock. The ICOR for the public sector has improved since 2012 but has tended to rise in the last two years. In 2009-2012, the ICOR experienced a significant decrease partly because the scattered investments in the public sector have started tightening since 2009, increasing the efficiency in public investment. In the period 2013-2014, with macro-economic stability,

[7]The ICOR for the public sector is calculated primarily to analyze the trend and not to compare with the ICOR for the total economy because of differences in the structure of investment in the state sector.

public investment increased (with a focus on infrastructure) for the purpose of promoting investments from other sectors, resulting in the increase in the ICOR for the public sector.

2.2.3.2 The efficiency of public investment

Public investment in Vietnam is understood as investment from state funds, including development investment from the state budget, government bonds, state credit, ODA, investment development of state-owned enterprises (SOEs) and other capital sources of the State.

In past decades, public investment in Vietnam has been considered the most important driving force of economic development, a vital component of aggregate demand as well as a contributing factor to increase aggregate supply and economic capacity. Obviously, the State has been a dominant investor, leading the market, imposing a strong impact on market performance. During the period of economic crisis, public investment was expanded to increase aggregate demand and to avoid recession.

Despite public investment comprising a large proportion of total investment, its contribution to GDP remained well below the State share of investment. In 2009, the share of public investment accounted for 40.5% of total social investment; however, its contribution to GDP was only 35.13%. Meanwhile, non-state investment, with the share of only 33.9% of total social investment, has contributed up to 46.53% of total GDP.

Besides, the efficiency of public investment in Vietnam is also evaluated through ICOR of the public sector. In spite of the slight improvement since 2012, ICOR of the public sector remained much higher than that of the overall economy (Table 1).

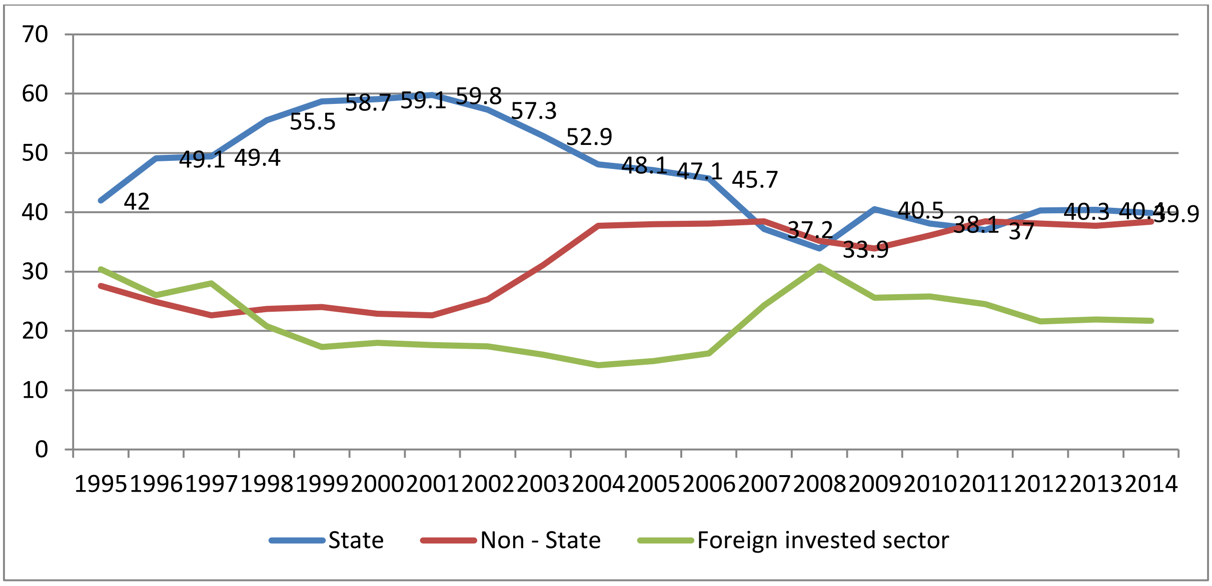
The reasons for the inefficiency of public investment include the frequently scattered investments resulting in the shortage of funds for projects and a prolonged approval process; and investments dispersed over too many non-specialized areas, leading to losses and wastes of invested capital (mainly from state budget and loans). Public investment is dispersed over almost all economic activities, even in areas where the private sector is capable of investing efficiently, such as hotels, restaurants, property services, trade and some other consumer services. Public investment has not actually performed its main function – creating the basis for development and growth, focusing on the areas where the private sector cannot operate or operate inefficiently.

Inefficient public investment not only leads to macroeconomic instability, but also reduces productivity, efficiency and overall competitiveness of the economy in the short and long term. Therefore, demand for restructuring and improving investment efficiency of public sector should be a top priority in the process of economic restructuring associated with transforming the growth model towards higher quality, productivity, effectiveness and competitiveness of the economy.[8]

Resolution No. 11/NQ-CP of the Government dated February 24, 2011 provides measures to cut public investment to reduce the budget deficit. The Resolution also emphasizes measures to control investments of SOEs, preventing scattered investments across multiple sectors and focusing on their specialized productive activities in order to increase the efficiency of capital.

Figure 14: The investment structures by types of ownership, 1995-2014

Unit: %



Source: GSO.

Thanks to significant policy progress to ensure the efficiency of public investment, public investment has made numerous positive changes. These changes are reflected firstly in the reduction of state capital share in total social capital, and in the acceleration of mobilizing investment capital from the non-state sector and the FDI sector (Figure 14). In the context of public investment having lower efficiency than private investment, reducing the proportion of public investment will limit the negative impact of the "crowding out" effects. However, Figure 15 also shows that, since 2011, the proportion of public

[8]Dr. Nguyen Dinh Cung, Improving the efficiency of investment and economic restructuring

investment has not decreased. This was due to the decline in non-state and foreign investment, thus putting upward pressure on public investment to make up for such decline. Currently, foreign investment and private investment have been recovering; the Government should be consistent in controlling public investment in order to maintain public debts within safe threshold.

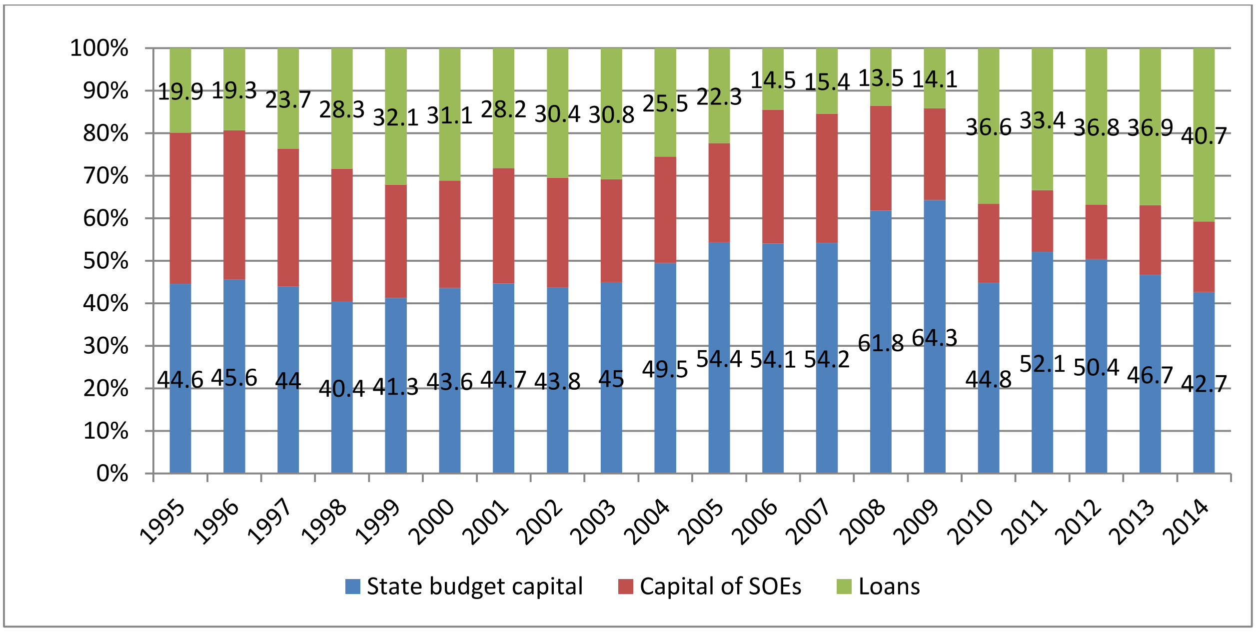
The improvement of public investment efficiency is also reflected in the positive movement of state capital: reducing the proportion of the state budget and increasing the proportion of loans. Despite being an important source for development investment, investment capital from the state budget has exposed many shortcomings. Investment efficiency from state budget is low, failing to meet the requirements of economic transition and international integration in the new era, especially in the stage of accelerated industrialization and modernization. The main reason is due to the "ask-give" mechanism, which causes the problem of negligent capital allocation, scattered and fragmented investment, lack of planning or subjective adjustments of planning; as well as the situation of wrongdoings, corruption or losses etc. Capital of the state budget is often not allocated based on market mechanisms; thus reducing capital investment from the state budget and switching to a borrowing-lending relationship in investment allocation in the state sector will be more market-oriented and more efficient.

In total implemented investment of the state sector, capital from the state budget has significantly contributed to the development of socio-economic infrastructure, social security and social welfare. From late 1990s until 2009, the proportion of capital from the state budget tended to increase and have a dominant role compared to other sources. In 2009, the proportion of state budget capital, capital of SOEs and loans of the total implemented investment were 64.3%, 21.6% and 14.1%, respectively (Figure 15).

In 2010, while growth rate of capital sources from the state budget and SOEs decelerated to 27.2% and 16.2%, respectively, growth rate of loans accelerated and reached 115.3% compared to 2009 (Figure 15). Accordingly, the share of state investment capital in total implemented investment of the state sector (at current prices) fell sharply, from 64.3% in 2009 to 44.8% in 2010, the first and largest drop since 1998.

Figure 15: The proportion of various capital sources in total implemented investment capital in public sector

Unit: %



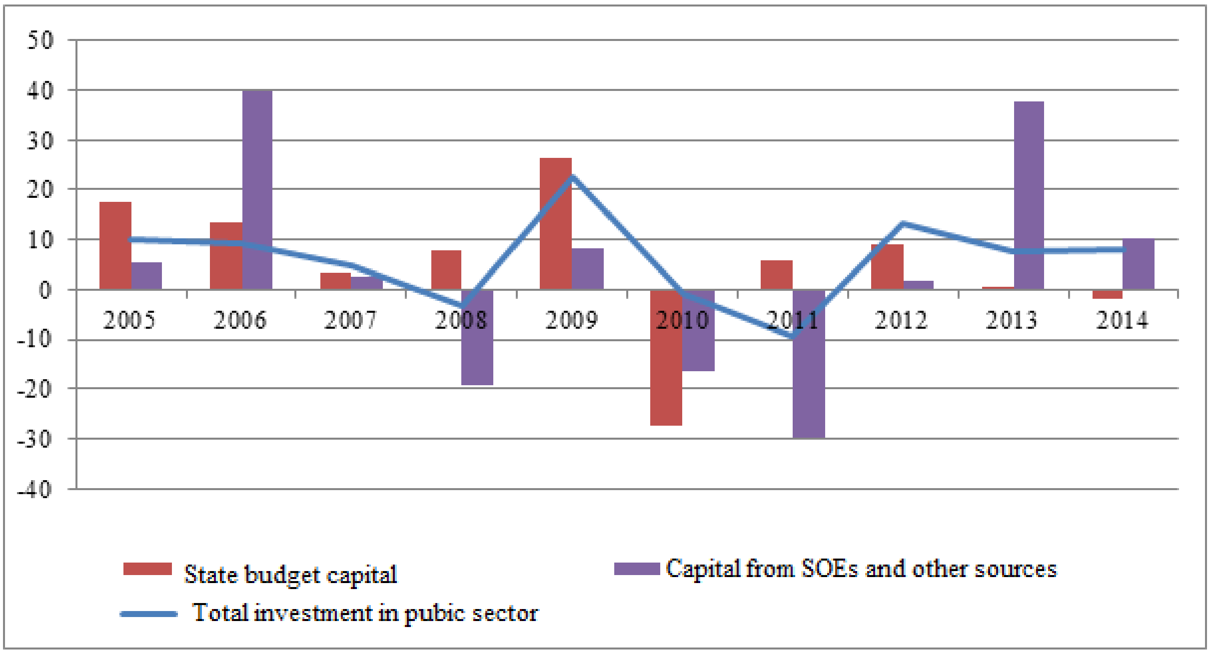
Source: GSO and authors' calculation.

Since 2011, although investment capital from the state budget has played a key role in the investment structure of the State, the proportion of this capital has decreased significantly, 52.11% in 2011, 50.43% in 2012, 46.69% in 2013 and 42.7% in 2014. Under the limited efficiency of investment capital from the state budget, the declining proportion of this capital increased the overall efficiency of investment in public sector. The proportion of loans in total implemented investments of public sector tended to move in the reversed direction with that of capital from the state budget, i.e. decreasing from the late 1990s until 2009, then increasing sharply in 2010 and increasing gradually from 2011 until now. The proportion of loans in 1995-2009 averaged only 23.2%, in 2010 increased to 36.6% and in 2011-2014 reached 37%.

Loans from the issuance of bonds, treasury bills, foreign loans, development investment loans from international organizations – which often have repayment obligations - tend to be better managed. However, a sudden rise in the percentage of loans in total state investment in 2010 was not a proactive adjustment of the state but rather a passive movement. At the beginning of 2010, tight budget revenues and rising expenditure needs forced the government to turn to loans to ensure investment for development. This passive movement was likely to create an increasing pressure of public debt, if the mechanism of borrowing of the government for re-lending is not changed. Re-lending must be based on principles of competitive market in order to reduce risks. Enterprises must compete together and only those projects with high profitability and best adequacy ratio are able to access the loans. Besides, the mechanism of monitoring such loans has remained loose, thus should be replaced by a mechanism similar to which the commercial banks apply to borrowers. Unfortunately, the mechanism of re-lending and monitoring the loans has experienced little changes. As consequences, the increase in the proportion of loans has been a potential risk for budget stability and financial security.

Figure 16: The growth rate of investment in public sector by investment sources

Unit: %



Source: GSO.

Growth rate of investments from SOEs and other sources in 2010 and 2011 have decreased compared to the previous years with the decrease of 16.2% and 29.8%, respectively (Figure 166). That was due to strong measures by the Government on managing enterprises after the VINASHIN case and the policy on prioritizing to curb inflation and stabilize the macroeconomy. Correspondingly, the proportion of investment capital of SOEs and other capital sources in public sector tended to decrease, from 21.6% in 2009 to 18.6% in 2010 and 14.5% in 2011. In 2012, along with the process of equitization of SOEs, the proportion of investment from SOEs and other capital sources continued to drop to 12.8%. For the last two years, although the proportion of investments from SOEs and other sources have increased, their role has declined more significantly than that of other capital sources compared to nearly twenty years ago (in 1995 accounted for 35.5% and in 2009 accounted for 21.6%). Given the weaknesses in the management of investment capital from SOEs, the lower proportion of this capital can be considered a positive sign for the improving public sector investment efficiency.

2.2.3.3 Public investment disciplines

The results of the settlement of debts derived from infrastructure development are ambiguous. As reported by the Ministry of Planning and Investment, by the end of 2013, unsettled debts fell to VND 28,000 billion compared to VND 85,000 billion in 2011.[9] However, the results were below the approved planning set by the Government under Directive 27/CT-TTg and Directive 14/CT-TTg. In the context that the localities, ministries and branches have yet to vigorously implement the directives of the Prime Minister, the Government Inspectorate recently conducted a large-scale inspection on strengthening investment management and handling unsettled debts from the state budget and government bonds. A total of 15 ministries, branches and 63 centrally-run provinces and cities have established 740 inspection teams to conduct inspections of 12,990 projects, inspecting 194 projects with the total investment of VND 502,202.900 billion. These moves demonstrate the government's resolution in establishing discipline in public investments in general and in infrastructure construction in particular. Inspection results show that wrongdoings in public investment have still occurred frequently.

Specifically, the common wrongdoings in capital management of localities are violations of the regulations on formulation, appraisal, approval and adjustment of projects. 789 projects showed violations in procedures, as found by the inspection teams, with total investment of VND 280 billion; 272 projects in formulation, appraisal, approval and adjustment with total investment of VND 248 billion; 1,527 projects in unsettled debts derived from infrastructural development with total investment of VND 1,869 billion.

It is alarming that there were 2,324 projects and works where “whistle-blowers” reported to the inspection team about violations, including: received payment exceeding the actual volume of construction; payment differed from

[9] These figures were released by the Minister of Ministry of Planning and Investment in the interview with Saigon Economic Times http://www.thesaigontimes.vn/108184/No-dong-xay-dung-co-ban-trung-uong-giam-dia-phuong-rat-phuc-tap.html

the approved estimation; capital was allocated but some VND 791.6 billion in contracts were not implemented.

At the local level, the inspection team has proposed total economic penalties of VND 3,189.5 billion, in which recovery for the state budget was VND 123.6 billion, reduction in payment value VND 128.6 billion and other penalties VND 2,937 billion. For those violations, the inspection team proposed to apply sentences to 240 organizations and 197 individuals; one case was proposed to be transferred to investigating authorities.

Regarding the issue of unsettled debts derived from infrastructure development, the report of the Government Inspectorate shows that there are still cases where projects have yet been allocated capital, but bidders were already selected and provided capital in advance, causing increased debts. In Ben Tre province, there are 14 projects with unsettled debts of VND 127 billion; In Kien Giang province – 31 projects with unsettled debts of VND 31 billion; In Lao Cai – 58 projects with unsettled debts of VND 193.6 billion.

Some provinces do not allocate sufficient capital for completed and transferred projects and works; in addition, new projects were initiated while there are still unfinished projects, thus causing unsettled debts from infrastructural development. For example, in Ninh Binh, by the end of 2011, despite a shortage of VND 9,147 billion for 599 construction projects, finished and unfinished, the province still approved 347 new projects for the next two years with total investment of VND 6,943 billion. This was a reason for arising unsettled debts.

In Bac Lieu, a majority of construction works that the People's Committees of districts and cities had decided to invest since 2012 did not have arranged capital in plans, but investors were still conducting the construction.

In this situation, recently the Prime Minister once again issued Directive No. 07/CT-TTg dated July 24, 2015 on promoting measures to handle unsettled debts derived from infrastructure development. Accordingly, the Prime Minister requires ministries, branches and localities prior to June 30, 2015 to accurately report the debt portfolio and the amount of unsettled debts from infrastructural development by the end of December 31, 2014 by capital sources, "in which, to clarify unsettled debts with acceptance report for completed volume by the end of December 31, 2014 and the those without acceptance report for completed volume due on that day". At the same time, the investors prior to May 31, 2015 have to complete acceptance procedures for implemented volume up until December 31, 2014 and clearly report remedies to handle unsettled debts. The ministries, branches and localities shall be responsible for the accuracy of information and data on unsettled debts derived from infrastructural development and for plans and roadmaps to settle the debts.

2.2.3.4 Allocating resources according to market mechanisms

There have been certain changes in public investment towards market mechanisms, such as promoting public-private partnerships, launching concession projects for airports, ports, etc. However, the allocation of public investment is still relying on political decisions rather than on expected projects efficiency. So far, the process of restructuring public investment was only focused on ensuring compliance with the provisions of the Stat [10] without providing mechanisms to competitively allocate resources. Currently, there is no mechanism to ensure the allocation of limited public investment into the most essential projects, with the lowest costs and highest efficiency. The amended Law on Bidding 2014 is a significant effort of the State to apply competitive bidding procedures to firms engaging in public investment projects. However, we have yet to have a competitive procedure in allocating investment to agencies that are project owners.

The biggest loophole in public investment has been the mechanism of the managing agencies. The managing agencies (ministries, branches and provincial People's Committees) are both the authorities to approve investment projects and the owners of the enterprises implementing such projects. At the same time, they are also the monitoring and evaluation agencies of those projects. Continuing this mechanism is likely to encourage profiteering from public investment projects.

The State still retains the roles of both producers and suppliers of public-utility services, instead of transferring the producer role to the private sector for competition and the State only serves the role of purchasing and re-selling services to the people.

[10] The Directive 1792/CT-TTg, the new Law on Investment, the Decree on mid-term and annual public investment plan are primarily to ensure that public investment is implemented within available resources, to prevent scattered investment, resulting in an outbreak of public debts. However, a mechanism to choose the best projects within the limited resources has not been developed.

2.3

2.4 Restructuring banking system

2.4.1 Policies

The restructuring of the banking system has been conducted since February 2011 with the implementation of Resolution 11/NQ-CP of the Government. Accordingly, the policies on tightening monetary, minimizing dollarization, preventing speculation and classifying banks, defining a credit line, etc. were implemented firmly and consistently. The measures according to Resolution 11/NQ-CP, which were continued to be implemented two years later, along with other technical measures such as recapitalization, interventions on the interbank market, etc. enabled credit institutions to overcome the risk of collapse from a liquidity crisis and were a foundation for the process of restructuring the system of credit institutions with the focus on commercial banks.

On March 01, 2012 the Prime Minister approved the Project on restructuring the credit institution system in the 2011-2015 period in Decision No. 254/QD-TTg. The objectives of the restructuring of credit institutions include: to basically, thoroughly and comprehensively restructure the system of credit institutions, expecting local banks to achieve safe operation and sustainable performance with diversified structures of ownership, sizes, and types to be more competitive and consistent with international standards and to better meet the demand for financial and banking services of the national economy.

In the 2011-2015 period, Vietnam will focus on improving the health and strengthening the operational capacity of credit institutions; improving their safety and operational efficiency; improving market discipline in banking operation; and striving to form at least one or two commercial banks operating on the regional scale by the end of 2015.

The roadmap for restructuring credit institutions was determined by the Government and SBV as follows:

In 2011-2012: To focus on assessing actual operations, assets quality and bad loans of credit institutions; to assess and classify credit institutions; to develop and deploy plans to reorganise credit institutions, prioritizing the reorganization of unhealthy credit institutions; to support credit institutions' liquidity in order to guarantee their affordability; to conduct merger, acquisition and consolidation of credit institutions; to increase chartered capital and to handle non-performing loans of credit institutions; to restructure activities and banking governance system.

In 2013: To complete basically the amendment and supplement of the regulations on safety operation of the banking system; to continue to improve financial health of the credit institutions (including settling non-performing loans and increasing chartered capital), to restructure activities and banking governance of credit institutions; to basically complete the restructuring of legal ownership of unsound joint stock commercial banks.

In 2014 – 2015: To complete the basic financial restructuring of credit institutions; credit institutions are expected to meet capital requirements, standards and safety limits according to the laws; to continue voluntary merger, acquisition and consolidation.

2.4.1.1 Settling non-performing loans

To implement the restructuring of credit institutions, SBV has inspected all credit institutions, identified unhealthy banks, their level of bad debt and liquidity, the status of executing regulations of SBV. Two emerging issues in the system of commercial banks include high non-performing loans and cross-ownerships, undermining the measures on maintaining safety of the banking system.

To handle the non-performing loan problem, the first measure will be preventing the increase and spread of non-performing loans in the whole system. SBV has set credit growth limits for each banking group, depending on the respective health of banks. Some small and weak banks are required to find partners to buy non-performing loans, or to merge into larger, stronger banks to have enough resources for settling non-performing loans. The next measure will be isolating non-performing loans in order to minimize the negative impact of non-performing loans on the resilience of the banks. Because of insufficient resources to acquire huge volume of non-performing loans, the Government issued Decree No. 53/ND-CP dated May 18, 2013 on the establishment, organization and operation of the Vietnam Asset Management Company (VAMC). VAMC serves as a tool to resolve non-performing loans during the restructuring of the credit institutions. According to the Decree, VAMC operates under the principle of covering expenditures with revenues and not-for-profit; must be open and transparent in the purchase and handling of non-performing loans; must limit risks and expenses in the handling of non-performing loans. Then the Government required SBV to study and submit to the Government the amendments of Decree No. 53/2013/ND-CP dated May 18, 2013 on the establishment, organization and operation of VAMC to enhance the capacity of VAMC in handling non-performing loans... In nature, VAMC operates as an "inventory" to deposit non-performing loans in order to remove them from commercial banks' balance sheet; this, in turn, allows banks to access other resources to gradually settle non-performing loans. Non-performing loans in VAMC are handled in two methods: (i) to seek a buyer for the non-performing loans and (ii) to offset by the banks' annual reserves. To present, the first method has not been as popular as the second method. This forced commercial banks to raise the reserve ratio, thereby, expanding the gap between lending and deposit rates. In other words, the annual provision for non-performing loans relief serves as a part of the difference between lending and deposit rates of the banking system, and of course, this amount is not paid by banks but by depositors (deposit rates are lower than the normal competitive level) and by borrowers (lending rates are higher than the normal competitive level).

Following Decree 53, on May 31, 2013 the Prime Minister issued Decision No. 843/QD-TTg on approving the two projects on "Dealing with non-performing loans of the credit institutions system" and "Establishing the Vietnam Asset Management Company". Since then, in order to realize and create the legal basis for the operation of VAMC to handle non-performing loan problem which has been severely affecting production and business activities of the economy, the SBV Governor stipulated:

(i) Decision No. 1459/QD-NHNN dated June 27, 2013 on the establishment of VAMC;

(ii) Decision No. 1590/QD-NHNN dated July 22, 2013 on approving the Charter of organization and operation of VAMC;

(iii) Decision No. 1738/QD-NHNN dated August 9, 2013 on providing charter capital for VAMC and completing the procedures, the guidelines on accounting the provision of charter capital for VAMC;

(iv) Decision No. 169/QD-NHNN dated February 11, 2014 on approving the Charter of operation of Supervisory Board of VAMC;

(v) Circular No. 04/2014/TT-NHNN dated February 26, 2014 on statistical reports and open and transparent information on the activities of VAMC.

At the same time, to create a legal basis for VAMC to buy and sell non-performing loans of credit institutions, as well as to encourage them to sell non-performing loans to VAMC, the SBV Governor stipulated the guidelines on trading non-performing loans of VAMC as follow:

(i) Circular No. 19/2013/TT-NHNN dated September 6, 2013 on the purchase, sale and settling non-performing loans by VAMC;

(ii) Circular No. 20/2013/TT-NHNN dated September 9, 2013 on refinancing loans by special bonds of VAMC.

In addition, SBV also submitted to the Prime Minister to issue Decision No. 2358/QD-TTg dated December 4, 2013 on the State Bank of Vietnam's refinancing rates applicable to credit institutions based on special bonds of VAMC and in coordination with the Ministry of Finance to stipulate Circular No. 209/2013/TT-BTC dated December 27, 2013 on guiding the financial regime for VAMC.

Furthermore, the Prime Minister also issued Decision No. 363/QD-TTg dated March 11, 2014 on the establishment of an interdisciplinary Steering Committee for the implementation of the project "Restructuring the system of credit institutions for the period 2011 – 2015" and the project "Handling non-performing loans of the system of credit institutions". The Steering Committee is responsible for advising the Prime Minister to direct the implementation of restructuring measures and handling non-performing loans of the credit institution system in accordance with the objectives, orientations defined in the projects; for studying and proposing to the Prime Minister directions and solutions of handling important issues during the implementation of the projects; for advising and assisting the Prime Minister directing the ministries, branches and localities to handle the problems belonging to functions and tasks of the ministries, branches and localities within the projects. At the same time, the Steering Committee is also responsible for advising and assisting the Prime Minister in harmonization and coordination between ministries, branches and localities, while enhancing accountability, participation, coordination of ministries, branches and localities in the process of implementation of the projects; for performing other duties as directed by the Prime Minister on restructuring and settling non-performing loans of the system of credit institutions.

2.4.1.2 Consolidating banking system

Restructuring the system of credit institutions covers not only unhealthy credit institutions, but also healthy ones, together with institutional capacity building (a system of mechanisms and policies, banking inspection and supervision) to improve the efficiency and strength of the banking system. Along with the non-performing loan handling solutions, SBV has also implemented measures to promote the restructuring and governance capacity of banks to overcome current weaknesses in governance and management of the credit institutions and to innovate the governance banking system towards adopting the international practices and standards consistent with Vietnam's conditions.

Some solutions which have been deployed

- *Firstly,* to enhance transparency in banking operations through the application of new mechanisms for the disclosure of the credit institutions; to promote commercial banks to issue stocks on the stock market; To increase the popularity of joint stock commercial banks.
- *Secondly*, the economic groups and state corporations, which are being the shareholders or members of the credit institutions, must have reasonable plans in divestment and termination of business in the banking sector.
- *Thirdly*, to limit the domination, manipulation of major shareholders over joint-stock banks; to resolutely handle major shareholders and relevant persons violating provisions on share ownership limits in joint-stock commercial banks and credit institutions with cross-ownerships.
- *Fourthly*, to improve conditions, standards of governance capacity, working experience and qualifications of leadership positions and key managers in the credit institutions.
- *Fifthly,* to deploy in credit institutions sound internal business processes and policies and to apply effectively governance practices and advanced management in accordance with international practices and standards and laws. To encourage credit institutions to develop risk management systems consistent with the principles and standards of the Basel Committee, with focus on the system of liquidity risk, credit risk, market risk (price, interest rate, exchange rate) and operational risk management. The objective is the application of Basel II in Vietnam's banking system by 2015.

- *Sixthly*, to develop the internal credit ranking systems, from which to implement loan classification and risk provision consistent with international practices and the level of credit risk. To improve the capacity of credit evaluation and approval and credit risk management and monitoring of credit institutions; To restructure and rearrange departments with functions of trading, governance and administration; To reasonably sort and allocate staffs and to develop banking managers and trading staffs with high qualifications, sense of responsibility and good professional ethics.

On January 21, 2013 the SBV issued Circular No. 02/2013/TT-NHNN on classification of assets, levels and method of setting up of risk provisions, and use of provisions against credit risks in the banking activities of credit institutions, foreign banks' branches. According to the Circular, the SBV requires the classification of violated assets into the highest risk level. The SBV also requires credit institutions to provide self-classification of debts to the Credit Information Center (CIC) to summarize; then CIC provides credit institutions a list of customers with highest risk level to adjust debts classification results, to set up risk provisions and to use provisions for dealing with risks. The requirements in Circular No. 02/2013/TT-NHNN are consistent with international practices to assess the actual credit quality and non-performing loans of each credit institutions. However, these requirements are assessed too strictly in the current context of the Vietnam's economy. For example, according to the Circular, based on the statistics of CIC, if customer A has non-performing loans classified in Group 5 in a particular bank, all his/her loans in other banks have to move to Group 5. Under this method, non-performing loans of banks will at least double, and bad debt ratio of the banking system will not be less than 15%.

SBV has delayed the implementation of this Circular by 2015, amending and supplementing it by Circular No. 09/2014/TT-NHNN dated March 18, 2014, which was implemented immediately on March 20, 2014. According to Circular 09, credit institutions must settle violated debts which are still "good" without transferring them to the higher-risk group. In addition, the previous transfer of non-performing loans to higher-risk groups as recommended by the CIC will be temporarily stopped, due to the fact that in Vietnam, various debts that had not violated any law were still considered "bad" by the inspectors because of incomplete dossier, unclear objectives of lending or not fully standardized procedures. Circular 09 amending and supplementing some articles of Circular 02 will support and create favourable conditions for enterprises to access loans in a favourable manner, to overcome difficulties in production and business, and at the same time, to maintain non-performing loans in credit institutions at a low level.

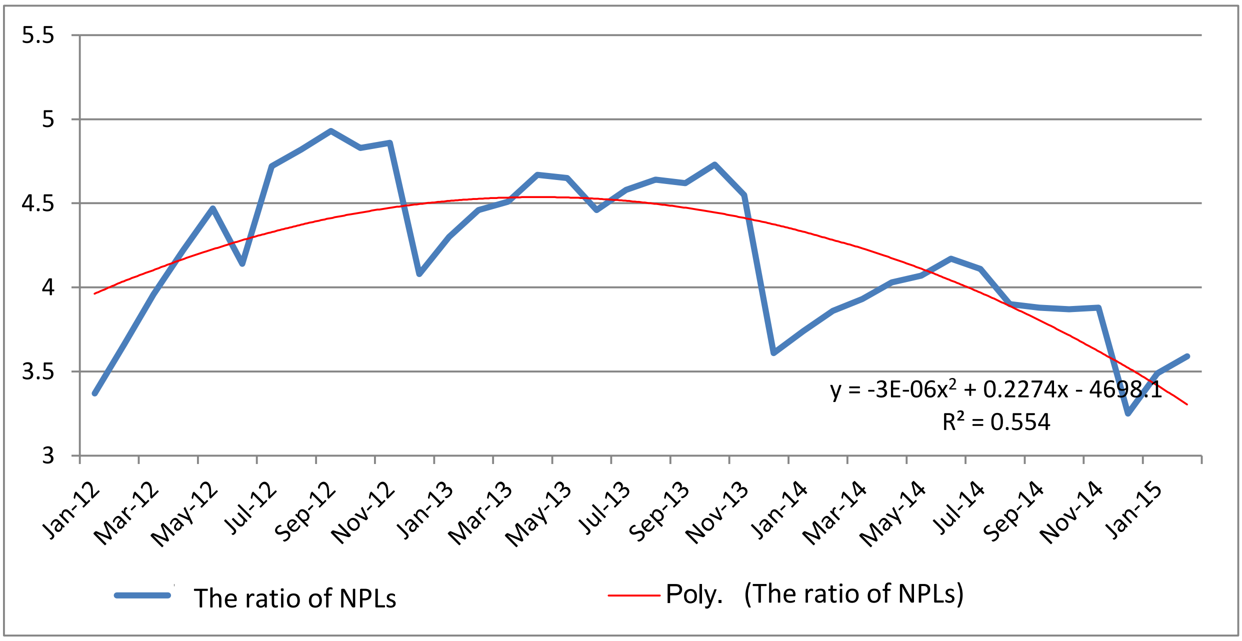
2.4.2 Some achievements

The success of the restructuring of commercial banking system has been remarkable. As described in Section 2.1.2, the banking sector has contributed significantly in the achievements of macro-economic stability. Controlling inflation, stabilizing monetary, reducing interest rates, increasing foreign reserves etc... are strong indicators showing that, prudent steps to restructure the system of commercial banks has brought encouraging results.

2.4.2.1 Increasingly stable banking system

The biggest risk of the banking system under restructuring consists of liquidity crisis and rising NPLs. For 4 years, the banking system has stabilized gradually. Bad debt has been basically curbed, the weak banks have been merged into healthy banks, some other weaker banks have been controlled by SBV through acquisition with value of VND 0, including Oceanic Bank and Construction Bank. The merged banks have been Tin Nghia Bank, First Joint Stock Commercial Bank, Western Bank, Mekong Development Bank, PG Bank, Mekong Housing Bank, Southern Bank, Habubank, ...

Figure 17: The ratio of non-performing loans of the whole system of commercial banks



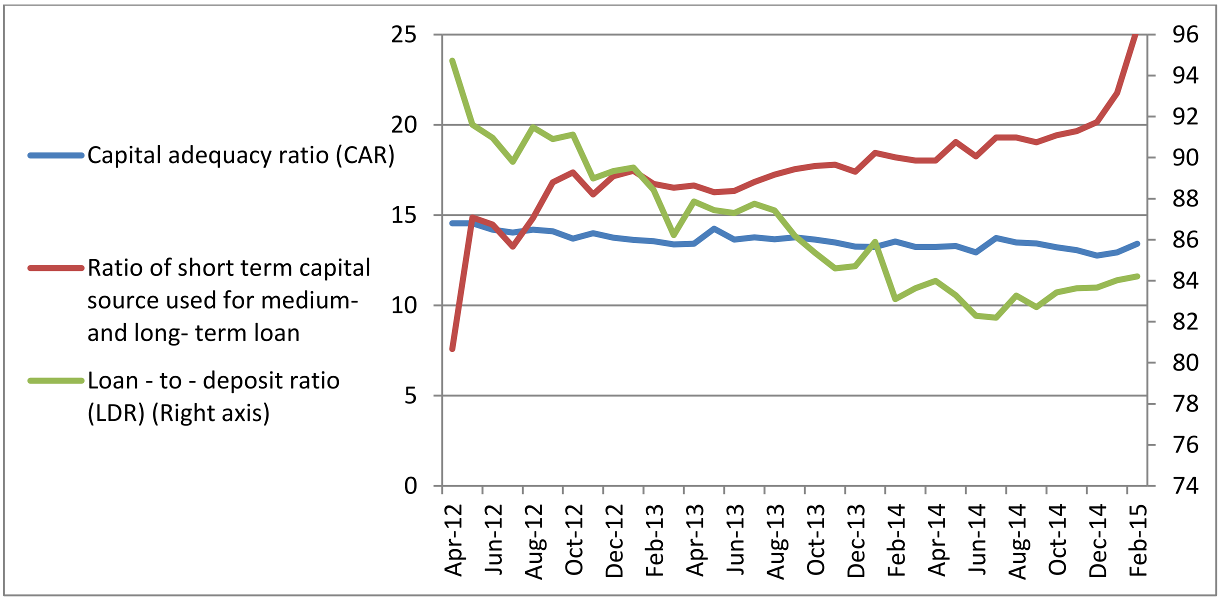
Source: SBV.

Up to this time, the system of commercial banks has narrowed to only 35 banks. After handling 9 weak banks in 2014, this year SBV is expected to continue to handle 6 other banks thereby to increase the competitiveness of remaining banks basing on a larger scale and better ability to in-depth investment. The greatest success of the restructuring of the banking system was the handle of a significant number of weak banks without causing collapse and systemic banking crisis.

The commercial banking system has now basically stabilized. Despite controversy on the inner value of the ratio of NPLs and the method to classify loans, according to the data using the classification method of SBV, the ratio of NPLs in the banking system has been stabilized and showed a clear downward trend since October 2013 (Figure 17). The highest ratio of NPLs according to the SBV method was 4.93% in September 2012 before stabilizing at relatively high levels of over 4.5%. In October 2013, there was a pronounced downward trend in the ratio of NPLs. At the end of 2014, this ratio was less than 3.5%.

It should be noted that this NPL rate is in the balance sheet, excluding NPLs out of the balance sheet (transferred to VAMC) as well as NPLs extended to pay in the past. This NPL rate has not been re-inspected by the Inspectorate of the SBV, but only reported by the commercial banks.

Figure 18: Prudential ratios of the banking system

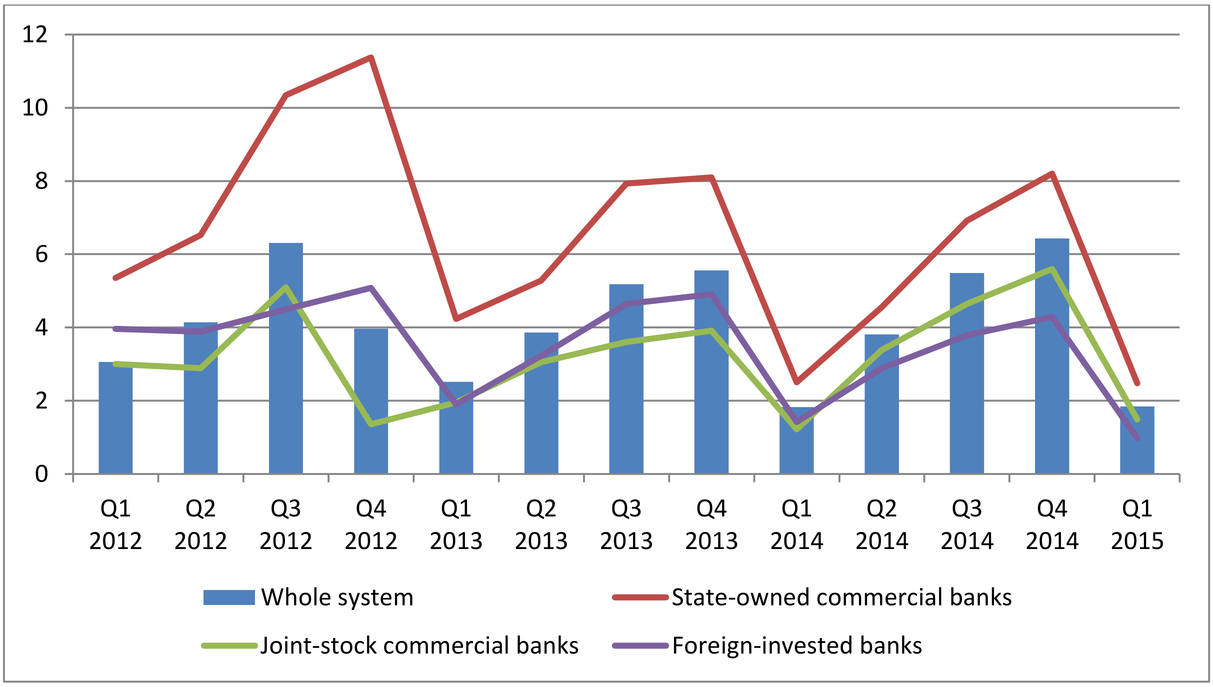


Source: SBV.

Thus, the picture of NPLs of commercial banks has remained ambiguous. Considering only official figures provided by the SBV, the NPL rate has improved dramatically. However, if analysing all the types of NPLs, the NPL rate has improved insignificantly. Given the limited transparency of the SBV's information on NPLs, it is very hard to establish a market to trade NPLs. The buyers face difficulties in risk pricing of those debts, tending to lower the price level at which the creditors want to sell. As a result, supply and demand cannot be met; the market cannot operate. Without NPL market, the NPL problem in the commercial banking system could not be solved completely.

The prudential ratios of the banking system were high in 2012 and then gradually became stable. The capital adequacy ratio (CAR) is regulated at a level over 9%, CAR of the whole banking system from the beginning of 2012 to date reached over 13% and in 2012 was nearly 15% (Figure18). As the banking system gradually stabilized, the maximum ratio of short term capital source which is used for medium term and long term loan has gradually increased, representing a strong demand for long-term loans. Macroeconomic stability, strengthening banking system, increasing capital mobilization, despite interest rates continued to fall, the loan - to - deposit ratio (LDR) decreased steadily from about 94% at the beginning of 2012 to around 82% at the beginning of 2015. This represents the liquidity surplus and the increase in safety of the banking system; on the other hand, it also shows low growth of credit, which creates little motivation for economic growth.

Figure 19: ROE by types of bank and of the whole system

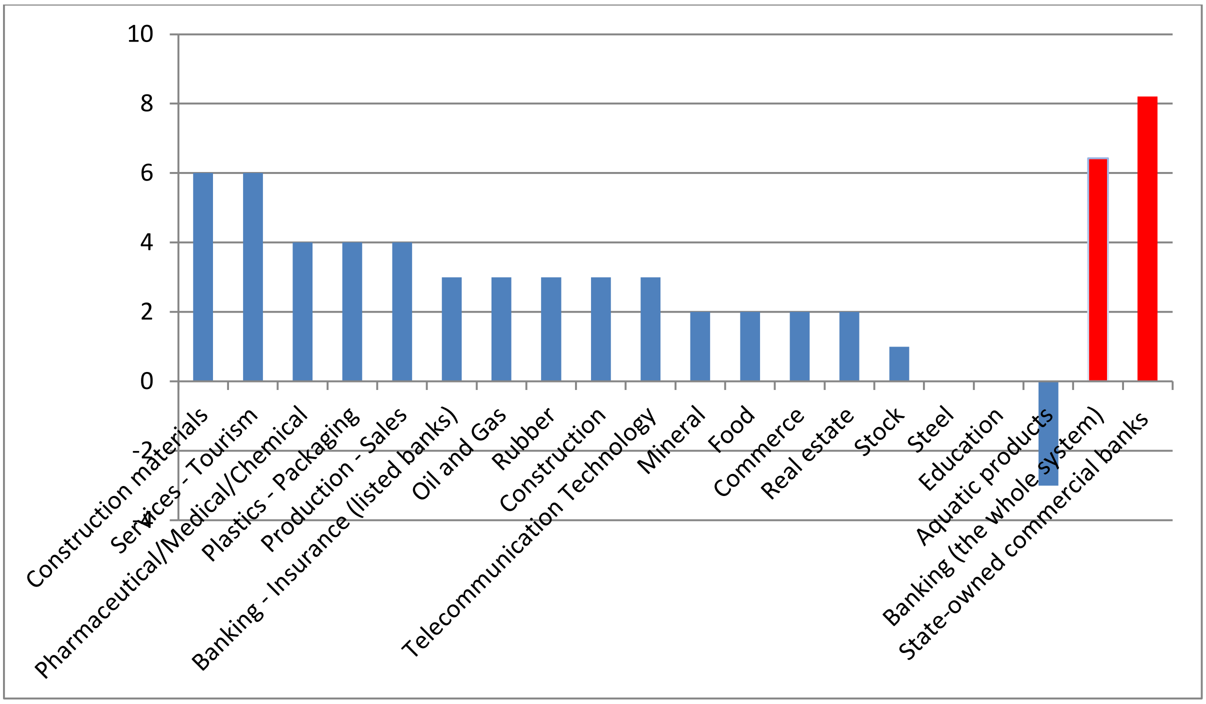


Source: SBV. ROE data are cumulative quarterly, ROE data of Q4 are ROE for the whole year.

Return on equity (ROE) of the system has changed constantly (**Error! Reference source not found.** 19). The banking system is the most affected in 2012 when the ROE of the whole system reached only 2.52%. Especially, the ROE in 9 months of 2012 was higher than ROE in 2012 for both joint-stock commercial banks and the whole system. This shows that, in the last 3 months of 2012 joint-stock commercial banks have suffered huge losses, leading to a drop in the profitability of the whole system. Additionally, while joint-stock commercial banks suffered huge losses, state-owned commercial banks recorded a sharp rise of ROE. This reflects the fact that when joint-stock commercial banks were lacking liquidity, they were forced to borrow at high rates from state-owned commercial banks, which can access to the refinancing resources of SBV. Thus, losses of joint-stock commercial banks contributed to the increase in profits of state-owned commercial banks. But as a whole, the banking system still suffered from losses. For the last two years, the ROE of the banking system has continued to increase, reaching 5.56 and 6.43 in 2013 and 2014, respectively (Figure 20).

Superior profitability of state-owned commercial banks shows their superior position compared to other types of banks. Joint-stock commercial banks, being the most affected by the restructuring process, were also gradually regaining competitiveness; their ROE exceeded that of foreign-invested banks in 2014. This once again shows that, despite domestic banks suffered high NPLs, their profits were almost unaffected. Costs for settling NPLs are likely to be covered by depositors and borrowers. This is consistent with the analysis on the difference between deposit and lending rates in Section 2.1.2.2.

Figure 20: ROE in different sectors

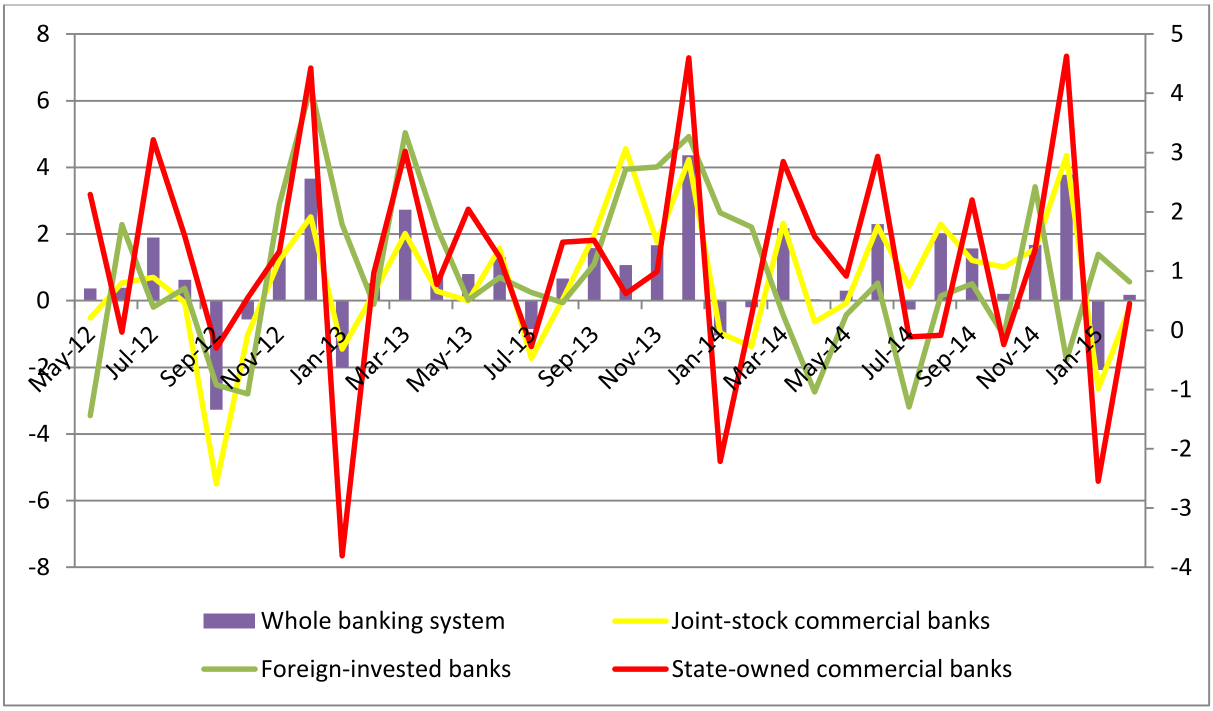


Source: Data on banking sector obtained from SBV, data on other sectors aggregated from www.cophieu68.vn.

Compared with ROE of enterprises listed on the stock exchange in 2014, the banking sector has a formidably high ROE. This again supports the argument that the banking sector is pushing difficulties towards enterprises in other sectors. Costs of handling NPLs virtually have no effect on the profit of the banking sector.

Figure 21 shows the growth of assets of the banking system and different types of banks. Overall, during 34 months from May 2012 to February 2015, only 8 months experienced negative growth of assets, while the remaining months always experienced positive growth of assets in the whole banking system. On average, the monthly increase was 0.82% throughout the system. The total assets of the entire system in February 2015 were 1.3 times higher than in April 2012. In the banking system, state-owned commercial banks had the highest average growth rate of assets of 1.13% per month; while joint-stock commercial banks had the lowest growth rate of assets of only 0.61% per month, and foreign-invested banks – of 0.85% per month. The increasing trend of equity capital was similar to that of assets. The state-owned commercial banks experienced the highest growth rate of equity capital at the average level of 1.00% per month; while joint-stock commercial banks experienced the lowest growth rate of equity capital at only 0.48% per month and foreign-invested banks – at 0.73% per month. Thus, the process of restructuring, although various banks have been merged or dissolved and the number of banks has reduced, but the size of assets and equity capital of different types of banks and of the entire system has remained its upward trend.

Figure 21: Asset growth rate of different types of bank and the whole system



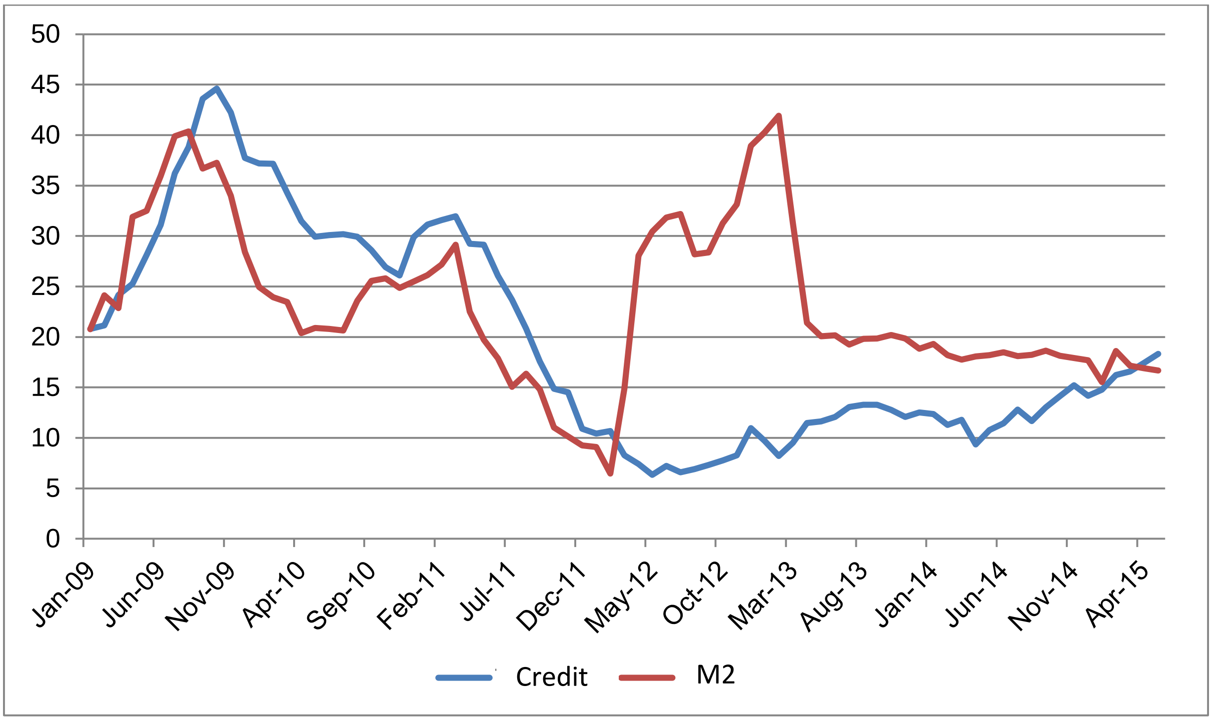
Source: SBV.

Low growth rate of capital assets of joint-stock banks showed that this banking group is most affected by the restructuring process. However, the growth rate of assets of foreign-invested banks was still modest while they were not much affected by the process of macroeconomic instability and the following process of remediation. This may imply that the business environment of the banking industry is still not attractive enough for foreign investors to increase their assets in Vietnam's market. Especially in the period from March 2014 to February 2015, banks with foreign capital tended to reduce assets, while joint-stock commercial banks and state-owned banks tended to continuously increase assets. Therefore, considering both asset size and ROE, domestic banks, especially the state-owned commercial banks, proved their stronger competitiveness compared to foreign-invested banks. These are signs of the most difficult period of joint-stock banks having passed and the new period of increasing scale being coming.

2.4.2.2 Credit and M2 growth

The growth rate of credit and total liquidity M2 was extremely high in 2007-2009. Under high inflation pressures in 2010, SBV had to cut drastically money and credit supply. The growth rate of credit and money supply fell sharply from October 2009 to February 2012, hitting bottom in 2011 (Figure 22).

Figure 22: MoM growth rate of credit balance, 2010-2014 (YOY)



Source: SBV.

The volatility of credit and money supply showed that prior to February 2012 the growth rates of credit and money supply often paralleled, where growth rate of money supply was lower than that of credit. However, since March 2012 the growth of money supply has hiked, while the growth of credit balance has remained at a low level.

Assuming *MB* is base money, *C* is cash in circulation, *R* is reserves in the banking system, *D* is total demand deposits, *T* is time deposits, r_r is ratio of compulsory reserve to demand deposits and r_e is the excess reserve ratio that commercial banks keep to ensure safety. Contracts of re-purchase and derivative markets in Vietnam have not developed yet, therefore:

$$MB = C + R$$
$$R = D * (r_r + r_e)$$
$$M_2 = C + D + T$$

Assuming $c = \frac{C}{D}$ and $t = \frac{T}{D}$, total money supply is:

$$M_2 = \frac{1 + c + t}{c + r_r + r_e} MB = mm * MB \qquad mm = \frac{1 + c + t}{c + r_r + r_e} \quad (1)$$

Where *mm* is monetary multiplier.

At the end of 2009, when inflation started to rise, confidence in VND fell resulting in reducing term deposits *T*, therefore, money multiplier *mm* reduced and growth rate of money supply decreased. The decline in deposits forced banks to increase deposit and lending rates (Figure 4). This in turn decreased the credit growth rate. Additionally, at the beginning of 2011, implementing Resolution No. 11/NQ-CP, commercial banks had to cut down credit balance in the non-manufacturing activities, such as securities, real estate, etc, resulting in declining growth rate of credit balance. At the same time, under the risk of collapse, SBV also implemented measures to tighten safety standards. The capital adequacy ratio CAR of commercial banks rose from 8% to 9% in October 1, 2010; compulsory reserve ratio for credit balances in foreign currencies was adjusted constantly in May, June and September 2011. For time deposits with term less than 12 months, this ratio increased from 4% to 8%. These moves of SBV raised the reserve ratio $r_r + r_e$, as a result, the money multiplier continued to decline. The parallel movement with downward trend of credit balance and money supply growth from October 2010 to January 2012 shows that during this period SBV seemed to have no impact on monetary base MB, but only on monetary multiplier *mm*.

Since January 2012 the growth in money supply has surged, while the growth rate of credit balance has remained sluggish. There were various reasons for the substantial increase of M2: the dollarization decreased, people moved from foreign currencies to local currency in savings account, leading to the rise in deposits *T* and SBV had to extend money supply to buy the increased amount of foreign currencies; SBV continuously implemented measures to cut compulsory reserves of commercial bank[11]; SBV refinanced commercial banks with liquidity problems[12], etc.

However, it is noteworthy that in spite of the strong growth of money supply, the growth rate of credit balance remained slow. This shows that, commercial banks used a large part of increased money supply to handle bad debts and mutual loans in the banking system, and only a small part to raise credit balances. M2 growing faster than credit balances shows that the increase in credit was primarily due to the pull of the money supply surplus but not the negative impact of the credit demand. In other words, if money supply does not grow, credit balances shall decrease rather than increase. Since April 2015, the growth rate of credit balances has surpassed the growth rate of money supply, and credit demand started its “pulling” effect – a sign of a new growth momentum.

It should be noted that although credit growth was much slower compared to the period 2007-2009 but GDP growth declined at a faster pace. The elasticity of GDP to credit was indicated in Figure 23. The elasticity shows that an increase in GDP by one percentage point needs to increase credit balance by how many percentage points. Figure 23 shows a sharp decline of this elasticity from 7.44 in 2009 to 1.75 in 2012 and in the last two years this ratio fluctuated around 2. It can be seen that, in some extent, credit has made a positive contribution to GDP when heading to manufacturing sector of the economy, serving as a driving force of economic growth, contributing to curbing the risk of high inflation, which happened in recent years.

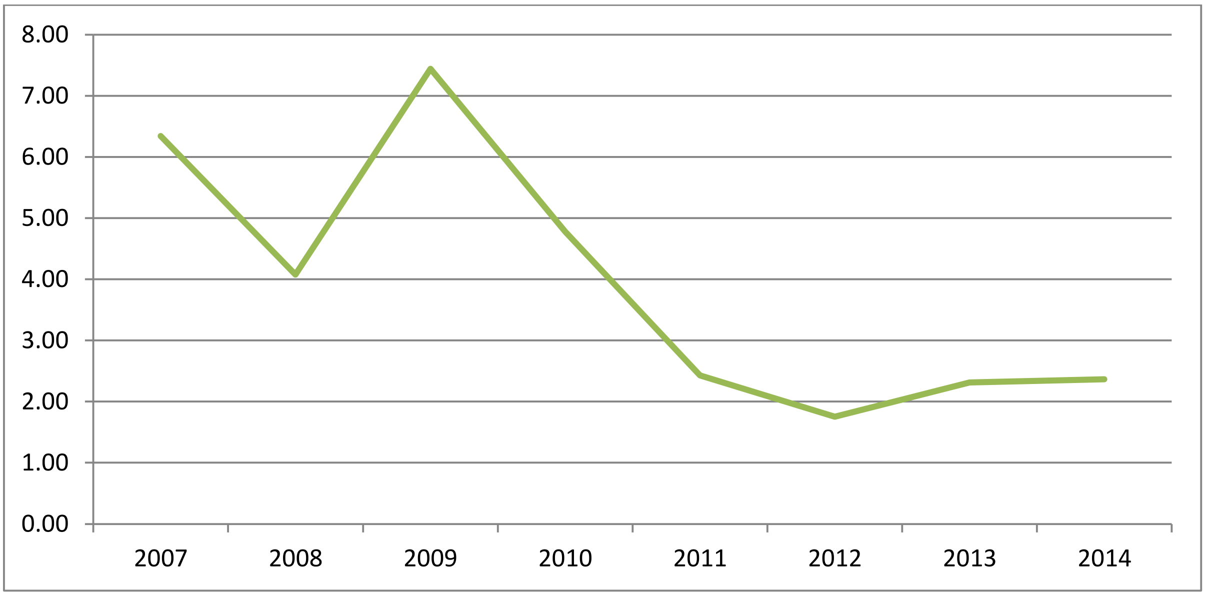
Additionally, the high growth period was also the period of large trade deficit. In 2007 trade deficit amounted to USD 14,203.3 million, attributing to the decrease of GDP by 18.35% (current USD value), whereas in 2012 and 2013 trade balance hardly caused negative effects for GDP and in 2014 trade balance attributed to the growth of GDP by 1.14 percentage points. Therefore,

[11] On February 2, 2012, the State Bank issued documents No. 29, 30, 31, 32, and 33 on Notification of applying required reserve ratio under Circular No. 20/2010/TT NHNN dated September 29, 2010. Accordingly, for the credit institutions whose ratio of loan outstanding for agricultural, rural development over the average total loan outstanding at the end of quarters in the consecutive fiscal year is from 40 to 70%, the required reserve ratio for VND deposits shall be 1/5 (one fifth) against normal required reserve ratio in proportion with the term of the deposit.

[12] Circular No. 15/2012/TT-NHNN dated May 4, 2012 on refinancing to support liquidity. In 2013, the State bank cut interest rates by 2 percentage points in refinancing interest rate, 3 percentage points in rediscount interest rate, etc.

in the context of low credit growth, the increase of exports could still result in a high GDP growth.

Figure 23: Elasticity of GDP to credit



Source: GSO and SBV.

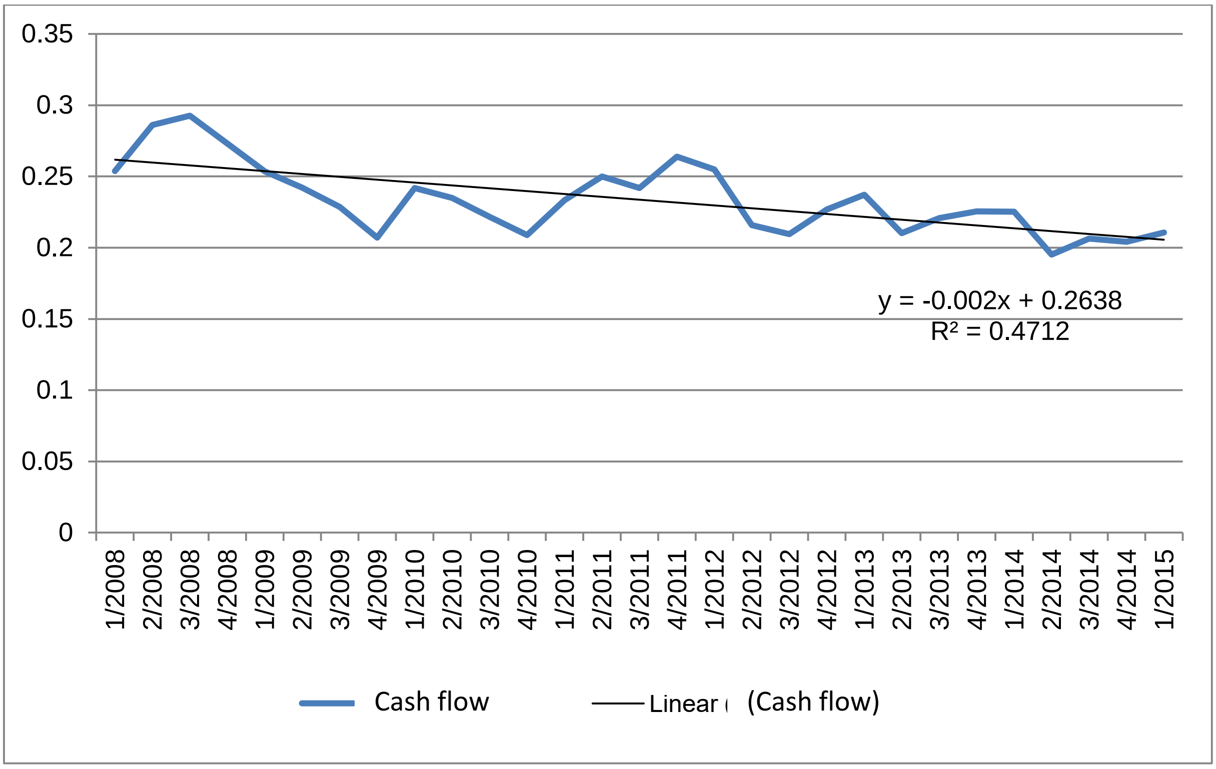
Moreover, the growth of credit balances is measured at nominal prices, while the growth of GDP is measured at constant prices. Therefore, the high pace of currency devaluation (inflation) during the years with rapid credit growth can lead to a high nominal GDP growth but a moderate real GDP growth. In recent years, decreasing inflation has caused real GDP growth rate to be close to the nominal GDP growth rate, so that low credit growth could reduce growth rate of nominal GDP but insignificantly impact on the growth rate of real GDP.

Credit structure by currency tended to be more balanced: the proportion of credit in VND rose from 81% in 2012 to 85% in 2013; with the proportion of credit in foreign currencies dropping from 19% in 2012 to 15% in 2013. The share of short-term capital reduced from around 70% in 2006-2009 to about 58%-59%; medium- and long-term credit increased to 41-42%. The proportion of short-term capital for medium and long term lending was over 18% by April 30, 2014. Thus, the risks arising from the problem of double mismatch are diminishing.

2.4.2.3 Cash flow

The higher the cash flow, the more dynamic the economy is, and thus the greater the impact of increasing money supply to growth. In contrast, falling cash flow hinders economic activities, resulting in lower impact of money supply on growth.

Figure 24: Cash flow by quarter, adjusted for seasonal factors



Source: *calculated from data of the State Bank (M2) and the General Statistics Office (nominal GDP by quarter).*

Data on money supply of the State bank and on nominal GDP by quarter of GSO are used to identify cash flow by quarter (*V*), which is then adjusted for the seasonality. Figure 24 shows that from 2008 to the present, cash flow has gradually declines. This shows that, although GDP has shown signs of recovery and the macroeconomy has become more stable, due to continuing slow credit growth, the level of movement of goods within the economy continued to reduce, resulting in the declining cash flow. If cash flow can recover at the average level of 2008, with the level of current money supply growth, the growth rate of nominal GDP will increase by 25%. To restore the value of cash flow, the most important indicator is the growth rate of credit balances. Settling NPLs, reducing lending interest rates, vigorously restructuring enterprises are solutions to boost credit; thereby, to increase cash flow and ultimately economic growth.

2.5 Policies to restructure state-owned enterprises

2.5.1 Policies

The guideline on restructuring state-owned enterprises was identified in the Resolution of the 3rd Plenum of the Party Central Committee (the 9th tenure).

After that, in October 2012, at the 6th Plenum of the Party Central Committee (the 11th tenure), the Committee issued Conclusion No. 50-KL/TW on the project of continuing reforming, re-arranging, and improving the efficiency of the state-owned enterprises, in which there were numerous recommendations on continuing reforming, re-arranging, and improving the efficiency of the state-owned enterprises in the years to come. Accordingly, "Vietnamese state-owned enterprises focus only on the most important and key parts of the following sectors: national security, national defense, natural monopoly, necessary goods and services provision, and some basic industries, high technologies with large spill over effects; as soon as possible, stop the scattered investment and non-core investment and complete the divestment of state capital at enterprises with less than 50% of state capital".

Decision no. 929/QD-TTg dated July 17, 2012 by the Prime Minister approved the project on restructuring the State–owned enterprises focusing on State-owned corporations, 2011-2015. The objectives of the project approved in the Decision is to restructure the system of state-owned enterprises to be more reasonable, focusing on the key sectors/areas which provide necessary public goods and public services for the whole society and for the national defense, as the core to help the state economic sector perform the leading role, an important material force for the State to orient and regulate the economy and stabilize the macroeconomic status. In addition, restructuring the state-owned enterprises is to enhance the competitiveness and equity margins of business enterprises; to complete the tasks of producing and providing necessary public goods and public services for the whole society and national defense of public utility enterprises.

2.5.1.1 Divestment of non-core investment

Decree No. 128/2014/ND-CP dated December 31, 2014 replaced Decree No. 109/2008/ND-CP. Decree No. 128/2014/ND-CP provides changes on principles of business transfer, policies for labour, implementation of business transfer, and principles of handling assets, financial issues, and public debts during business transfer.

Prime Minister Decision No. 37/2014/QD-TTg, dated June 18, 2014, provides criteria and a list categorizing state-owned enterprises. The decision stipulates sectors/subsectors where state-owned enterprises must hold 100% of charter capital, enterprises equitized and rearranged that state holds from 75% of total equity, enterprises equitized and re-arranged that state holds from 65% to 75% of total equity, and enterprises equitized and re-arranged that state holds from 50% to 65% of total equity. Therefore, the decision provides a base to classify and promote re-arrangement and reforms of current state–owned enterprises. This decision replaced decision No. 14/2011/QD-TTg dated March 4, 2011 and took effect from August 6, 2014.

Government Decree No. 71/2013/ND-CP dated July 11, 2013 regulates investment of state capital into enterprises and financial management in enterprises that the State holds 100% of charter capital. The Decree also provides some regulations on investing capital into other enterprises of 100% state-owned enterprises: those enterprises are not allowed to invest in the real estate sector (except enterprises whose core business is real estate); not allowed to invest or buy equities of banks, insurance companies, stock exchange companies, venture capital funds, stock exchange investment funds or stock exchange investment companies, except in special cases as stipulated by the Prime Minister, and other forms of investment or forms of receiving investment in order to curb cross-business investment.

2.5.1.2 Promoting equitization

On March 6, 2014, the Government issued Resolution No. 15/NQ-CP on some solutions to promote equitization and divestment of state-owned enterprises. The resolution does not only assign responsibilities of the heads of ministries or provinces for the progress of equitization and divestment of non-core investment, but also provide some specific orientations to realize those targets. The most important point of the resolution is to allow the state-owned enterprises to divest non-core investment under the par value or under accounting book value of the enterprises after subtracting provisions for loss of financial investments. This is considered an important solution to remove the bottlenecks hindering divestment in recent years in the context where the stock market has not really taken off. In addition to the above most important point, the resolution allows state-owned enterprises to be active in forming their divestment plans. First, it allows state-owned enterprises to be active in divesting capital through public auction of their shares in enterprises which have not been listed or offering their share of public enterprises that they have invested to the public. Second, for divestment in financial investment companies and commercial banks of state-owned corporations, the government may assign commercial banks to buy those shares or the State Bank of Vietnam to become owners' representative. Third, the government may assign the State Capital Investment Corporation (SCIC) to consider to buy non-core investment or core business of state-owned corporations and 100% state-owned enterprises in banking and insurance if the above solutions do not work. With those contents, after 2015, state-owned enterprises are expected to divest all capital in the fields that are not in their functions and mandates.

Prime Minister Directive No. 06/CT-TTg, dated December 3, 2014, requests ministries, ministerial agencies, government agencies, provincial people's committees, state-owned corporations to focus on restructuring state-owned enterprises. Accordingly, the Prime Minister required the Ministry of Finance in April 2014 to submit the draft of the decision to legalize the resolution No. 15/NQ- CP dated March 6, 2014 by the government on some solutions to promote equitization and divestment of state capital in some enterprises and to guide some ministries, sectoral agencies, local authorities, state-owned corporations on implementation.

Decree No. 189/2013/ND-CP, dated November 20, 2013, on amending and adding some articles of Decree No. 59/2011/ND-CP, dated July 18, 2011, on transforming 100% state-owned enterprises to become joint stock companies. One of the amended and added contents was the re-valuation of land use rights when transforming the state-owned enterprises. The Decree is one of the important legal documents creating conditions to promote the process of restructuring state-owned enterprises, especially equitization process, implementation of transparency based on market principles; addressing the problems of closed equitization within the enterprises; associating with capital market and stock exchange market development.

2.5.1.3 Transparency in state-owned enterprise management

The Prime Minister signed Decision No. 36/2014/QD-TTg dated June 18, 2014 and in effect from August 5, 2015 on issuing the regulation on disclosing operational information of one member liability limited company owned by the state. Information which should be public includes: (1) report of enterprise's operation status (within 5 working days after the report is approved by ownership implementing agency and members' council or chairman of the enterprise); (2) six- month financial report and yearly financial report of the enterprise (within 05 working days after being approved), salary and bonus of the enterprise; (3) long term development strategy and plan of the enterprise (within 5 working days after being approved); (4) annual business, production, and investment plans of the enterprise and the criteria to evaluate the efficiency of business, production, and investment of the previous year of the planned year within 5 working days after the annual plans are approved; (5) Plan of rearranging and reforming the enterprise and its operation results by January 31 of the year after the implemented year. However, the requirement of providing information by this regulation is not applied to one member limited liability companies of the Ministry of Defense and the Ministry of Public Security or state-owned enterprises operating in banking. Those companies operate under the regulations of the Ministry of Defense and the Ministry of National Security, and sector regulations. The Decision helps promote transparency and publicity of the state-owned enterprises in line with common requirements and regulations.

On June 25, 2013, the government issued Decree No. 61/2013/ND-CP regulating the monitoring of finance, evaluating operational efficiency, and publishing financial information of enterprises owned by the state and enterprises partly owned by the state. The Decree provides 5 criteria to evaluate the operation efficiency of the enterprises; from those criteria, enterprises are classified into 3 categories: A, B and C. One of the noticeable contents of this Decree is on special cases of financial monitoring, that is, when an enterprise operates at a loss, has debt-to-equity ratio over the safe level as regulated; has losses of 30% of charter capital or accumulated losses exceeding 50% of charter capital, etc… If an enterprise being specially monitored operates at a loss in two consecutive years, that enterprise should be changed its ownership form or dissolved or bankrupted as stipulated. The regulations issued in the Decree also stipulate financial information publicity for relevant stakeholders. Those regulations help evaluate the real status and operation efficiency of the enterprises, helping the enterprise to address problems in time in order to achieve the business targets. At the same time, those regulations also help the State, owner of capital invested in other enterprises, state management agencies in corporate finance to find the weakness in operation of the enterprises in order to make warnings and propose solutions in time; publish financial status of the enterprises owned, or partly owned, by the state.

2.5.1.4 Standardization of state-owned enterprises' forms

State-owned corporations and state-owned economic groups

Decree No. 69/2014/ND-CP, issued on July 15, 2014 to replace Decree No. 101/2009/ND-CP and in effect from September 1, 2014, clearly stipulates that corporate economic groups expected to be established must meet some conditions, including that core business must be in sectors/fields that produce and supply products and services of special importance in ensuring national economic security; creating the foundation for national infrastructure, or creating incentives to improve competitiveness of enterprises and the whole economy. If they cannot meet the above requirements, those state-owned corporations and economic groups must stop their operation as state-owned corporations and economic groups. In addition, state-owned corporations and economic groups may be established under the following forms: merging or consolidating enterprises; acquiring shares or contributed capital; investing or contributing capital by visible or invisible assets; other forms of linkages negotiated by enterprises legally. The government only considers and chooses state-owned corporations to be key enterprises to form economic groups and establishes new economic groups and state-owned corporations when specific requirements are met. Particularly, state-owned corporations chosen to be key enterprises to form economic groups must meet some following requirements: their business makes profits in 3 consecutive years; financial status is evaluated by the owners to be at a safe level; and human resource capacities and labour productivity are higher than the average level of other enterprises operating in the same sector; their equipment and technologies at advanced level; modern management; effective management of equity and other contributed capital in other enterprises; and operating in domestic and international markets. Especially, parent companies in economic groups must have charter capital not less than 10,000 billion VND; Economic groups must have at least 50% of subsidiaries operating in the key stages of their core business. For state-owned enterprises, they must meet the requirement that the charter capital of parent companies is not less than 1,800 billion VND. On the other hand, it is not allowed to contribute capital or buy equity of enterprises holding dominant positions in the same economic group or state-owned corporation. Controlled enterprises within an economic group or state-owned corporation are not allowed to contribute capital to, nor purchase shares from one another for cross ownership. In addition, the government stipulates that economic groups and state-owned corporations establish no more than three levels of enterprises.

One member limited liability company

On March 14, 2014, the government issued Decree No. 19/2014/ND-CP on issuing model charter for one member limited liability companies owned by the state. The model charter associated with the Decree is a document to orient the basic contents of charter for enterprises, ensuring reasonability in orienting the operation of enterprises owned by the state as well as guiding and supporting enterprises to form specific charter.

Prime Minister Decision No. 35/2013/QD-TTg, dated June 7, 2013, on issuing operation regulation of inspectors in one member limited liability companies which the state holds 100% of charter capital. The regulation provides standards, conditions, operation mechanism, mandates, responsibilities, competences, and functions of inspectors and the relationship between inspectors and individuals and relevant organizations of one member limited liability companies which the state holds 100% of charter capital. The issuance of this regulation is towards the objective of strengthening the owners' monitoring of their enterprises, thus making business operation of enterprises more efficient.

Decree No. 172/2013/ND-CP, dated November 13, 2013, on the establishment, re-organization, and dissolution of limited liability companies which are subsidiaries of companies of one member state-owned limited liability companies; Government Decree No. 50/2013/ND-CP, dated May 17, 2013, stipulates labour management, salary, and bonus for labour working in one member state-owned limited liability companies; Government Decree No. 51/2013/ND-CP, dated May 17, 2013, on salary, wage, and bonus for member of members' councils or chairman, inspectors, general managers, directors, deputy directors, and chief accountants in one member state-owned limited liability companies. Some decrees stipulate management organization of state-owned enterprises, particularly one-member state-owned limited liability companies.

Decree No. 99/2012/ND-CP, dated November 15, 2012, on the establishment, re-organization, dissolution of one-member state-owned limited liability companies; specifically stipulating assignment and decentralization in implementation of rights, responsibilities, tasks of state owners of state-owned enterprises. This is an important legal document stipulating the principles of assignment, decentralization in implementing the rights and responsibilities of state owners consistently from Government, Prime Minister, Ministries, local authorities to each state-owned enterprise.

SCIC

Decree No. 151/2013/ND-CP dated November 1, 2013 approves the charter on organization and operation of State Capital Investment Corporation (SCIC). The Decree does not only stipulate the functions, mandates, and operation mechanism of SCIC but also stipulates management and investment of state capital. One of the important contents of the Decree is to create mechanism to accelerate the divestment of state capital in enterprises transferred to SCIC, creating conditions to accumulate capital to invest in key sectors/fields of the economy.

2.5.1.5 Reforming enterprise management

Prime Minister Decision No. 704/QD-TTg, dated June 11, 2012, approves the project on reforming enterprise management based on market economy practices. On the basis of international practices[13], Vietnam has undertaken the following key measures: (i) impose SOEs to comply with the same set of business rules as private enterprises'; (ii) have better identification of accountability for SOE performance and enhancing the supervision for SOEs, clearly stating operational objectives of SOEs (Decree No. 99/2012/ND-CP, Law on Managing and Using State Capital Invested in Enterprises, 2014); (iii) apply the fair treatment for shareholders holding the small share in enterprise which is dominated by State through improving the mechanisms to implement the Law on Enterprises; (iv) apply the standards of information disclosure for public companies to SOEs (Decision No. 36/2014/QD-TTg); (v) enhance the capacity and accountability of members' councils in SOEs towards increasing autonomy together with increasing monitoring from the state owner side, etc. Thus, the management of SOE has improved; however, the results are still limited.

Decree No. 206/2013/ND-CP dated September 12, 2013 on the management of corporate debt for 100% state-owned enterprises. The Decree guides the principles and the methods to manage debt, and handle outstanding debts of 100% state-owned enterprises. The Decree also provides some contents on how to monitor the debts, to assess the ability of paying the debts, as well as makes the guidance on how to set up the provisions and to use the provisions for non-performing loans. The Decree was issued in order to remove difficulties for production and business, support the market, resolve the non-performing loans, overcome the shortcomings and limitations of the current regulations on

---

[13] World Bank (2014): The main elements in upgrading corporate governance framework are: Developing a strong legal framework and regulations to governance SOEs, enhancing the ownership role of the state; forming accountable activity monitoring system; strengthening financial and fiscal disciplines for SOEs; professionalizing the management board of SOEs, enhancing transparency and information provision; protecting the rights of shareholders in mixed-ownership companies; creating support in implementation and enforcement capacity.

OECD guidelines on corporate governance in SOEs (2005): Ensuring a legal framework and effective regulation on SOEs, equitable treatment of shareholders, building a good relationship with shareholders, ensuring the transparency of Board of Management, provision of information and accountability.

the management and handling of outstanding debts from the state-owned enterprises, and create a legal basis for debt management for SOEs.

Directive No. 17/CT-TTg dated August 9, 2013 of the Prime Minister on strengthening the management and controlling importing technology, machinery and equipment of enterprises. Accordingly, the Directive requires the investment project dossier to contain the explanation document for the technology together with the list of machinery and equipment that enterprises intend to import. Investment projects must be verified regarding their contents of technology, list of machinery, equipment, and technological lines. Enterprises are only allowed to import new machinery, equipment and technology lines, prioritizing imports of machinery and equipment with advanced technology level which are appropriate for the investment projects, and encouraging the imports of machinery and equipment which save energy and resources and are environmentally friendly. In case of importing second-hand machinery, equipment, technological lines, they must meet the requirements under the guidance of the Ministry of Science and Technology. The Directive was issued to prevent the import of second-hand, out of date and backward machinery, equipment that do not meet the requirements of production, increasing the product costs, and causing the environmental pollution.

Some ministries such as the Ministry of Industry and Trade, Ministry of Agriculture and Rural Development, and the Ministry of National Defense have developed and issued guidelines to specify the contents of the Directive such as operation regulation for the inspectors; the process of appointing a representative of the State in an enterprise; regulations on the formulation, appraisal and approval of the list of investment projects of group A, B annually; management, monitoring and evaluation of the effectiveness of production and business of enterprises.

Furthermore, ministries have also drafted legal documents to stimulate the process of restructuring state-owned enterprises towards market orientation such as:

- Drafting the management regulation of state-owned one-member limited liability enterprises. The draft is being formed and expected to be issued in 2015. The objective of regulation includes (1) guiding the implementation of new points in the Law on Enterprises and Law on Managing and Using State Capital Invested in Enterprises; (2) making clear some contents on enterprise management, method of using ownership in representative agencies internally, making clear the accountability in implementing the tasks of ownership; (3) making clear transaction forms of relevant stakeholders and (4) publicizing and ensuring transparency in internal relations in enterprises.

- The drafting of projects on establishing agencies responsible for implementing ownership in enterprises is assigned to MPI. MPI will lead and co-operate with other Ministries, ministerial agencies, governmental agencies, and provincial/city people's committees in the third quarter/2013 to submit to the Prime Minister and the Government (Directive No. 11/CT-TTg). Currently, the draft of project is being studied and formed with objective to separate function of state management and function of ownership representative of state management agencies, enhancing investment efficiency of the state at enterprises, implementing objectives that the state assigns state-owned enterprises and completing market economic institutions. The important point of this draft is to choose the model of independent state agency specializing in implementing the function of representative of the state ownership because this model has numerous strengths and is able to address significant weaknesses of the old model; meanwhile, there are many favourable domestic conditions for stimulating restructuring state-owned enterprises and strong political will.

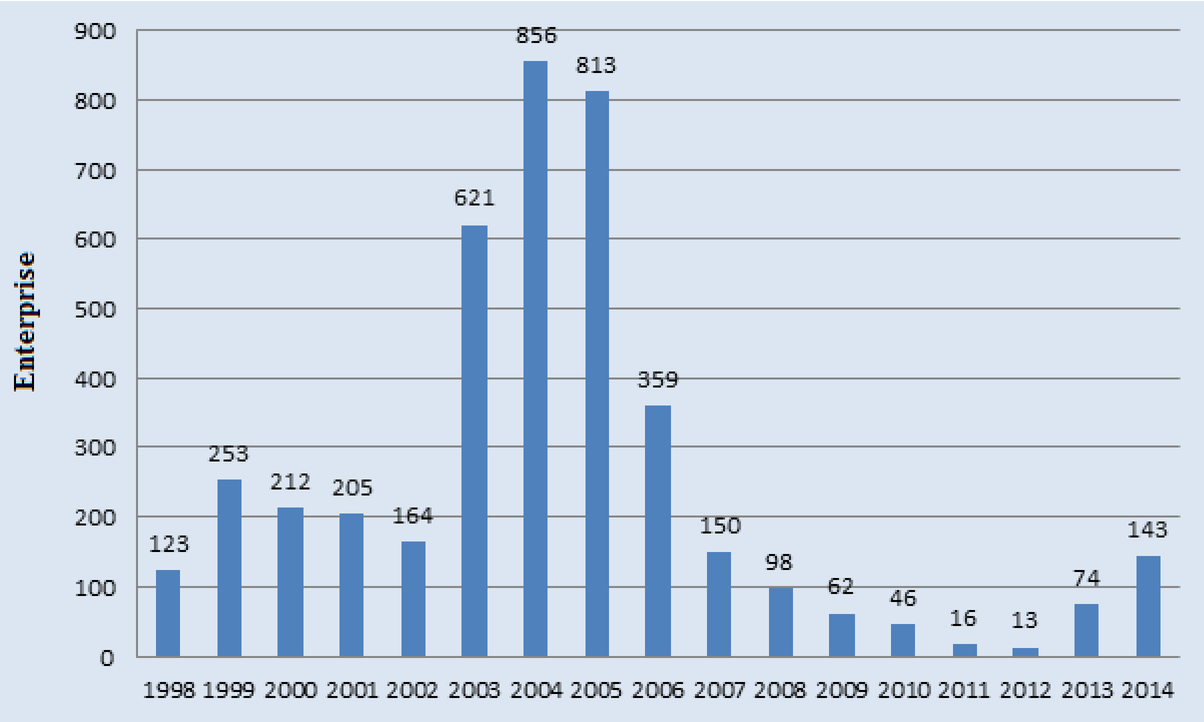
2.5.2 Achievements

2.5.2.1 Equitization

Total number of state-owned enterprises equitized from 1998 to 2014 was 4,208, in which, almost all of them were equitized in period 2003-2006. The number of enterprises that the State holds 100% was about 800 as of December 31, 2014 (excluding agricultural and forestry farms of the state).

Figure 25 shows the high speed of equitization in the period 2000-2005 and the speed reduced quickly in the period 2006-2012. Especially in 2012 there were only 13 enterprises equitized. In order to restructure the state-owned enterprises, the Prime Minister has approved the projects on restructuring and rearranging state-owned enterprises during 2011-2015 of ministries, sectors, locations, and state-owned corporations. According to those projects, at the end of 2015, Vietnam will equitize 531 state-owned enterprises, merge 25 state-owned enterprises, dissolve and/or bankrupt 16 state owned enterprises and sell 10 enterprises. The Prime Minister has approved the project of restructuring 17 state-owned corporations and equitizing 19 state-owned corporations. Ministries, sector agencies, and local authorities have approved 46 projects of state-owned corporation that they manage. The core contents of those projects are to identify core operation sectors, core business sectors, and financial restructuring; the list of enterprises going to be equitized and divested, the proportion of charter capital that the state holds, the progress rate of implementation, comprehensively and strongly reforming the state-owned enterprise management, improving efficiency, competitiveness, technology, productivity, etc.

Figure 25: Number of enterprises equitized



Source: Synthesized from different reports of the Ministry of Planning and Investment.

In order to implement the above projects, from 2011 to the end of 2014, the whole nation had rearranged 347 state-owned enterprises[14], in which, 242 enterprises were equitized and 101 enterprises were re-arranged by other forms. Compared to 2013, the number of enterprises rearranged in 2014 was 1.65 times higher; the number of enterprises equitized 2 times higher; the amount of divested state capital was 6 times higher, equivalent to 6,076 billion VND. Hence, it has been seen that the process of equitizing the state-owned enterprises has been re-started strongly and achieved some remarkable results although they were lower than planned.

According to the plan of 2015, 289 state-owned enterprises will be equitized nationwide. To the end of the first quarter of 2015, 29 enterprises (3 state corporations and 26 companies) have had their equitization plans approved; the remaining 260 state-owned enterprises has had their steering boards, in which 207 enterprises are being valued, and 71 of 81 enterprises publicizing their values in 2014 have been equitized. This number is much lower than the target of equitization in 2014.

[14]In 2014 there were 167 state-owned enterprises rearranged, in which some enterprises were transformed to limited liability companies with two or more members, 3 enterprises were dissolved, 14 enterprises were merged and 3 enterprises were suggested to be bankrupt.

Equitized enterprises must be listed in UPCoM market. Decision no. 51/2014/QD-TTg by the Prime Minister, document no. 2660/BTC-UBCK by the Ministry of Finance guides in detail some issues related to divestment through equity auction and listing and registration of transaction of equitized enterprises. State-owned enterprises after being equitized, if meeting all requirements to become public enterprises as stipulated in article 25 of the Law on Stock Exchange (charter capital from 10 billion VND, and having at least 100 shareholders), must register to implement transaction with the Ha Noi Department of Stock Exchange within 90 days from the date to be granted certificate of business registration. This regulation has created conditions for investors to make transaction soon after being equitized, contributing to creating the liquidity for securities of enterprises and creating opportunities for enterprises to practice the mechanism of providing information, financial report, etc. before being listed.

Remarkably, the number of enterprises carrying out auction of their shares and divestment through 2 departments of stock exchange last year were 1.4 times higher than the total number of those in the three previous years. To date, there have been 23 ministries, sector agencies, local authorities, state-owned corporations submitting to the Prime Minister to approve their projects of rearranging state-owned enterprises based on criteria, classification list of 100% state-owned enterprises. The Prime Minister has approved 19 projects, adding 106 enterprises to be equitized in 2015 and 109 enterprises to be equitized in the period 2016-2020.

According to evaluation at a briefing of Steering Committee on Reforming and Developing Enterprises in order to evaluate the implementation of restructuring the state-owned enterprises, the Prime Minister thought that state-owned enterprises had adjusted their strategies and objectives of their business towards focusing on some main sectors, reforming enterprise management, and transparency and publicity implementation. The operation efficiency of enterprises had been improved, as shown by the increase in total assets of state-owned enterprises, reaching 3.2 million billion VND, state capital had been preserved and increased to 1.2 million billion VND. Revenues, profits, income of labour had increased. Especially, equitization had created new enterprises with multi-ownership, attracting investment from other sectors, from that contributing to completing market institutions, especially capital and stock market.

However, the equitization process is still slow because some problems related to refund risk provisions into state capital; identifying the enterprises' value for equitization; identifying the value of long-term investment; potential value, fully depreciated assets; re-evaluating financial investment at the time of transforming enterprises into joint stock companies; identifying stock exchange prices selling to the labour, etc as well as the appraisal process for re-arranging agricultural and forestry enterprises.

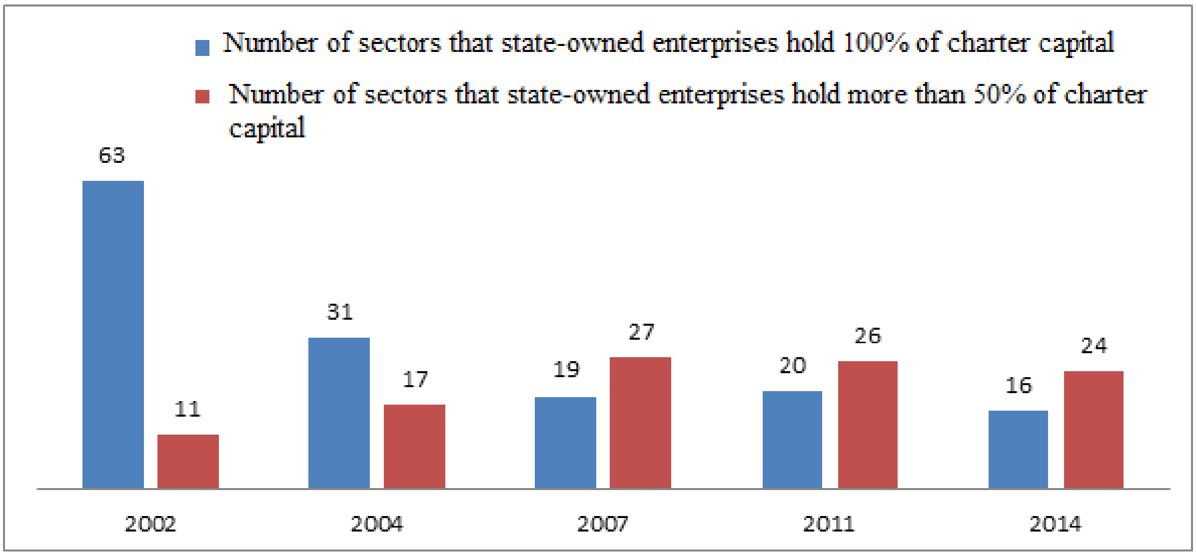
In addition, equitization itself does not change enterprise management if there is no strategic shareholders from the private sector or FDI sector to participate and to have dominant right on the operation of the enterprises after being equitized. If the state still owns no less than 75% of shares in an equitized enterprise, or if its main shareholders are equitized enterprises in which the state holds dominant rights, the management of this enterprise really remains unchanged. Although the recent equitization process has achieved some remarkable results, almost all enterprises do not have strategic partners, and the state still holds dominant shares or other state-owned enterprises (where the state holds more than 50% of shares) hold dominant shares. This makes the results of equitization not practically meaningful. In order to really restructure the economy, the state must absolutely abandon the dominant role in the enterprises where the state has no need to hold a dominant share. Only if this is the case, state-owned enterprises are able to reform their management mechanism towards a technocratic and modern way.

2.5.2.2 Divestment

To the date of March 24, 2015, there had been 4,937 billion VND divested out of total non-core investment of 21,797 billion VND, accounting for 22.7%, and 6,987 billion VND being returned (including SCIC), equivalent to 1.4 times of book value. Specifically, divestment in real estate was 2,690 billion VND, taking back 3,177 billion VND (accounting for 45% of total taken back value of divestment); divestment in insurance, finance was 613 billion VND, taking back 622 billion VND; selling state capital that the state should not hold at other enterprises with book value at 1,634 billion VND and took back 3,187 billion VND (Steering Committee on Enterprise Reform 2015).

Up until April 2015, the State Capital Investment Corporation (SCIC) has received capital of nearly 1,000 enterprises and sell all capital of 678 enterprises and took back 6,000 billion VND.

Figure 26: Some sectors that the state holds dominant right



Source: The author synthesized from different legal documents.

To date, the number of sectors that state-owned enterprises hold 100% capital has reduced, from 63 in 2002, to 16 in 2014 (Figure 26). The number of sectors the state-owned enterprises should hold more than 50% of charter capital has reduced since 2004 to 24 sectors. Therefore, the number of sectors that state-owned enterprises holding dominant position have quickly decreased, thus opening up opportunities for private investors and foreign investors. However, the state hold 100% of more than 1,200 state-owned enterprises and since 2011 that number has reduced negligibly. Hence, although the number of sectors/fields that the state holds 100% capital have reduced, the number of 100% state-owned enterprises have only decreased slightly. This reflects the hesitancy in doing 'real' equitization of large corporations.

2.5.2.3 Enterprise management

Almost all state economic groups and state-owned corporations have implemented the project of restructuring approved by the Prime Minister, ministries, sector agencies, and local authorities. In which, they have focused on (*i*) equitizing parent companies and member enterprises; (*ii*) re-identifying their core capacities and focusing on their core business; (*iii*) forming long term plan and development strategy to 2015, 2020 and financial plan to implement; (*iv*) eliminating enterprises level 4, compacting enterprises level 3, re-organizing production and business and re-arranging member enterprises; (*v*) improving financial capacities, increasing charter capital as stipulated in legal system; (*vi*) focusing their resources for research and the application of science and technology to improve the competitiveness of products, labour productivity, and international economic integration.

Although in all plans of restructuring state-owned enterprises, all enterprises have submitted reforms in enterprise management, including completing internal management regulations, amending organization regulations and operation methods according to the law; clearly assigning functions and mandates of all management levels in state economic groups and state-owned corporations and representative of state capital in other enterprises. However, when the state holds the dominant shares, the state-owned enterprises are not able to have management system that is as effective as enterprises in other economic sectors because there are big differences between them.

- First, compared to non-state enterprises, benefits and responsibilities of the managers in the state-owned enterprises do not associate with capital ownership and asset ownership in the enterprises. They are only representatives of state-owned capital, and therefore have incentive to maximize individual benefits during their working term without caring about the long term benefits of the enterprises. Therefore, they have little motivation to improve production capacity and productivity, and instead focusing on short term benefits and quick profits. This in the long run will damage the competitiveness of state-owned enterprises.
- Second, the agencies which are responsible for managing the state capital in enterprises are usually managing ministries and provincial people’s committees for 100% state-owned enterprises, State Capital Investment Corporation (SCIC) for enterprises that partly owned by the state after being equitized. Therefore, the direct intervention through administrative commands in the operation of state-owned enterprises is frequent and in large-scale. In addition, the managing ministries and SCIC are both state management agencies; hence, we cannot avoid the phenomenon that they are both players and referee, or give preferential treatment to state-owned enterprises or sacrifice business objectives of state-owned enterprises for objective of implementing socio-economic policies of state management agencies. We will clearly analyze this phenomenon in the section on preference for state-owned enterprises.
- Third, people chosen by state management agencies to be representatives of state-owned capital at enterprises. Those people will directly or indirectly run the enterprises. The criteria to choose are the same as criteria to choose public staff and civil servants and this is

much different to the criteria used to choose enterprises' managers. Therefore, even if the chosen people are righteous, their mindset as a public staff cannot help enterprises to compete in a strong global competitive environment today.

In short, state-owned enterprise management will undergo comprehensive reform if, and only if, there is clear separation between state management, state-owned enterprise management, and doing business with state-owned capital; between administrative management and business management; between public staff and manager of state-owned enterprises; between managing state-owned capital and doing business with state-owned capital.

2.5.2.4 Financial status and operation efficiency of state-owned enterprises

State investment capital into enterprises is still safe and grows from 700 trillion VND in 2010 to 810 trillion VND in 2011 and 1,019 trillion VND in 2012 (average annual growth rate increases by 15%). Total assets in 2011 was 2,274 trillion VND, in 2012 was 2,570 trillion VND, increasing by 296 trillion VND. Total liabilities in 2011 was 1,343 trillion VND, in 2012 was 1,422 trillion VND, increasing by 79 trillion VND. The ratio of debt/equity of state-owned enterprises in 2012 was 1.39 times (reducing by 27% compared to 2011), within the allowable limit (3 times).

Total revenues in 2011 was 1,638 trillion VND, in 2012 was 1,709 trillion VND. Contribution to the state budget in 2011 was 207 trillion VND, and in 2012 was 222 trillion VND. Many state-owned enterprises created profits. Total profits before tax in 2011 was 149.6 trillion VND, the ratio of return on equity was 18.47%; in 2012 was 167 trillion VND, the ROE was 16.38%.

In 2013, 18 large-scale state economic groups and state-owned corporations have state capital of 840 trillion VND (accounting for 83% of state capital in state-owned enterprises); assets of 1,989 trillion VND; total revenue of 1,184 trillion VND; contribution to state budget of 191 trillion VND; and profits before tax of 136 trillion VND. 17 out of 18 these economic groups and corporations created profits. The ratio of return on equity was 16.19%. The ratio of debt/equity was 1.3 times.

2.5.2.5 Implementation of hard budget constraints

The Central Institute for Economic Management[15] has evaluated in detail the implementation of hard budget and its consequences of providing incentives for state-owned enterprises for the market as follows:

Box 1: Unreasonable management framework and market disorder caused by state-owned enterprises

After many year of innovation, legal system on Vietnam's enterprises (including market entry, operation in the market and market exit) has put state-owned enterprises in a common legal framework with private enterprises. However, limitations in legal document implementation as well as behaviours in the reality of the state and other stakeholders have created many advantages and favourable conditions for state-owned enterprises in many fields.

- *Private enterprises have faced a lot of difficulties and barriers to enter markets in which the state sector is holding the dominant position, are unable to create competition pressure for state-owned enterprises, thus resulting in distortion in market relation.*

- *Current position and roles of state-owned enterprises, together with the support from the state owner, are the reasons that state-owned enterprises enjoy advantages in accessing resources, especially financial resource, creating disorder in the market of production factors.*

- *Easier in accessing resources leads to market status of state-owned enterprises more and more consolidated. This does not only makes the objective of more efficient redistribution of resources fail (restructuring the economy) but also exacerbate the weaknesses of current economic structure.*

(2) Unreasonable points of institutions on implementing the ownership function for state-owned enterprises have created a huge defect in the framework of state-owned enterprise management. This is one of the main reasons of that the state-owned enterprises have not had modern management, negatively affecting the operation efficiency and competitiveness of the state-owned enterprises and the whole economy.

- *Compared to international practice, there are three problems: first, there*

[15] "Report on hard budget constraint, unreasonable management framework and market disorder caused by state-owned enterprises" prepared by the Enterprises' Reform and Development Department, CIEM under the financial and technical support from RCV Project.

is no separation between function of ownership and other functions of the state. Secondly, there is no concentration and inconsistence in implementing the ownership of the state at state-owned enterprises. Third, the state apparatus implementing the ownership of the state has not been professional.

- *Unreasonable points and main consequences: i) there has not been policy on state's ownership separating with state management in general, leading to lack of foundation for reforming and improving the state-owned enterprise management; ii) management efficiency and effectiveness of owner on state-owned enterprises are still low because of lack of professional apparatus, capable and having enough resources to meet the requirements of ownership activities in the market economy; implementing the right and responsibility of ownership of the state has not been concentrated, inconsistent, unclear accountability; iii) State administrative management agencies, who at the same time also implement ownership rights on state-owned enterprises, have not created preconditions for consistent state management to create a level playing field. This is the main reason of disorder in the market caused by state- owned enterprises.*

(3) State-owned enterprise monitoring system is still a "hole" in the management framework, failing to meet the expectations to be a tool for owners, people, and the whole society to understand the operation status of the state-owned enterprises, and from that, to have timely and reasonable decisions, helping state-owned enterprises to solve the problems and improve their performance. The current monitoring mechanism lacks warning system and preventing the weaknesses of the state-owned enterprises in production and doing business as well as risks caused by state-owned enterprises, especially the risks stemming from concentrating too much resources into large scale state-owned enterprises, creating disorder of the market and phenomenon of "too big to fail".

(4) Information publicity and transparency in state-owned enterprise's operation is a weakness in state-owned enterprise management although recently, there have been a lot of efforts in issuing legal documents on this issue. In the market where monopoly by state- owned enterprises exists or state-owned enterprises hold the dominant position, lack of information transparency, especially information on setting price and accounting cost, have increased the transaction cost in the market and created distortion in business relations and competition relation. In the near future, we should increase the accountability of state-owned enterprises as well as state management agencies

in publishing information on state-owned enterprises timely, correctly, and comprehensively as common practice.

(5) The organization of state-owned enterprise managing apparatus still has drawbacks regarding autonomy and self-management mechanism. The mechanism of enterprise management by public staff has not created motivation for improving state-owned enterprise management. The accountability of people who have responsible for protecting the interests of state owner at enterprises is still low, first of all, members of member councils and inspectors in state economic groups and state-owned corporations.

(6) In the practice of state-owned enterprise management in Vietnam, there have been a lot of symptom that we have not been able to enforce the mechanism of budget binding for state-owned enterprises, first of all is binding in expenditure, investment, procurement; binding in responsibility of self-borrowing and self-paying; and binding in business results.

- *Financial discipline for state-owned enterprises has not been stringent.*

- *Some state-owned enterprises have spent unreasonably, operated inefficiently, failed to reach the targets, and created burdens and risk for state budget. Those enterprises deserve to be eliminated from the market. However, they are not eliminated but supported and bailed out by different measures.*

Many unreasonable forms of subsidies, creating preference and special rights, special benefits for state-owned enterprises have been implemented. Consequently, they do not create pressure on state-owned enterprises to improve operation efficiency and create distortion in the market and competition relation.

In conclusion, state-owned enterprises have not had to face ‘hard’ budget constraints, nor operate under strong competitive pressures. Unfair incentives for state-owned enterprises create not only disadvantages for private enterprises but also disadvantages for state-owned enterprises themselves in the context of globalization. Those are key points which should be implemented in restructuring state-owned enterprises in the time to come.

2.6 Some other restructuring programs

2.6.1 Local and regional restructuring

2.6.1.1 Local restructuring

Decision No. 339/QD-TTg dated March 19, 2013 by the Prime Minister requires ministries, ministerial agencies, and local authorities to implement in the early 2013 the action program on restructuring sectors, areas, or locations that they have competence to manage; in which, projects and programs of restructuring have to be implemented in all the following contents: objectives, contents, tasks, and specific solutions, implementation roadmap, responsible agencies and relevant issues; at the same time, reviewing and complementing necessary tasks in the program of issuing legal documents and relevant working programs.

Currently, there have been 45/63 provinces/cities reporting the implementation of restructuring projects and 38 provinces/cities establishing steering boards of restructuring and 23 locations issuing the economic restructuring action plans. However, the process of local economic restructuring heavily depends on the national and sector economic restructuring orientations. The process of economic restructuring in provinces/cities have not been active and specific, mainly focusing on reporting the priorities at the national level, including public investment, state-owned enterprises, and commercial banks. Local authorities cannot create much impact on these three priorities, and they are not the priorities of local level. Some provinces/cities have issued their provincial restructuring programs in order to choose the priorities for state management at provincial level. Provinces have followed that way are Ca Mau, Dong Thap, Thanh Hoa, Nghe An, Ha Tinh, Ba Ria Vung Tau, etc,.

However, the process of local economic restructuring heavily depends on the national and sector economic restructuring orientations and the options of local economic restructuring are quite limited. The options for local authorities are mainly business environment improvement, resource allocation to take the best use of national resources, foreign resources, and local natural advantages. Therefore, local authorities should build action programs in line with the changes of national economic restructuring and if they see that those programs are not able to meet the requirements of diversified and long –term development of their provinces, the provincial people' committees can build their own local projects of restructuring. It is not necessary that all provinces/cities build their own economic restructuring programs.

In addition, in order to have local restructuring programs in line with the whole national economy, the state should issue a law on socioeconomic development master planning. Until now, it has not been implemented.

2.6.1.2 Economic regional linkage

Economic regional restructuring has not been implemented. Strategy of building huge clusters to take advantage of economy of the scale and economic accumulation has not been formed. The Law on Master Plan has not been issued; therefore, overall sector socioeconomic master plan has not been implemented.

The approach of building economic regions has not changed and still follows the old way; that is, provincial authorities build co-operation and linkage programs at their own whim. This approach is non-market and therefore is mainly political rather than based on stakeholders' interests. Hence, those linkages are not sustainable and are unable to create industrial clusters.[16]

Economic regional restructuring should be implemented based on market principles that enterprises make options and the state supports. For example, Ho Chi Minh city wants to collaborate with provinces in the Southern Key Economic Region, the approach that Ho Chi Minh city should encourage enterprises of Ho Chi Minh city to invest into infrastructure to link Ho Chi Minh city with provinces in the region, including roads, ports, industrial zones, etc,.. Those infrastructure works can be used to link all provinces in the regions with one another. Currently, Tan Cang Corporation is building river port network in the region. Thanks to that network, Dong Thap, Tien Giang, Can Tho, etc. can link with Sai Gon river port. If those provinces together with Ho Chi Minh City invest in industrial zones around those ports, it can encourage industrial enterprises to use labour moving from Ho Chi Minh City to those provinces; meanwhile, Ho Chi Minh City focuses on developing supporting services for those clusters. Unfortunately, till now, the regional linkage view still stops at issuing institutions to force provinces to co-ordinate with each other rather than co-ordinate based on the market signals.

2.6.2 Sectoral restructuring

Sector restructuring process relates to 3 groups of ministries and/or ministerial agencies:

---

[16]For example, to now, Ho Chi Minh city has 35 documents on co-ordination with 35 princes/cities nationwide with the participation of 1134 enterprises. However, according to the evaluation of the Department for Planning and Investment of Ho Chi Minh city, such linkages it not substantive, not to create suppliers for investors from Ho Chi Minh city but mainly for speculation.

- Ministries/ministerial agencies/sector agencies directly related to production and business: the State Bank of Vietnam, Ministry of Finance, Ministry of Planning and Investment, Ministry of Industry and Trade, Ministry of Agricultural and Rural Development, Ministry of Natural Resources and Environment, Ministry of Transport, Ministry of Labour, Invalids and Social Affairs.
- Ministries/ministerial agencies/sectorial agencies related to state management and development support: Ministry of Education and Training, Ministry of Health Care, Ministry of Science and Technology, Ministry of Internal Affairs, Ministry of Justice, Ministry of Information and Communication, Ministry of Culture, Sport, and Tourism.
- Ministries/ministerial agencies/sectorial agencies related to national security, national defense, and external affairs: Ministry of National Defense, Ministry of Public Security, and Ministry of External Affairs.

In current period, the state focuses on restructuring the first group and reforming state management institution in the second group.

In the first group, the State Bank of Vietnam, Ministry of Finance, Ministry of Planning and Investment have actively implemented 3 focal sectors of restructuring as required in decision No. 339/QĐ-TTg. The Ministry of Industry and Trade and Ministry of Agricultural and Rural Development have issued their action programs on restructuring their sectors. However, there exist some problems which are discussed in the section below.

The Ministry of Transport and the Ministry of Construction have promoted restructuring process of state-owned corporations under the management of those ministries. Reforms of state management for infrastructure development and improvement in investment efficiency have achieved some very first results when those projects were completed in time or earlier than planned. However, measures to manage projects' costs and capital allocation procedure for projects based on socioeconomic efficiency have not met the expectation.

The Ministry of Labour, Invalid and Social Affairs and the Ministry of Education and Training have had a program of restructuring labour market. Some hot issues in labour market such as trained labour not able to meet the requirements of market, using labour that were trained in other fields, lack of high-quality labour for key economic sectors, etc. should be put into restructuring programs of those sectors.

For other ministries, programs of restructuring should be put in the context of state management institution reform nationwide. It is time to have break-through on economic management institution reform. The more we delay economic management institution reform, the higher the price of restructuring process is and the results of other restructuring programs will be limited, reducing the motivation for restructuring other sectors.

Restructuring programs at ministries and provinces are not necessary to be implemented at the same time and hence, it is not necessary for the Government to approve all restructuring projects of ministries and provinces. Delaying implementation of restructuring is mainly because ministries, sector agencies, and provinces think that it is not necessary for them to build restructuring programs for their own. The important thing is that together with implementing restructuring in the three focal areas, a breakthrough in state management institutions should also be considered as one focal area in the current period.

2.6.2.1 Project of restructuring agriculture

The project of restructuring agriculture was approved by the Prime Minister at Decision No. 899/QD-TTg dated June 10, 2013 and currently is implemented in provinces/cities. In general, this program is consistent with the overall restructuring program toward improving labour productivity in agriculture, shifting agricultural production toward increasing production scope, increasing value added in agriculture. The program promotes policies such as "agricultural plot exchange and re-allocation", "large paddy field", "collaboration of the four actors", etc.

The orientation of restructuring agriculture is to make agricultural production become large scale production, building agricultural clusters with some key products. This allows farmers to apply science and technology in the process of production in order to reduce production cost and improve competitiveness of the products.

Box 2: The efficiency of restructuring agriculture in Dong Thap province

Dong Thap province has strongly implemented restructuring agricultural process focusing on producing products where Dong Thap province has advantages, including rice, mango, flower, ducks, and cat fish. For those products, the provincial authority encourages farmers to exchange their fields *and build linked paddy fields (large paddy fields). In 2014 the whole province implemented linked paddy fields with area of 86,630 ha, accounting for 16.5% total rice production area of the whole year. According to the Dong Thap department of agricultural and rural development, through linked paddy fields, production cost of rice reduced by 650-700 VND per kilo, increasing profit by 4-5 million VND per ha per crop. The whole province applied 100% mechanization for land preparation, 22% for row-seeding, 78% for spraying, 86% for irrigation, and 99% for harvesting; consequently, helping to save 4.3 million VND/ha/crop in production costs.*

However, the most important point of restructuring agriculture is to build reliable and sustainable relationships between enterprises and farmers. From there, it helps stabilize inputs for enterprises and income for farmers under continuous changes of prices in the agricultural market. Because of instability of agricultural production process (cannot identify exact date for harvesting, harvested quantity, the quality of harvested products, prices of products at the time of harvesting, etc.) therefore collaboration contracts between enterprises and farmers are always broken up depending on the changes in market. This phenomenon constrains the ability of collaboration between enterprises and farmers. In order to address this issue, the state should have policies to encourage farmers to participate into production cooperatives, and use production cooperatives as their representatives to sign collaboration contracts with enterprises. Cooperatives have larger production scope, taking advantage of economy of scale. With large scale, the stability of income is very important, therefore, cooperatives will have the incentive to obey the contracts with enterprises. The development of this collaboration process can help integrate cooperatives with enterprises to create a closed-loop production value chain. The program of restructuring agriculture currently needs solutions to encourage the establishment of large scale agricultural producers through cooperatives or land accumulation. Experiences in guaranteeing cooperatives to access credit, adding staff with experience and knowledge for cooperatives, training staff for cooperatives in Dong Thap province are good lessons to learn.

2.6.2.2 Project of restructuring the industrial and trading sector

Project of restructuring the industrial and trading sector is actually a sum of programs of restructuring trading sector and industrial sector. The project of restructuring a sector should be a consistent framework for subsectors to base on that framework to build their own programs of restructuring consistently, avoiding conflicts in the process of implementation. Simply summing up all projects of restructuring without a consistent framework and without priority order can lead to conflicts, especially in the implementation of resource allocation. The second weakness of current sector approach is that we cannot see the mutual relationship among subsectors. For example, the development of agricultural, forest, and aquaculture product processing sector can promote mechanization process, electrification and automation of agriculture and rural areas. Those are important preconditions to develop mechanical engineering, metallurgy, electronics, etc. In contrast, if we only develop mechanical engineering in general without orienting it to serve agricultural sector, or if we misguide this sector, the cost of restructuring this sector will be enormous and the probability of failure will be high. Similarly, project of developing domestic commercial sector and international trading sector must associate with creating the market for prioritized sectors. If we prioritize agricultural, aquaculture, and forestry product processing sectors, the import-export sector should also focus on helping these sectors, not others, to maintain and expand their markets.

The most serious issue of Vietnam's industrial sector in recent years is the reduced proportion of value-added in total output, and the lowering labour productivity. For instance, labour productivity in the electronics and information technology industries has been decreasing at the rate of 10% per year. The project has not analyzed the ultimate causes of this issue, which are necessary in order to recommend reasonable solutions. Some questions have not been clearly answered:

- Have we over-invested in those industries?

- Is it true that those industries do not have competitive advantage?

- Is it true that these industries are saturated in the world market, hence their value-added decreases as output prices falls?

- Is it true that we are depending too much on imported materials and currently, inputs' prices are increasing, hence value added decreases?

- Is it true that our manufacturing technology is too outdated?

- Is it true that we are completely passive in our market operations, hence letting international partners dictate the prices of both inputs and outputs?

- Is it true that our logistics system is outdated, fragmented, hence increasing intermediate cost? (Currently, logistics cost of Vietnam accounts for 25% GDP when that of Singapore is only about 11% GDP).

Solutions for restructuring industrial and trading sectors are too general, not focusing on addressing some pointed issues, including spreading investment, low investment efficiency, and low labour productivity. Solutions on clearly identifying the responsibility of state management agencies and owner agencies for state-owned enterprises under the management of Ministry of Industry and Trade have not been mentioned. Those solutions lack the linkage between trading sector and industrial sector. We should have trading models associated with each subsector, creating incentive to promote the development of those. In addition, this project has not clearly mentioned what kinds of resources (land, infrastructure investment, supporting programs, incentives, etc.) we need to develop trading and industrial sector. To what extent can the state support? What are the roles of domestic and foreign investors for each subsector?

In the production value chain, goods distribution always creates high value added proportion. Currently, the domestic contribution sector is being dominated by foreign investors. Supermarket systems controlled by foreign investors account for 40%, trading centres controlled by foreign investors account for 25% and this is increasing trend when Vietnam opens distribution market completely in 2015. The consequences of this trend should be considered in this project. At the same time, the project should also take into account long-term penetration into the international distribution market in order to promote export with higher value added.

Competition in the context of globalization requires building industrial clusters through leading enterprises. Solutions of restructuring should mention cluster building that Vietnam has competitive advantage, including coffee, aquaculture, etc.

Project of restructuring trading and industrial sector lacks specific quantitative indicators in order to monitor and evaluate the process of implementation. The objectives that the project mentioned are too general; hence, it is difficult to evaluate success or failure of the project.

2.6.3 Some other changes in institutions

The Law on Real Estate Trading was approved and in effect from 1/7/2015, replacing the Law on Real Estate Trading 2006. New points of the amended Law include: (1) Permitting enterprises to do business in off-the-plan buildings; (2) Expanding the scope of business activities in real estate of domestic organizations and individuals; (3) Legal capital of real estate enterprises must not be less than 20 billion VND. Individuals who conduct irregular transactions of real estate are not required to set up enterprises but shall declare taxes in accordance with the law; (4) The time for transferring the ownership right of houses, construction works is the time that sellers hand over those houses and construction works to buyers or buyers pay enough money for sellers, except there are other deals; (5) Off-the-plan real estate can be put on market if it meets some conditions: having paper works on land using right, project documents, construction drawing design approved by competent agencies, construction permission if required, documents on acceptance on technical infrastructure construction completion in line with progress of the project. Before selling or leasing off-the-plan buildings, investors must have document to inform housing management agencies at provincial level that those buildings meet the conditions to be sold or leased. In addition, investors who want to sell or lease off-the-plan buildings must have financial guarantees of commercial banks; (6) Providers of real estate brokerage service, real estate trading floor service, and real estate management service must set up enterprises.

The Law on Accounting (amended) is being drafted by the Ministry of Finance and is open for comments. The draft focuses on amending and complementing 10 articles in the Law on Accounting 2003. A noticeable change in the amended Law on Accounting is the regulation on accounting principle (article 7), which states that besides the principle of recording asset value at original price as stipulated in the current law, for some assets whose market values change continuously, the accounting units can report either the original price or a reasonable value as stipulated by the Ministry of Finance. Some prohibited activities (article 14) are also added, including a regulation prohibiting the creation of two or more different accounting systems. The draft also complement regulations on issuing electric accounting vouchers and storage of electric accounting vouchers besides paper-based accounting vouchers. It is expected that the draft law will be submitted to the National Assembly in 2014, 2015 and formally applied from January 1, 2016.

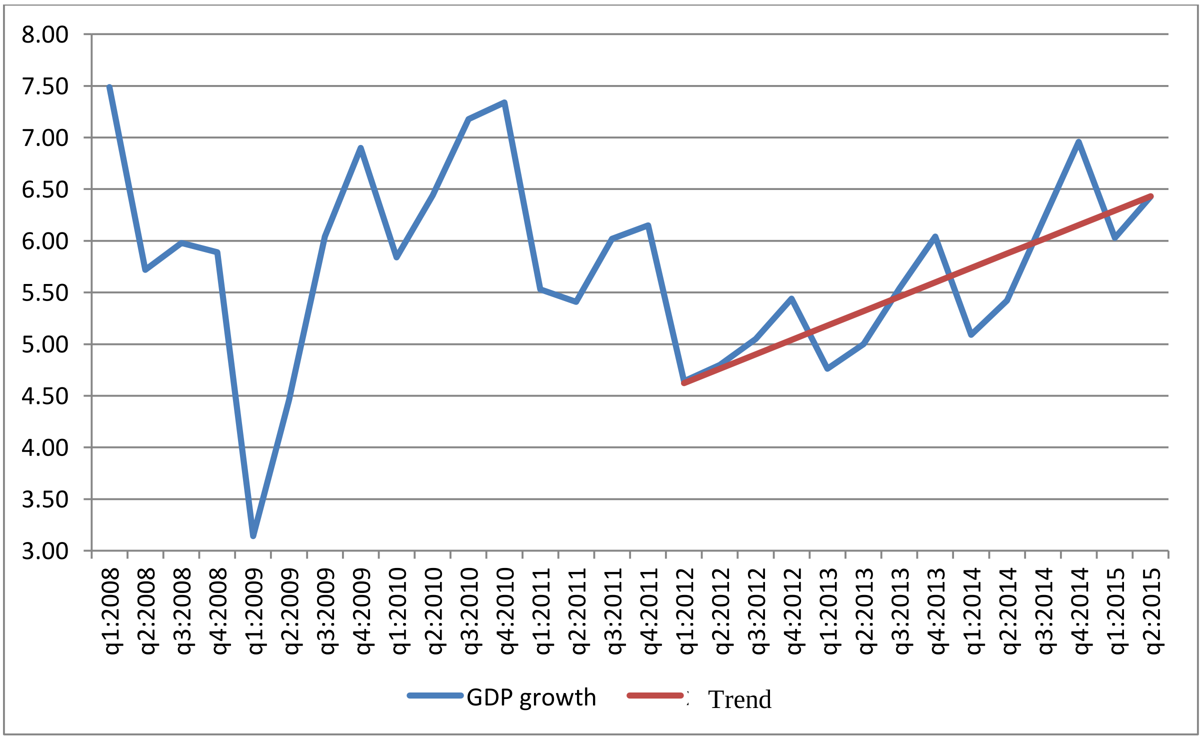
Decision No. 1826/QD-TTg dated December 6, 2012 by the Prime Minister on approving the project “Restructuring the stock exchange market and insurance enterprises”. Up to now, the Ministry of Finance are getting comments on the draft of Decree which replaces Decree No. 58/2012/ND-CP on detailed regulations on implementation of some articles of the Law on Stock Exchange. The amendment creates conditions for state-owned enterprises to be sold to the public in order to implementation of divestment of state capital. At the same time, this Decree also is amended in order to be in line with new regulations in the Law on Enterprises (amended) 2014 and the Law on Investment (amended) 2014. Accordingly, regulations on foreign investment are stipulated in details in order to encourage the participation of foreign investors into the stock exchange market in Vietnam.

3 OVERALL EVALUATION OF MACROECONOMIC STATUS

3.1 Economic growth

Gross Domestic Products have increased quarterly since 2012, in contrast with large fluctuation in the period 2008-2011 (Figure 27).

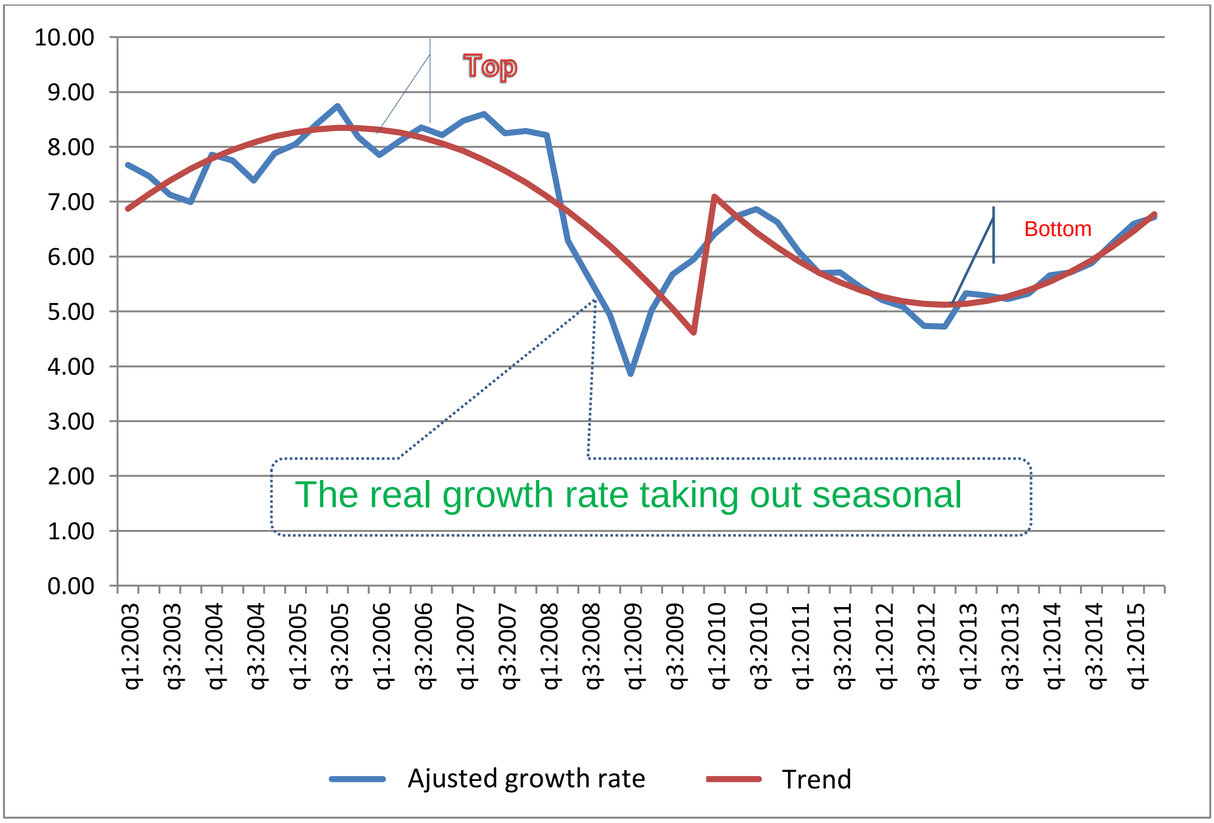
Figure 27: Growth rate of GDP by quarter , 2008-2015



Source: GSO.

Remarkably, the growth rate of quarter IV in 2014 reached 6.96% compared to the same period of previous year, the highest quarterly growth rate since 2011. The growth rate of 5.98% in 2014 was higher than growth rate of 5.25% in 2012 and the growth rate of 5.42% in 2013 and this trend continues in the first two quarters of 2015. This is positive signal of economic growth rate recovery. The downturn of economy's growth rates has stopped and reversed. Those phenomena show that although the process of changing the economic structure in our country has many problems, this process is on the right track and has achieved some encouraging results. Recently, the World Bank has forecasted that the economic growth rate of Vietnam in 2015 will be at least 6%, adjusting an increase by 0.4 percentage point compared to the forecast of this organization in January 2015. The speeding up in economic growth in recent 2 years have been higher than the forecast by the World Bank[17], this shows that the market is responding more positively than expected. However, the average growth rate in period 2011-2015 was expected about 5.8%, much lower than that of 7.5% in period 1990-2010. Recent results show that we are on the right track and should continue pushing for stronger reform, eliminating recognized weaknesses in the recent adjusting period in order to create a new growth period which is quicker and more sustainable.

Figure 28: Seasonally-adjusted growth rate and long-term growth trend



Source: Calculated from GSO's data.

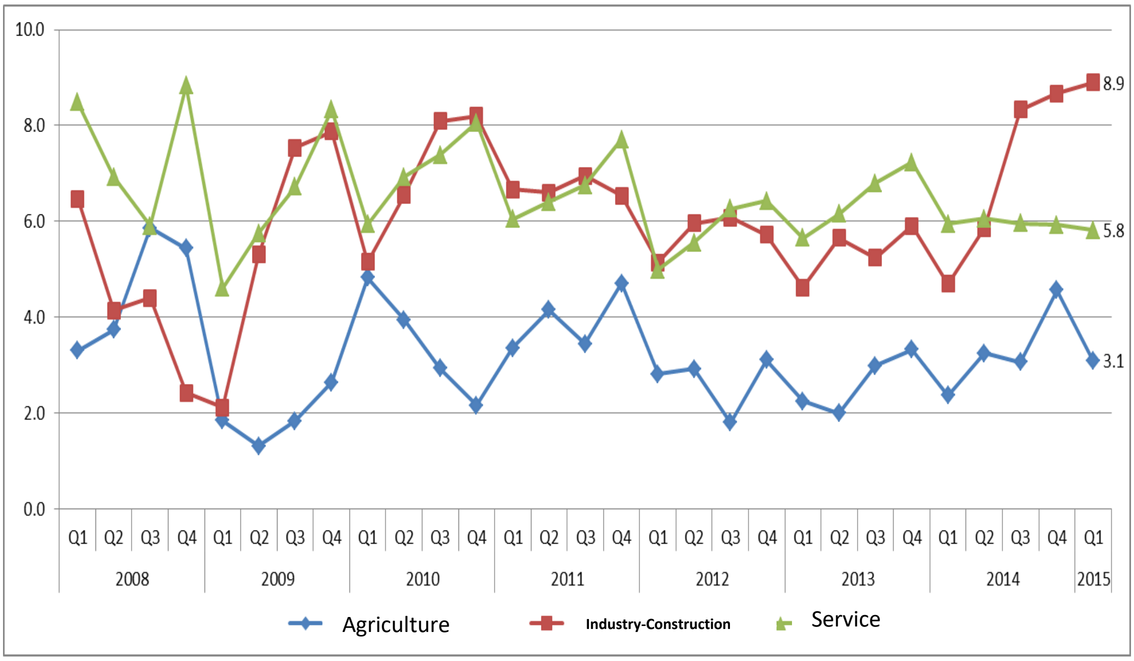
Using the data series of GDP growth rates by quarter from 2003 to the end of second quarter of 2015, after season adjustment (because GDP by quarter is highly influenced by seasonal factor, quickly increasing in the beginning of the year and quickly reducing in the end of the year), we implemented Chow test and saw two clear cycles. Growth rate increased from the first quarter of 2003 to the highest point in the first quarter of 2006 and from there started to fall till the fourth quarter of 2009. The real growth rates from the second quarter of 2006 to the first quarter of 2008 were higher than long-term trend and from the second quarter 2008 to the first quarter 2009, those rates were under long-

[17]At the end of 2013 the World Bank forecast that Vietnam's economic growth rate would be 5,4% in 2014, but in fact the growth rate was 5,98%.

term growth rate. The Government's stimulus package in 2009 promoted long-term growth trend, however, it could not overcome the downward trend from 2009 until Q4 2012. Since the first quarter 2013, the real growth rate and long-term growth trend of the economy have shown a sustainable increase trend (Figure 28).

Hence, with this trend, in 2015, if there is no external unfavourable shock, the growth rate was forecasted at about 6.5%. This is the highest growth rate in the whole period 2011-2015, but it is not as high as the average growth rate in period 2006-2010.

Figure 29: Growth rate by quarter in each economic sector



Source: GSO.

The current recovery of growth is mostly thanks to accelerated growth in the manufacturing industry and construction (Figure 29). These two industries have contributed nearly 50% to the total economic growth in the first 6 months of 2015. The service sector, which accounts for 40% GDP, has achieved only a very modest growth rate of under 6% since 2014, about 1.5 percentage point lower than the average growth rate in the period 2008-2010. The decline in service growth rate was because the financial and banking sectors are in the period of adjustment; a number of key countries for Vietnam's tourism industry such as Russia and the EU are in a difficult and unstable economic situation; China's economy has reduced its growth rate; Vietnam dong was appreciated[18]compared to Euro, RUB, CNY, JPY, etc. However, till now, there has been no comprehensive solution to address all the internal weakness of service sector, such as: lack of linkage among trading enterprises, transportation firms and tourism companies; fragmented logistics system; lack of linkage between domestic importers and exporters with transportation firms - therefore, Vietnam still mainly exports by FOB and imports by CIF prices.

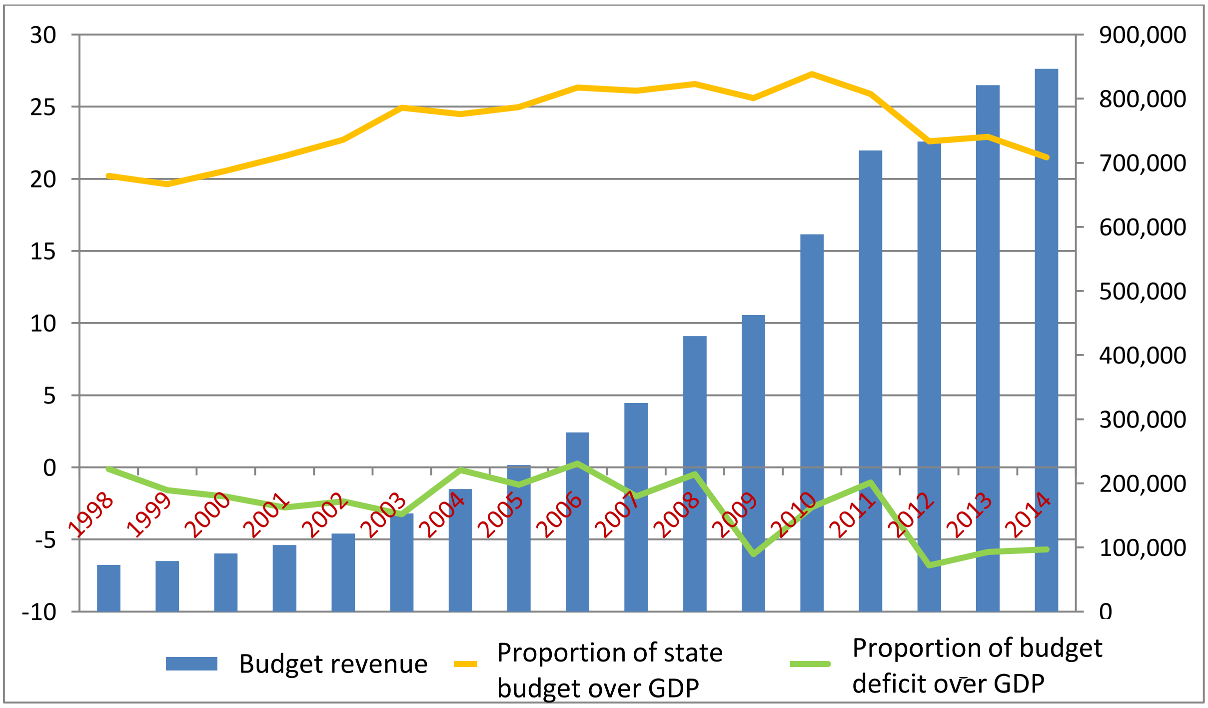
The trend growth rate of agriculture is increasing trend; however, this increase is only within the usual fluctuation margin of growth rate in this sector. It is too early to evaluate the impacts of policies on restructuring agricultural sector.

3.2 Budget

3.2.1 Level of contribution to the state budget[19]

The absolute value of Vietnam's budget revenue has continuously increased in recent years. In terms of relative value, the proportion of budget revenue in GDP of Vietnam before 2000 was in the group of countries with low proportion of budget revenue compared to other countries in the world.

Figure 30: The size of Vietnam's state budget, 1998-2014



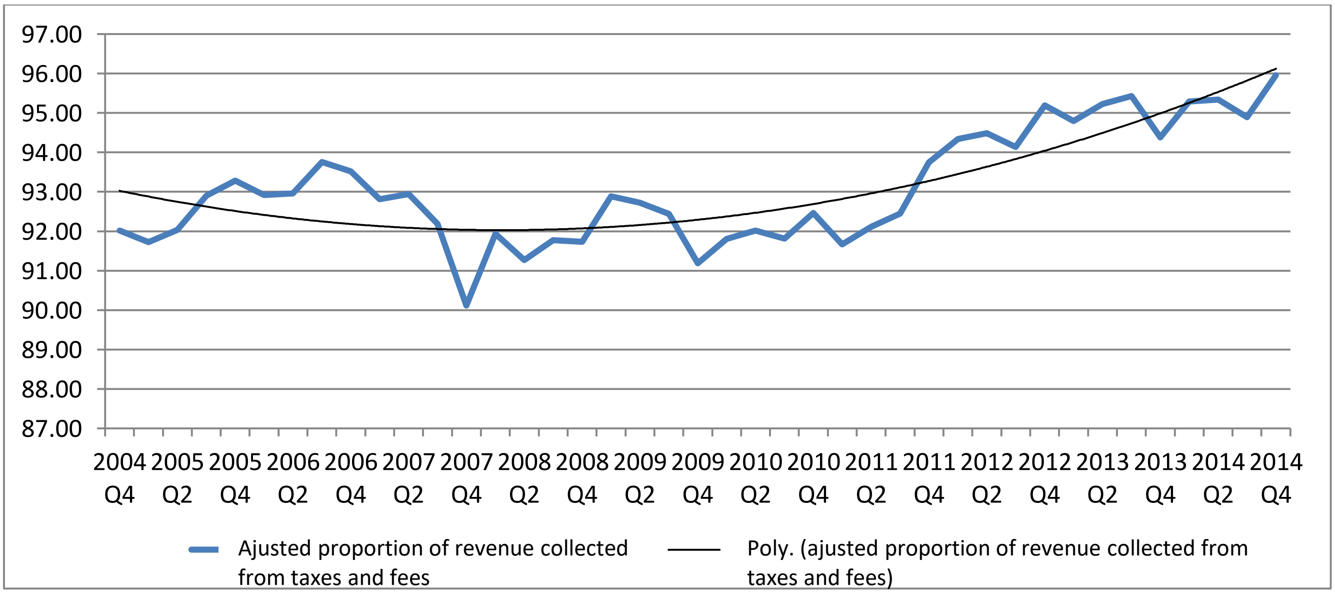
[18]Vietnam dong was anchored to the value of USD, while USD was appreciated to the value of other currencies, including Euro, RUB, CNY, JPY, etc.therefore, Vietnam dong also was appreciated to those currencies.
[19]Because the understanding on items in state budget of Vietnam is different to that of the world, the statistic on state budget of Vietnam is quite differenr to that of the IMF. In order to make comparision with other countries in the world, this part we use the statistic of the IMF.

Source: IMF (World Economic Outlook 2014). Proportion of state budget and budget deficit over GDP (%) and Budget revenue (Billion VND).

In the period 1998-2003, the proportion of state budget revenue increased gradually, and by 2003, this proportion was stable around an average level of 25%. The ratio of budget revenue from taxes and fee over GDP of Vietnam is equivalent to that of low average income countries (about 26.4%) according to statistics from the IMF based on 48 countries including Vietnam in May 2011.

The time of implementation of restructuring the economy was also the period that the proportion of state budget over GDP of Vietnam continuously reduced and closed to the lowest level in the period 1990-2000 (Figure 30). Hence, although being in the process of restructuring the economy, the economy has faced decreasing growth rate, the demand for budget expenditure has been high, but the government has tried to reduce mobilization of budget to support the enterprises to implement restructuring. The crowding out effect of public sector over private sector in Vietnam, on budget revenue collection, is at the lower-middle level of the world and continues to reduce in the period of restructuring. This is a support of the Government for enterprises in the period of restructuring. However, because the rate of budget mobilization was low and the demand for expenditure was high, since 2012, Vietnam has had quite high budget deficit of over 5%.

Figure 31: Proportion of revenue collected from taxes and fees over total budget revenue



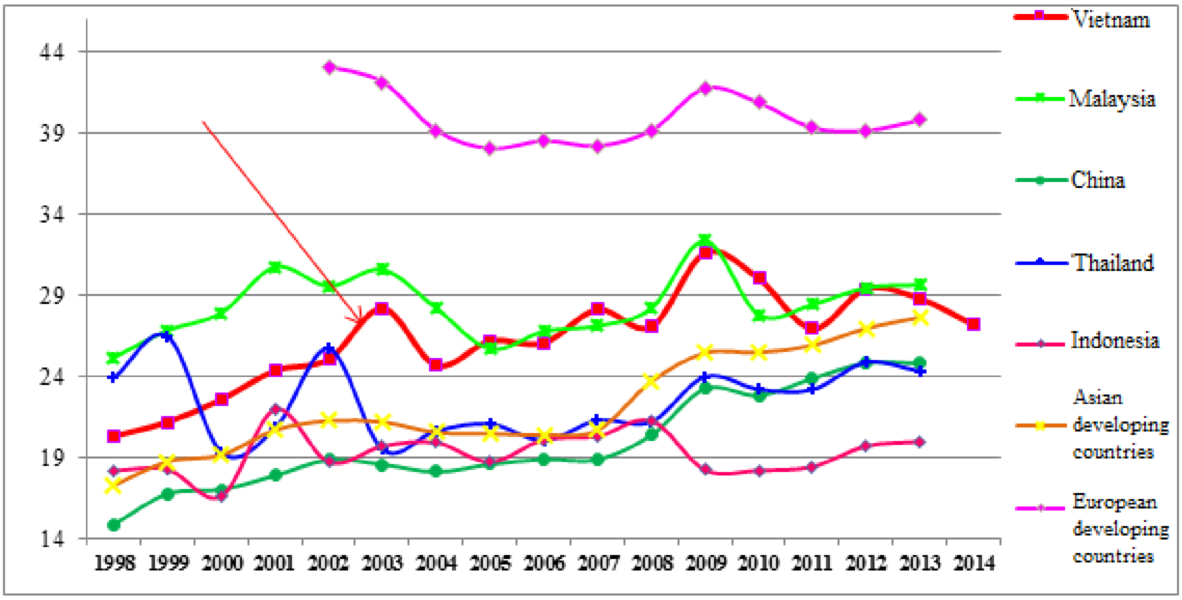
Source : IMF, http://elibrary-data.imf.org/

In addition, the structure of budget revenue has changed positively. Using the statistic of budget revenue of the IMF, we can calculate the proportion of budget revenue from taxes and fees. Figure 31 31 shows the trend of that proportion (after seasonal adjustment) and since the first quarter 2011, the budget proportion collected from taxes and fees in total budget revenue has increased continuously. Therefore, the state budget sources are showing a more sustainable trend since the implementation of restructuring.

3.2.2 Government's expenditure

The restructuring of many enterprises and sectors is a difficult process and requires active support from the state. In addition, private investment reduction requires increase in public investment to support private investment. Hence, we can see that demand for budget expenditure in this period is very high. The Vietnamese government has determined to stablize the macroeconomy, and considered macroeconomic stability as the top priority to ensure the success of restructuring the economy. Therefore, although the rate of budget mobilization decreased and the demand for budget expenditure has been high since 2009, the proportion of state budget expenditure over GDP has steadily declined to 26.94% in 2011, then increased to 31.61% in 2012, and has been slowly falling till now (Figure 32). By 2014, the proportion of budget expenditure over GDP was lower than that of developing countries in Asia. This is a huge effort of Vietnam in constraining the budget expenditure in order to stabilize the macroeconomy when budget expenditure over GDP reduced from 1998 to 2009 continuously (Figure 32).

Figure 32: The proportion of the government's expenditure over GDP of Vietnam and some other countries in the region 1998-2013



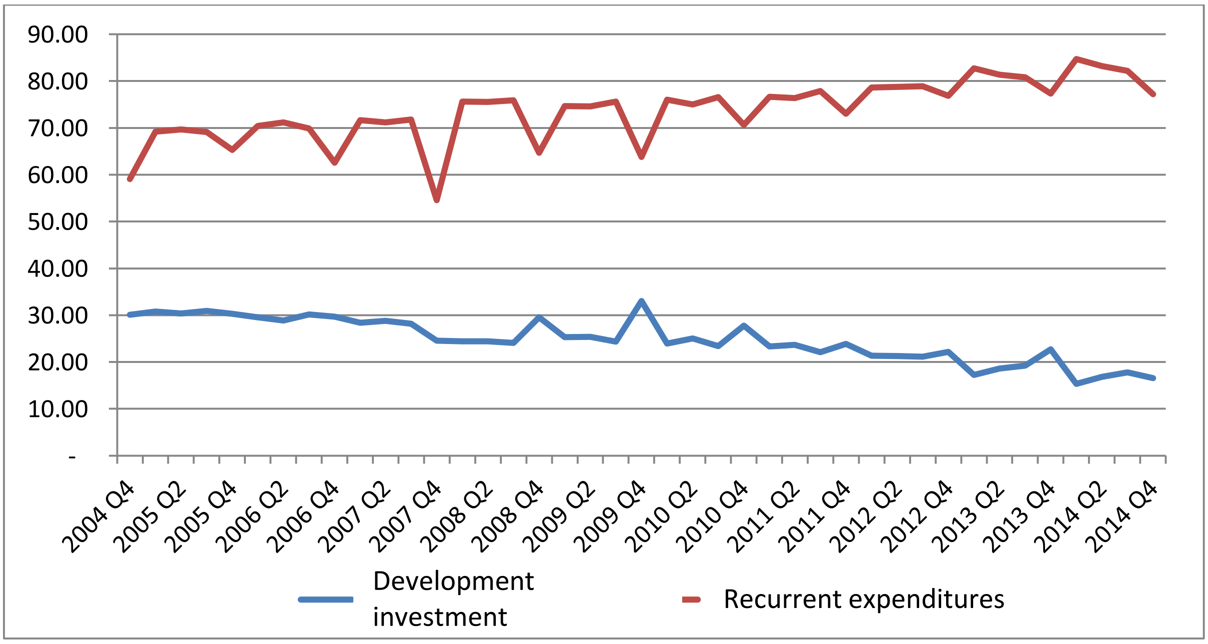
Source: IMF (World Economic Outlook 2014).

Currently, Vietnam's proportion of state budget expenditure over GDP is lower than the general level of developing countries in Asia and among the low and average level in the world. Compared to European countries, the Vietnamese government's expenditure is low. Britain, France, and Germany always maintain their governments' expenditure at 40% of GDP. However, compared to other countries in the region, especially China, with a quite a similar state model to Vietnam's, state budget expenditure of Vietnam is quite high.

We should say that the big difference between Vietnam (and Asian countries in general) and European countries is that the of European governments spend a lot more on education, health care, social security, etc. That means that state budget expenditure is mainly used to address market failures. Budget expenditure structure of Vietnam is mainly for the state apparatus (recurrent expenditure) and development investment (market interference).

Another remarkable trend is that the proportion of budget expenditure for development in total budget expenditure has quickly reduced since early 2010, while the proportion of recurrent expenditure has sharply increased, most of which is used for the operation of state apparatus, with little change in expenditure shares for education, health care, and scientific research. This reflects the cumbersome administrative apparatus in Vietnam, thus creating high pressure on recurrent expenditure and reducing the availability of government resources to address market failures and to support development (Figure 33).

Figure 33: Structure of recurrent expenditure and development investment (%)



Source: IMF.

Recurrent expenditure has risen quickly because the number of people receiving salary from the state budget has increased. According to a Ministry of Finance report, there are currently about 8 million public officials, civil servants, retired public staff and people with meritorious services currently receiving salary and allowance from the state budget; that means for every eleven people, there is one person enjoying a salary from the state budget[20]. The number of people enjoying a salary from the state budget is too large because the state apparatus is too cumbersome. If we count only un-specialized public staff at commune and village levels, the number is about 900,000 people[21]. Most of them receive an allowance from the state budget, the rest is paid by the fund contributed by local people. The cumbersome state apparatus does not only increase the current expenditure from the state budget but also creates harassment and corruption in the state apparatus. If there is no comprehensive restructuring of state apparatus from the central level to grassroots level, recurrent expenditure will continue to increase and the efficiency of state management will continue to decline.

[20]An island commune in Quang Ninh province with nearly 200 households, in which 100 staff are enjoying salary and allowance from the state budget; Mao Khe town, Dong Trieu district has 639 civil servants enjoying salary and allowance from the state budget. In all Quang Ninh province, one in every 8.5 people in enjoying salary and allowance from the state budget. Source: http://vietnamnet.vn/vn/kinh-te/179904/-bo-may-hanh-chinh-gio-kinh-khung-the--.html

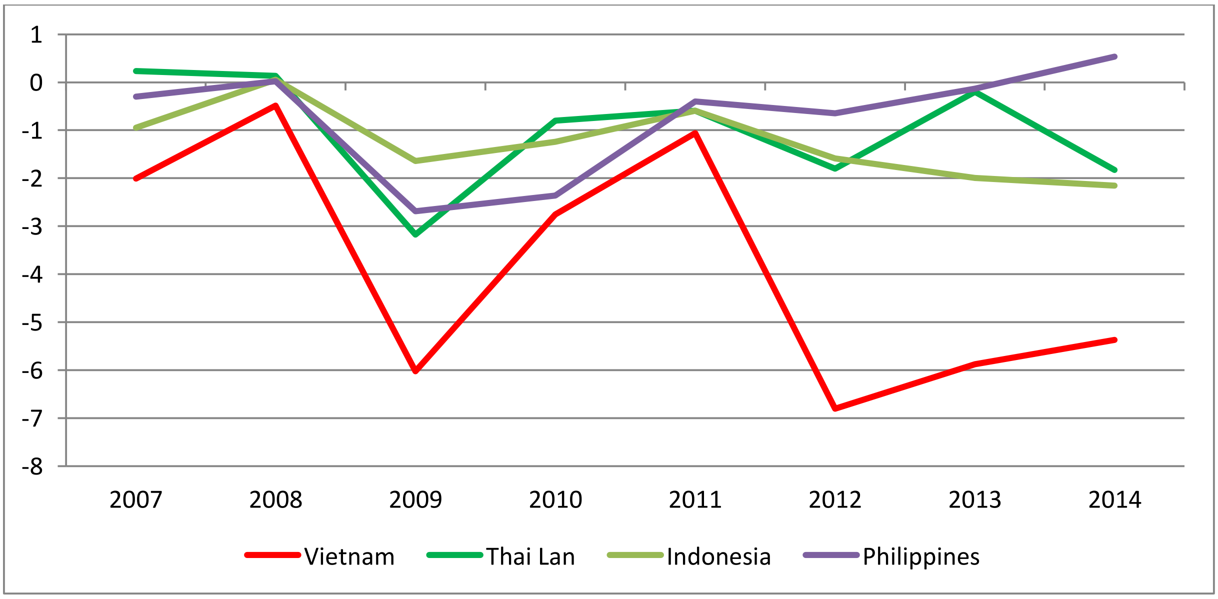
[21]Department of Local Authority, the Ministry of Internal Affairs

3.2.3 Budget deficit and public debt[22]

Expansionary fiscal policy when there was reduction in revenue has resulted in increase in budget deficit of Vietnam. Vietnam's method for calculating data on the budget deficit is different to that of the IMF, because of different understandings on budget revenue and budget expenditure. In order to compare to other countries in the ASEAN, we have to use IMF data [23] updated in April 2015. Figure 34 shows that compared to other countries in the region, budget deficit control of Vietnam is much weaker, and since 2011, the budget deficit has been expanding. A high budget deficit creates increasing pressure on public debt.

Since 2008, Government debt has been increasing, especially in the economic downturn period. Public debt increased because demand for state budget funding was large, due to the mind set of using state investment to compensate for the reduction in private investment (the ratio of public investment/total investment continuously increased from 2011 to 2014: see Figure 14).

Figure 34: Budget deficit calculated by IMF method of some countries in the ASEAN



Source : IMF, World Economic Outlook, April 2015.

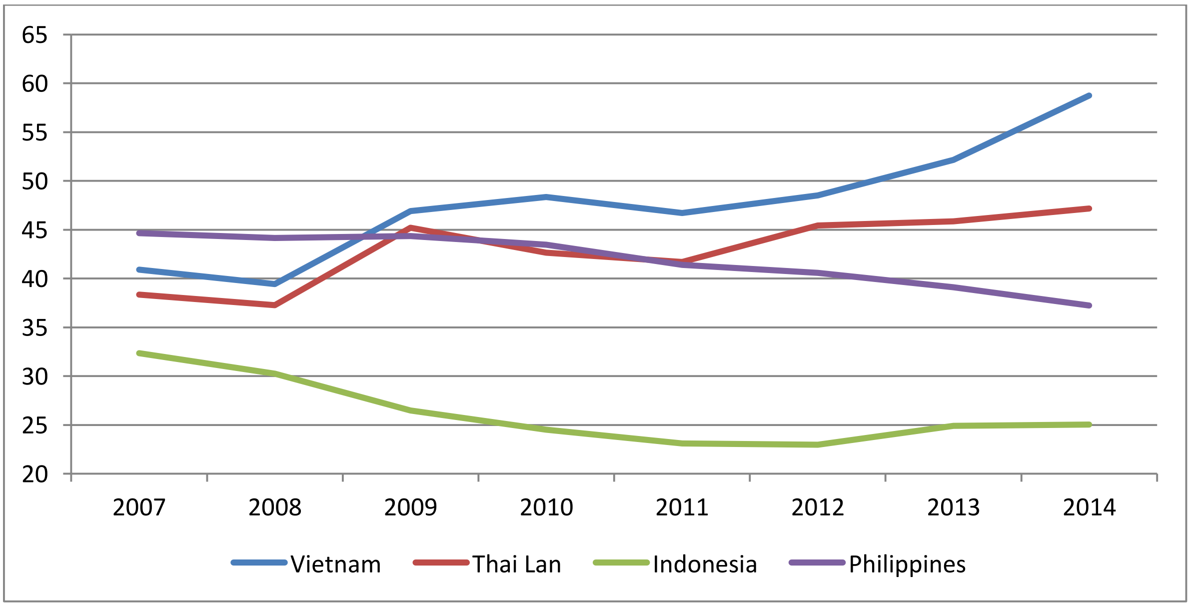
This not only increases public debt but also has a crowding out effect in the financial market. The government competes with the private sector to get

[22]Public debt as the understanding of the IMF in order to compare to other countries, therefore it does not include debt of state-owned enterprises

[23]World Economic Outlooks April 2015

resources in the financial market. A very big part of financial resource of commercial banks went to the Government's bonds and the government distributes that resource by administrative and non-market mechanism. Investors who should have been unable to access capital through bank credit channels due to lack of efficiency or high risk potential can fully access funds through government bond sources. Hence, resources should be contributed by market mechanisms are instead distributed by state management mechanism. Clearly, this will reduce the efficiency of using resources, especially given that public investment management institutions have not been reformed to make them more efficient. In addition, State competition can increase the cost of accessing capital and constrain business recovery. Given the pressure of increasing public debt, it is necessary to change the mindset from expecting the State to takes over certain activities from the private sector, to encouraging the State to create markets so the private sector to participate to provide public goods. State capital should be distributed through competitive bidding mechanism in order to ensure that resource can be used most effectively (Figure 35).

Figure 35: Proportion of public debt/GDP in some countries in the ASEAN



Source: IMF, World Economic Outlook, April 2015.

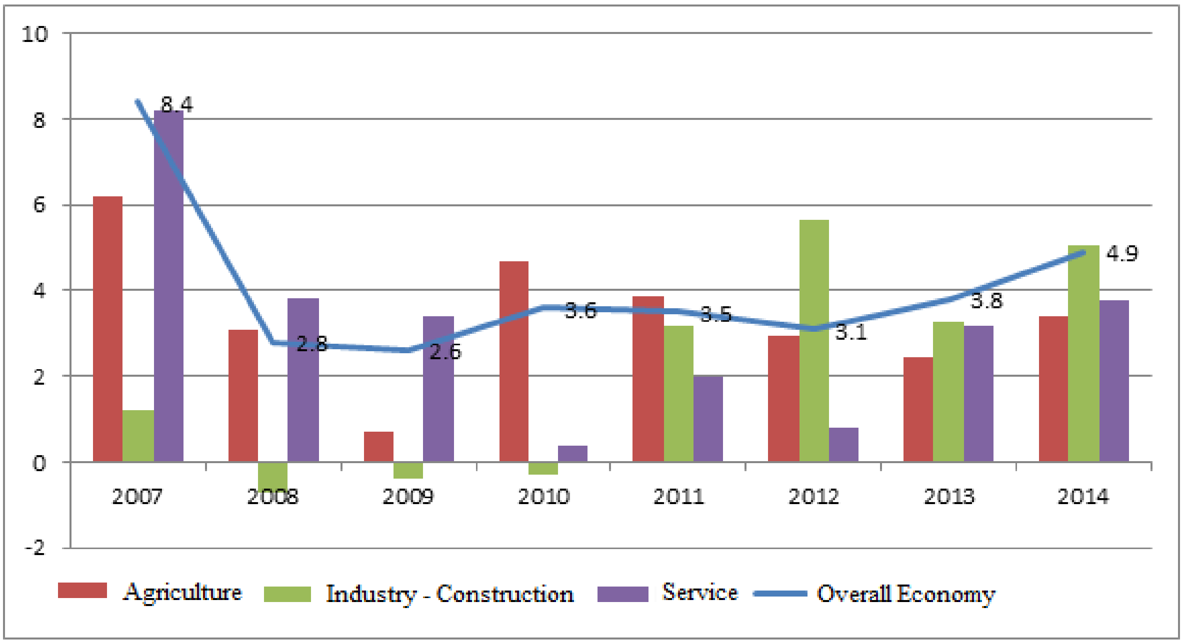
The sharp increase in public debt of Vietnam shows that Vietnam has not been ready to reduce the State's operations in the economy in order to creat competitive environment for non-state sector. Although public debt is currently under the threshold that the National Assembly set (65% GDP), if we maintain the leading role of the State in economic activities and public investment efficiency is not improved, public debt will certainly increase and surpass any threshold set by the National Assembly.

3.3 Productivity

3.3.1 Labour productivity

The problems of the economy before 2011, as discussed above, have strongly constrained growth in labour productivity of the leading sectors, namely industry - construction sector and services sector. This is constraining growth in national productivity. The growth rate of labour productivity dropped to its lowest level in 2009, reaching only 2.6% while growth rate of labour productivity in industry and construction sector fell by 0.7% (Figure 36). Particularly, the industry and construction sector experienced three consecutive years of reduced labour productivity. During the 4 years implementing economic restructuring, there was a rebound in labour productivity in this sector. Labour productivity in the services sector bottomed out in 2010 and began to show signals of rebound in three consecutive years from 2012-2014. The productivity growth rate of the agricultural sector also declined in the period 2007-2009 before rising rapidly again in 2010. Since then, the growth rate of agricultural productivity has declined slightly but remained stable at approximately 3.2%. As a whole, changes in labour productivity have signalled the improvement in economic growth. In 3 years from 2012 to 2014, the growth rate of the overall economy grew constantly, from 3.1%, to 4.9%. However, the growth rate of labour productivity is still much lower than the figure of 8.4% in 2007 and when compared to China and India in 2007-2013 with an average growth rate of labour productivity of 8.48% and 5.99% respectively.

Figure 36: Growth rate of labour productivity by sector



Source: Calculated from data of the General Statistics Office. The value-added data of the whole economy used to calculate labour productivity growth rate of the overall economy include the value of indirect taxes.

This report applies the Shift-Share Analysis (SSA) on 20 sectors of Vietnam in the period 2008 - 2014 to identify factors that contribute to labour productivity growth rate recently:

$$g_p = \sum_{i=1}^{20}\left[\left(\frac{P_i^t - P_i^{t-1}}{P_i^{t-1}}\right)\frac{Y_i^{t-1}}{Y^{t-1}}\right] + \sum_{i=1}^{20}\left[\frac{P_i^{t-1}}{P^{t-1}}\left(\frac{L_i^t}{L^t} - \frac{L_i^{t-1}}{L^{t-1}}\right)\right] + \sum_{i=1}^{20}\left[\frac{P_i^t - P_i^{t-1}}{P^{t-1}}\left(\frac{L_i^t}{L^t} - \frac{L_i^{t-1}}{L^{t-1}}\right)\right] \qquad (1)$$

Of which g_p is the overall productivity growth of the 20 sectors; P_i^t, Y_i^t, L_i^t are labour productivity, value-added, and total number of labour of industry i in year t, respectively; P^t, L^t are the overall labour productivity of the economy and total employment of the economy in the year t. It should be noted that since 2014, the value-added data by sectors is calculated based on basic prices which excludes indirect taxes. Due to this difference, the growth rate of labour productivity of the overall 20 sectors did not match the growth rate of labour productivity of the overall economy in Figure 36.

The first component of equation (1) is the contribution of productivity growth within each sector to the productivity growth rate of the overall economy.

The second component of equation (1) is the contribution of labour mobility across sectors *due to differences in productivity levels* to the overall productivity growth. A positive sign of this component indicates a shift of labour from low productivity sectors to high productivity sectors and vice versa. This is the static shift effect.

The third component of equation (1) is the contribution of labour mobility across sectors *due to differences in productivity growth rates* to the overall productivity growth. A negative sign of this component reflects a shift of labour from sectors with high productivity growth rates to sectors with low labour productivity growth rates and vice versa. This is the dynamic shift effect.

Due to changes in the calculation method of sectoral value-added (excluding indirect taxes) of GSO, there was no data for sectoral value-added based on this method prior to 2009. Therefore, we only calculated sectoral productivity and its contribution to the whole economy for 2011-2014 and used the results of Nguyen Thi Tue Anh (2015), whose data for 2008-2010 were based on former calculation method, for references.

The SSA method of the authors is applied to the structural shift of labour. The effect of structural shift on labour productivity is disaggregated by the authors into static and dynamic effects. Static effect is the contribution of labour moving into sectors with high growth rate in labour productivity in the base year while dynamic effect is the contribution of labour moving into sectors with high productivity growth rate in the year of calculation.

Data in Table 2 shows that the key contribution to productivity growth rate in the period 2011-2014 was from the within effect[24]; the contribution of structural shifts was obvious in 2011 and 2012, but rather insignificant in the two years 2013 and 2014. Also, industries with high labour productivity growth rates are usually less able to absorb labour and consequently, the contribution of labour shift into sectors with high productivity growth is always negative; it means that the proportion of labours in industries with high labour productivity growth tends to decline.

Table 2: Growth rate of labour productivity and the contribution of structural shift

	Overall	***Growth rate of***	***Due to structural shift***

[24] However, because there is no data available for sectors at lower levels, we only calculate 20 sectors at level 2 classified by the GSO. Therefore, we can not separable labour mobility element within a sector at level 2 from the increase in labour productivity of that sector.

	productivity growth	***productivity by sector***	Net effect	Of which	
				Static	Dynamic
2008	2.81	2.54	0.27	0.49	-0.21
2009	2.57	0.47	2.1	2.69	-0.59
2010	3.59	0.51	3.09	4.48	-1.40
2011	4.07	1.75	2.3	2.59	-0.26
2012	3.98	2.5	1.47	1.84	-0.37
2013	3.76	3.84	-0.08	-0.05	-0.03
2014	4.62	4.35	0.26	0.3	-0.04

Source: Data for 2011-2014 are calculated from the 2014 data of GSO. Data 2008-2010 are from Table 7 of Nguyen Thi Tue Anh (2015) – different sources are highlighted in different colours.

It should be noted that because the SSA method uses labour shares of sectors as weight, for a country where the labour force is growing fast like Vietnam, the drop of labour share in one sector does not necessarily mean a reduction in the number of labour in that sector, but can simply be due to an increase in the total workforce. The positive static effect (except for 2013) shows that the labour market is quite dynamic, and sectors with high productivity of one year will attract more workers in the following year. This shows that sectors with no increase in labour productivity are still the main source of employment generation and the labour shares of these sectors hardly decrease, and even increase.

The net effect of structural shift in 2013 was negative while the within effect was quite high. This suggests that there is a clear difference between sectors with increasing labour productivity and those without labour productivity increase. Sectors with increasing labour productivity have not been able to raise their labour shares. The increase in productivity of these sectors is the result of more "deepening", but not "widening".

Table 3: Average labour productivity in 2010-2014 (million VND per person) and the shift of labour shares among sectors

	Changes in labour	Average labour

	shares 2014-2010	productivity 2010-2014
Agriculture, forestry and fishing	-3.223	17.43
Activities of households as employers	-0.069	18.94
Education and training	0.115	32.90
Commerce and repair of motor vehicles	1.296	33.66
Activities of Public administration; defence, Activities of Communist Party, social-political organizations	0.018	39.86
Administrative and support service activities	0.119	40.94
Construction	-0.055	43.27
Accommodation and food services activities	0.874	43.84
Transportation, storage and	0.023	47.70
Manufacturing industry	0.509	48.38
Other services	0.048	53.31
Human health and social work activities	0.043	56.73
Arts, entertainment and recreation	0.068	64.99
Information and communication	0.078	83.24
Water supply, sewerage, waste management and remediation activities	-0.033	121.21
Professional, scientific and technical activities	0.032	135.39
Financial, banking and insurance activities	0.149	428.55
Electricity, gas, steam and air conditioning activities	-0.003	608.06
Mining and quarrying	-0.082	797.70
Real estate activities	0.093	1049.46

Source: Calculated from GSO's data.

Table 3 shows that the agriculture, forestry and fishing sector has the lowest labour productivity and its labour share fell most rapidly in the period 2010-2014. Similarly, the *activities of households as employers* sector has the second lowest productivity level, reflecting the shift of labours out of this sector. Besides, the two sectors with very high labour productivity – namely electricity, gas, steam and air conditioning supply and mining industry - show a slight decline in their labour shares. Since these are resource- and capital-intensive sectors with high labour productivity and low capability to expand production, their declining labour shares is obvious when the labour force in Vietnam has continually increased in recent years.

Almost all other sectors have experienced higher labour share. This shows that in recent years, a significant number of labourers in agriculture and rural areas have withdrawn and been allocated in higher productivity sectors. Yet, the largest increases in labour share are in the commerce and repair of motor vehicles sector (up 1.3 percentage points), the accommodation and food services activities sector (up 0.874 percentage point), the administrative and support service activities sector (up 0.12 percentage points), etc. which have lower productivity than the national average of VND 47.2 million based on 2010 price. The manufacturing sector accounted for 14.1% of employment and in 2010-2014, the labour share of this sector increased 0.51 percentage points. Labour productivity of this sector in 2014 reached VND 54 million and was higher than the national average of VND 51.1 million. Thus there has been a shift of labour from lower productivity sectors to the manufacturing sector which has higher labour productivity. However, the shift is quite moderate.

3.3.2 Total Factor Productivity

The assessment of total factor productivity (TFP) is always uncertain. Because Vietnam does not have data on the total capital of the economy, most TFP calculations must be based on the estimated total capital of the economy. Different estimates give different results.

The database of Penn Word Table[25] includes estimates of total capital value of Vietnam's economy until 2011. This database uses the World Bank World Development Indicators[26]. However, when we combine the data of Penn Word Table with the data from the World Bank, there is a conflict. If the two databases are correct, there are years when the value of depreciation of Vietnam is negative. Therefore, we do not use data from the Penn Word Table.

Using the data of the World Bank WDI recently updated in 2015[27]we estimate the total capital value of the economy using the standard convergence method. Accordingly we assume that the depreciation rate of Vietnam will be estimated close to the common value of the least developed countries which is around 6%[28]. Based on this result and the share of income of labour estimated by GSO, we estimate the contribution of factors to economic growth in Vietnam in recent years as shown in the table below.

Table 4: Contribution of the factors in economic growth rate (%)

	GDP growth rate	Capital	Labour	TFP
2005	7.55	61.23	22.88	15.89
2006	6.98	60.18	24.24	15.58
2007	7.13	68.83	23.49	7.68
2008	5.66	72.51	29.36	-1.87

[25] https://pwt.sas.upenn.edu/
[26] http://data.worldbank.org/data-catalog/world-development-indicators
[27] Be noted that the updated data series of Vietnam in 2015 is very different from the data series in earlierWDI tables.
[28] This estimation method will be published in the Journal of Economic Research in May 2015.

2009	5.40	71.84	30.70	-2.55
2010	6.42	60.08	25.52	14.40
2011	6.24	45.13	25.55	29.32
2012	5.25	44.72	24.32	30.96
2013	5.42	51.17	16.90	31.93
2014	*5.98*	*48.29*	*24.23*	*27.47*

Source: Calculation of authors. Be noted that 2014 data is estimated based on estimation of income components of capital and labour.

The results in Table 4 show that in 2008 and 2009 contribution of TFP is negative compatible with the calculation of growth rate of labour productivity as above. The trend of TFP contribution is consistent with the calculation of ICOR in section 2.2.3.1. The TFP calculation results showed a significant improvement in total factor productivity during the implementation of the recent economic restructuring.

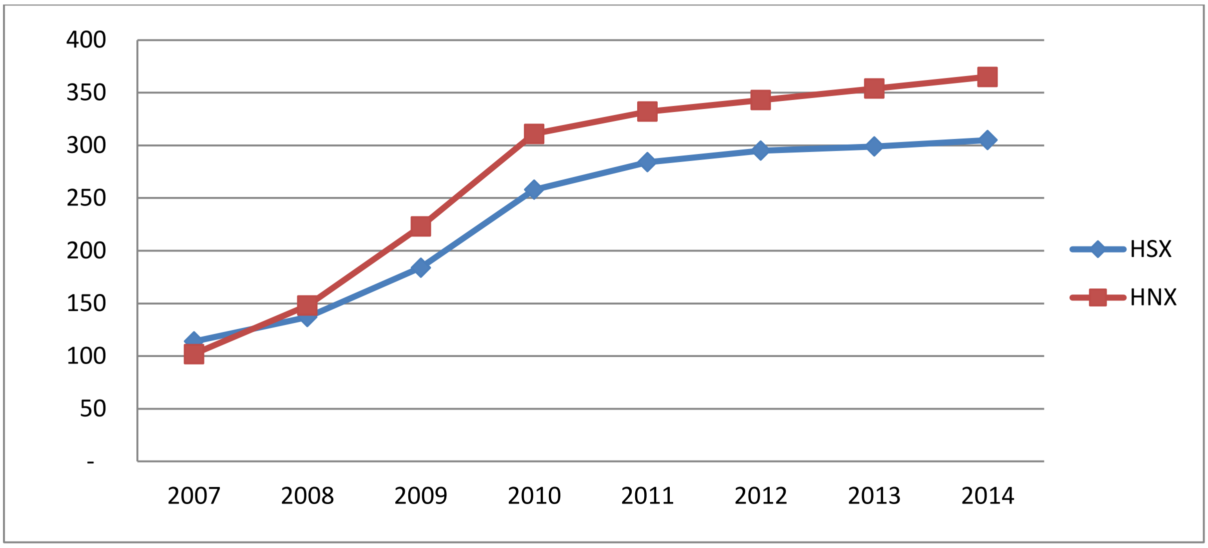
3.4 Stock market

3.4.1 The number of listed companies

The Stock market was formed in Vietnam in 2000 with two stock exchanges in Hanoi (HNX) and Ho Chi Minh City (HSX) (excluding UPCOM). Currently, there are 670 listed companies with a large number of listed and traded shares, thus becoming an important channel of capital mobilization for production and business activities in Vietnam.

Figure 37 shows that the number of listed companies increased rapidly from 2007 to 2010 with an annual growth rate of the number of companies listed in HSX at 4.24% and in HNX at4.93%. In the latter period from 2011-2014, the number of companies listed on the two stock exchanges increased but at a slower rate -1.76% per year for HSX and 2.21% per year for HNX on average. However, there is a large number of delisted companies.

Figure 37: Number of Listed Companies



Source: Calculated from collected data.

The reason is that these companies suffered losses for three consecutive years and their accumulated losses exceeded their chartered capital. In 2012, there were 22 companies leaving the Stock Exchange while in 2013 the number of 37 securities delisting also surprised the market. In 2014, the number of companies delisting was 30[29].

3.4.2 The vigorous rally of securities market

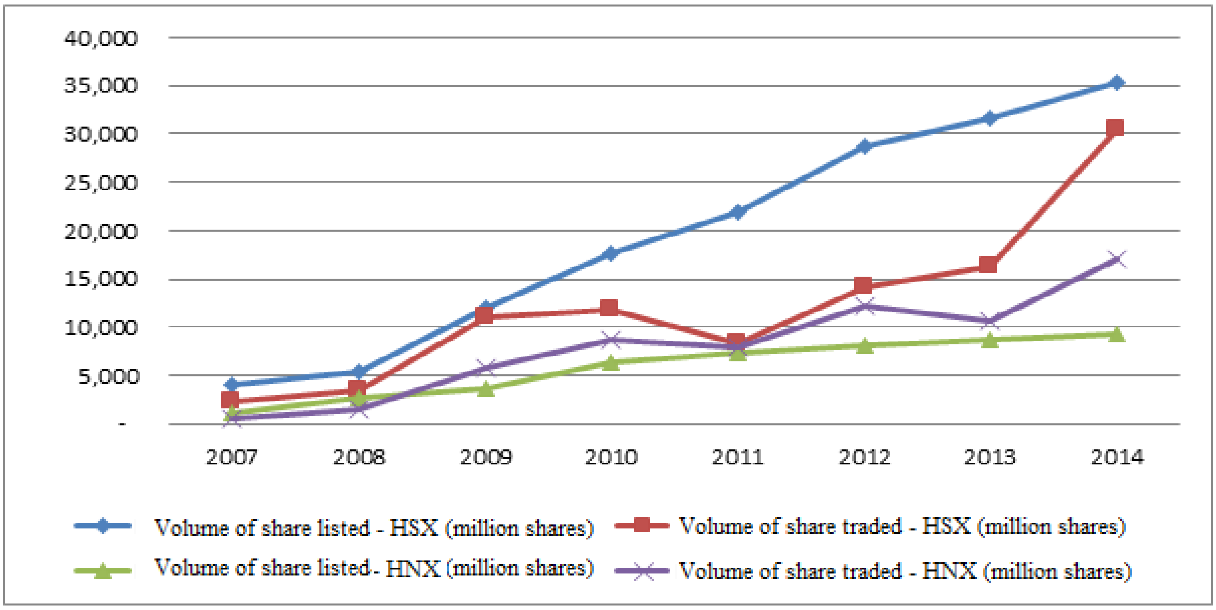
The volume of listed shares of the Stock Exchanges of Ho Chi Minh City and Hanoi had increased over the years but the number of listed shares in the HSX had a faster average growth rate of 30% per year (from 2007 to 2014). The HNX grew at a slower pace but still quite high at 25% per year during the same period. In the HNX, there were 1.2 million shares listed in 2007 and 9.3 million shares listed in 2014 (Figure 38).

The supply of shares issued continuously increased in this period reflecting the considerable needs of enterprises to raise capital and the securities market is gradually becoming one of the important capital mobilization channels for enterprises.

It is worth noting that in the period of economic restructuring, the number of stocks listed and traded on both stock exchanges increased, of which the HSX has remarkable growth. Thus, there has been a strong shift in attracting capital through the banking system to attracting capital via the stock market.

Figure 38: Volume of shares listed and traded (million shares)

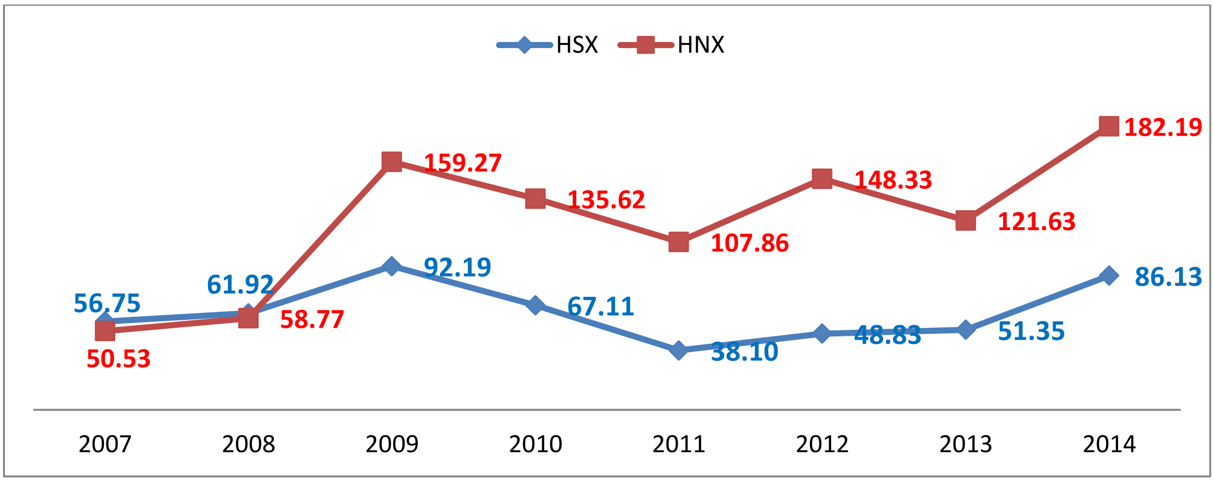
[29]According to http://cafef.vn/thi-truong-chung-khoan/co-phieu-huy-niem-yet-nam-2014-ra-di-trong-muc-gia-rau-dua-tra-da-20141224115511108.chn



Source: Calculated from collected data.

The proportion of stocks traded among the number of stocks listed on the two stock exchanges fell sharply from 2009 to 2011. From 2011 to present, this ratio has a clearly rising trend and increased in both exchanges, especially the HNX (Figure 39). As such, with the process of economic restructuring, the stock market has become more and more active, partly substituting the banking system in providing capital for production and business activities.

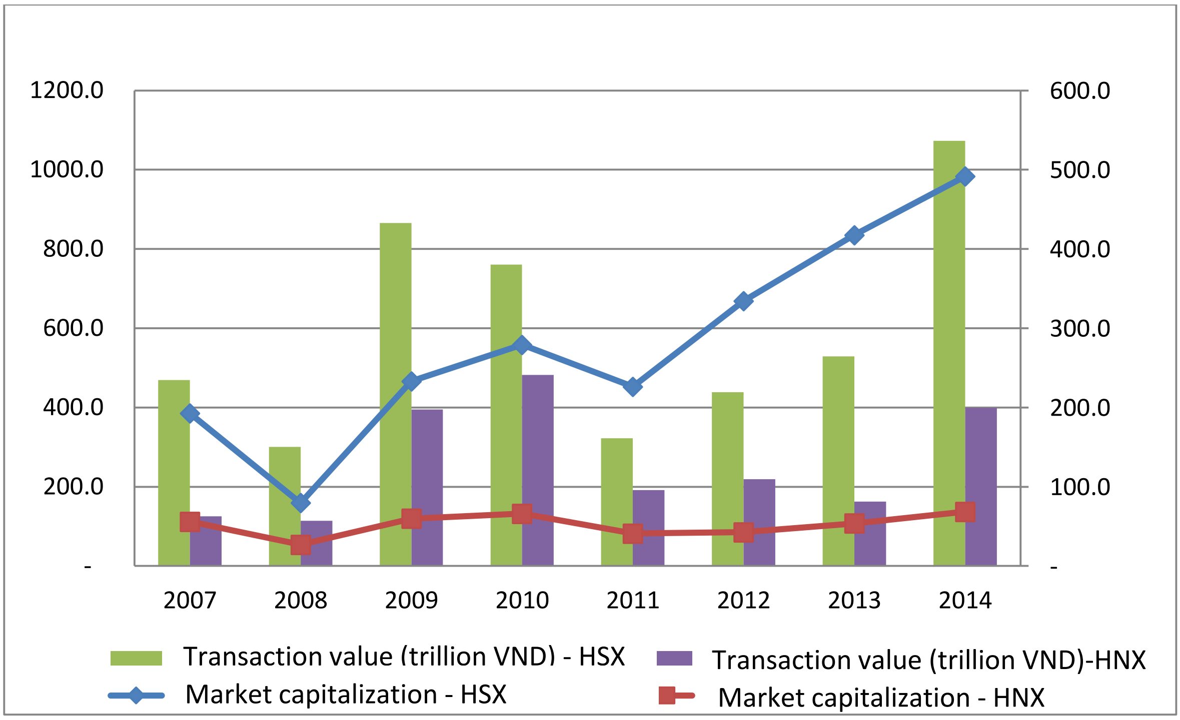
Figure 39: Proportion volume of traded /listed shares (%)



Source: Calculated from collected data.

Thus, indicators such as the number of listed companies, the volume of shares traded, transaction ratio, the transaction values showed the strong rally of the stock market as a capital supply channel substituting the banking system (Figure 40).

Figure 40: Value traded and market capitalization (trillion VND)



Source: Calculated from collected data.

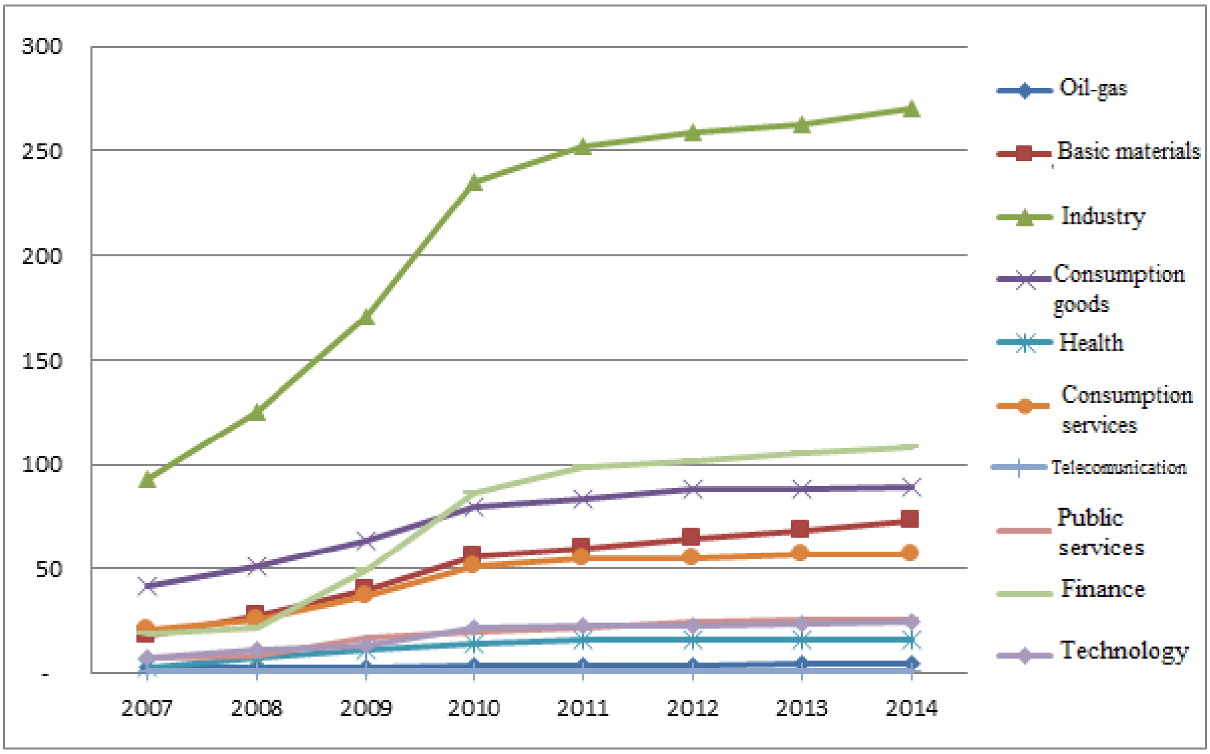
This is an encouraging shift to minimize the dependence of the economy on the banking system, and to create an effective capital mobilization channel for the economy.

3.4.3 Market fluctuations by sector

3.4.3.1 Number of companies listed by sector

The number of listed companies concentrated mainly in the industrial sector. At the end of 2014, there were 270 companies operating in this sector, accounting for 40% of the 670 companies listed on Vietnam's stock market. Three other sectors, which account for 40% of companies mobilizing capital in the stock market, were finance, consumer goods and basic materials with the respective figures of 108, 89 and 72 companies. In comparison with the period of four years 2011-2014, the earlier four-year-period from 2007 to 2010 had a higher speed of the number of new companies listing in the stock market, especially in the industrial sector. Figure 41 also shows a strong increase of stocks of high-technology-content sectors such as finance, basic materials, health, technology and industry in general.

Figure 41: Number of listed companies



Source: Calculated from collected data.

In terms of trading volume, transaction value and end-period capitalization, the fact that these sectors are being well received and have increased rates of foreign investors' holdings shows that the market is shifting gradually to high value-added industries and market signals show that these sectors are promising.

3.5 Institution indicators

3.5.1 The institutional reforms implemented in the period 2011-2014

Efforts to improve the business environment of the Government in the process of restructuring is recognized through the changes of the provincial competitiveness index (PCI) showing the perspective of enterprises and the Provincial Governance and Public Administration Index (PAPI) reflecting the governance quality of the local government through the eyes of the people.

3.5.2 Institutional environment evaluation of enterprises: the PCI

The PCI consists of sub-indices reflecting economic governance fields that affect the development of private sector. A province is considered obtaining good operating quality when having:1) low market entry costs; 2) easy access to land and land use stability; 3) transparent business environment and open business information; 4) low unofficial cost; 5) quick inspection, testing and implementation of administrative regulations, procedures; 6) fair competition environment;7) dynamic and creative provincial leadership in solving problems for businesses;8) developed and high quality business supporting services; 9) sound labour training policy and 10) fair and efficient procedures for resolving disputes.

It should also be noted that the PCI is used primarily to compare the perceptions of enterprises about the progress of institution and the quality of the governance and business environment of the provinces at the same time. The comparison of indices between different years will face a number of limitations such as: (i) some indices are available in one year but not in other years; (ii) an index surveyed in a year is often added with extra sub-indices in the following years, thus, the scores of those indices in the following years may be lower due to the low score of these sub-indices; (iii) the indices are surveyed mainly based on the perceptions of enterprises, so in favourable economic conditions, these indices tend to be higher and vice versa. Indices in the later years often reflect their intended connotations better than in the previous years; therefore, lower scores in the following year do not necessarily reflect the deterioration of those indices, but rather because they are measured more accurately. Because of these weaknesses, despite the continuous improvement of business environment, institutions and regulatory quality, the volatility of the PCI may fluctuate.

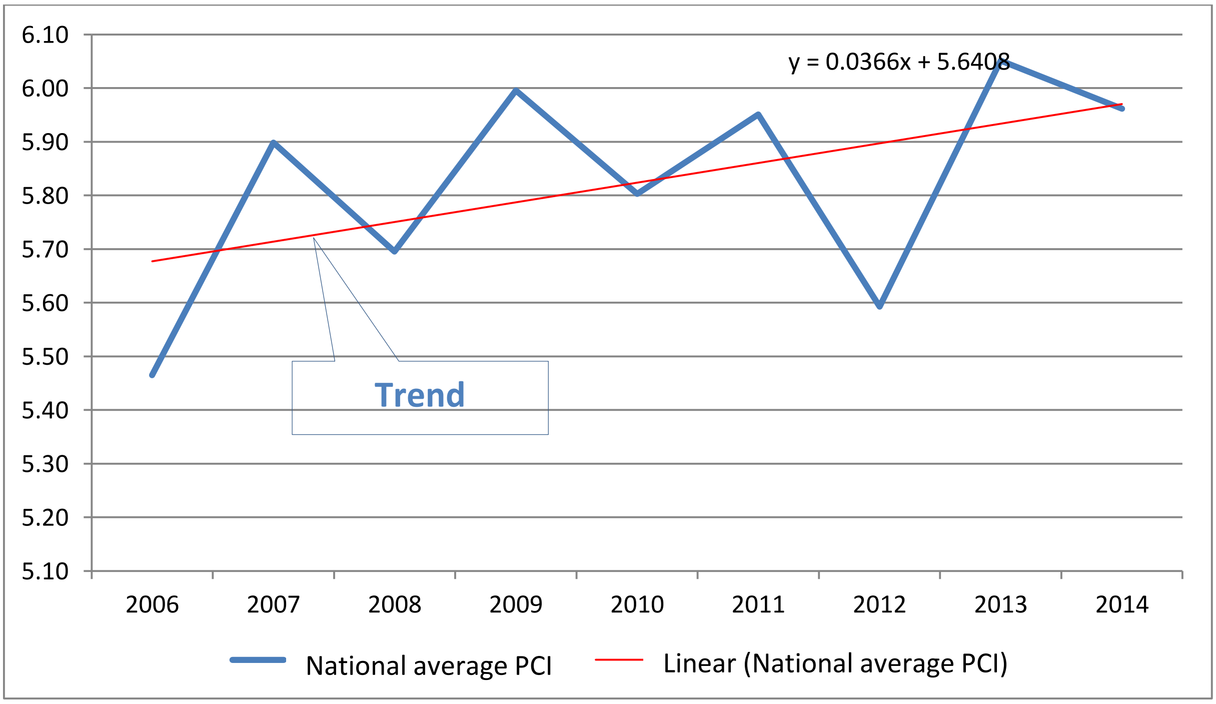
Despite these shortcomings, the research team assume that in general, these indicators can reflect the general trends in the business environment, institutions, regulatory quality of the local government in the eyes of enterprises. Particularly, if these indices tend to go up, we can affirm that these indices have made better improvement than before.

The PCI data is provided by the PCI center of Vietnam. To compare in time series, for each sub-index we calculate an annual average weighted index of the country with the weight of each province is the proportion of province's labour force in the country's labour force[30]. As mentioned above, the sub-indices in each year may vary, the number of sub-indices are different and thus to be able to compare the average national PCI, we base on the 9 sub-indices which have full surveys from 2006 to present, of which there are 6 indices that have been surveyed from 2005: Market entry, Land access and Tenure, Transparency, Time costs, Informal charges, Leadership proactivity, Legal

[30] We can take the weight as theproportion of province's percentage of enterprises + number of non-state economic entities of each province out of the country.However we assume that the business environment and the quality of economic institutions eventually affect workers, so we use the percentage of labour force.

institutions, Business support services and Labour training. The recently-added new index on "equal competition" will be excluded from the average national PCI.

Figure 42: The country's average PCI on a 0-10 scale



Source: Calculated from data from PCI center of Vietnam, based on eight key indices investigated annually from 2006 to present.

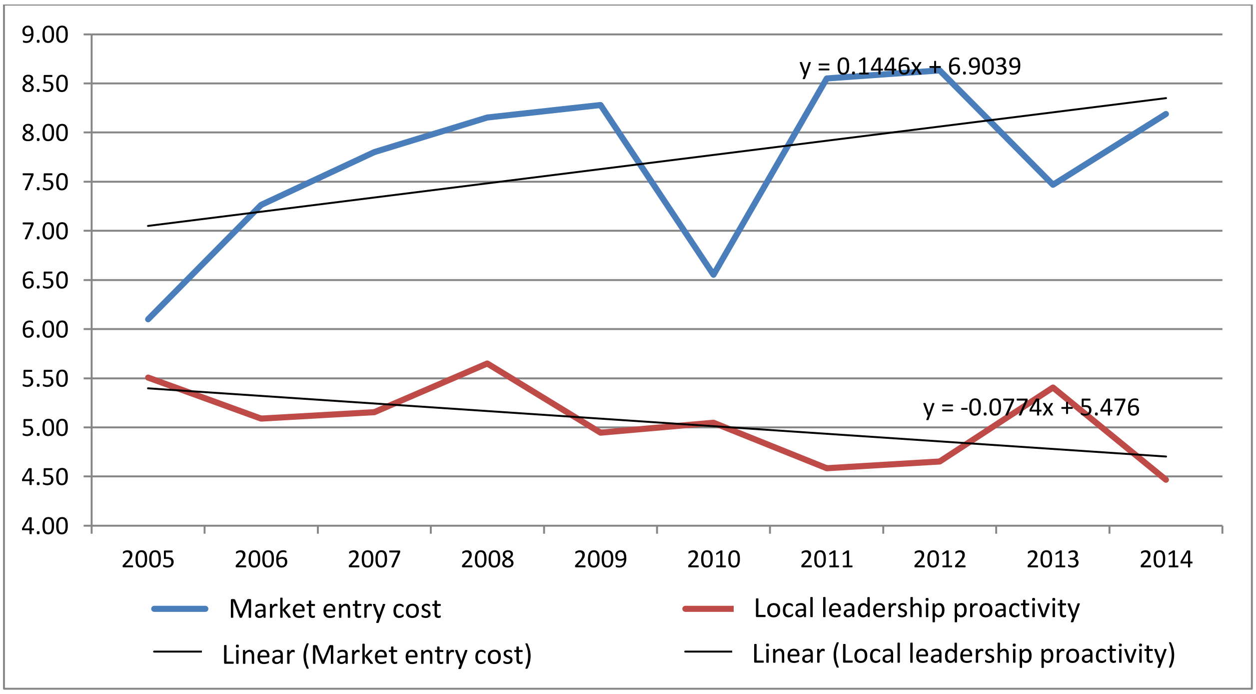
In general, the national average PCI during 2005-2014 shows a quite clear rising trend with the average annual increase of 0.037 point. However, from 2010 to date, this growth rate has slowed down (Figure 42).

The fluctuation over the years of the PCI shows that, despite the above mentioned reasons for limitations in using PCI over time, to some extent it also reflects that the improvement of business environment, institutional and regulatory quality in Vietnam has not been implemented consistently. Some indices improve in one year but plummet in the following year. The most obvious example is the "market entry" index which is always highly evaluated by enterprises and has the increasing tendency but in 2010 and 2013 this index declined sharply. The number of licenses for enterprises to operate in 2010 is higher than both in 2009 and in 2011. Similarly, the time to obtain licenses, time of business registration, etc. in 2010 were higher than in 2009 and 2011.

Indicators of "Local leadership proactivity" shows a clear and stable downward trend. This suggests that the quality of provincial officials has not met the requirements of enterprises and the trend is becoming increasingly worse.

The "Informal charges index" shows strong fluctuation without clear trend. However, from 2011 to date, this index continuously declines and 2014 is the year that scores the lowest index since the first PCI survey. Therefore, economic restructuring has not addressed the issues of economic institutions to prevent corruption. In the eyes of enterprises, this evil now becomes increasingly worse. The Legal institutions index showed stable improvement of legal institutions from 2006 to 2011. However, this indicator strongly declined in 2012 below the level in 2006 and only improved in the last 2 years of 2013 and 2014. Provincial regulatory environment is not highly evaluated, as reflected in national competitiveness indicators discussed in the following section (Figure 43).

Figure 43: Market entry and leadership proactivity



Source: Calculated from data from the PCI center of Vietnam.

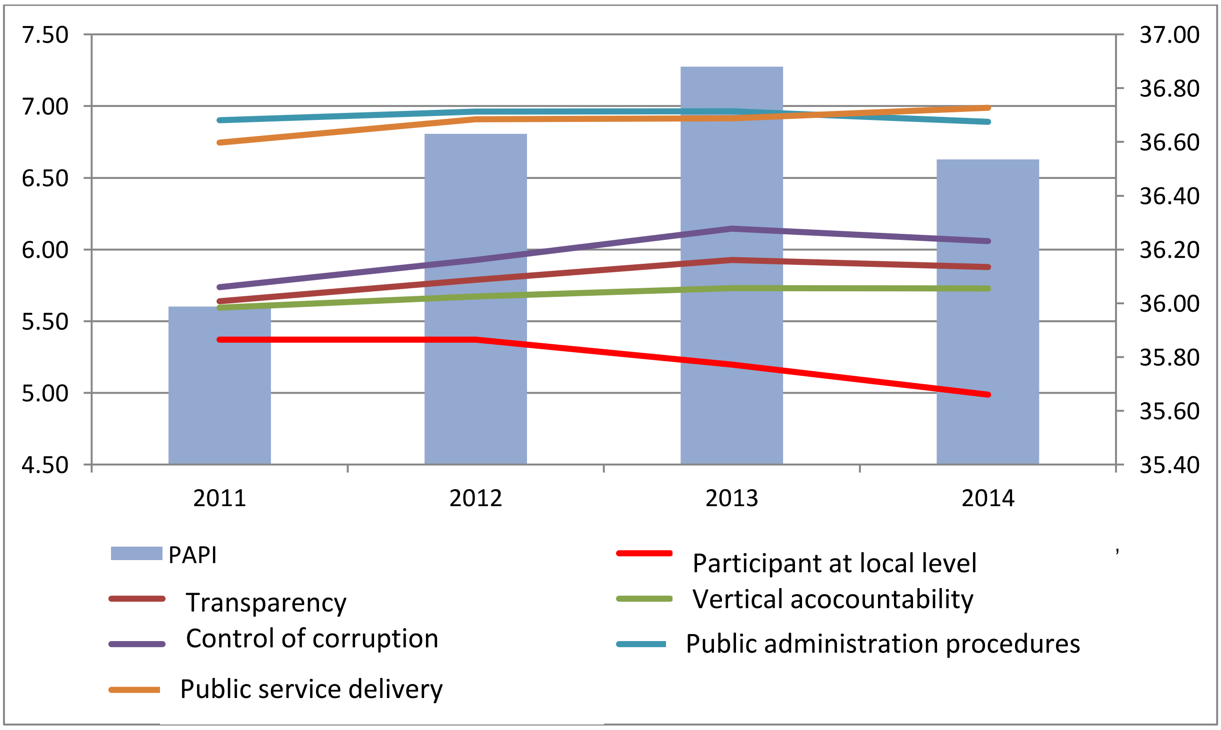
In general, apart from the highly evaluated "Market access" index (8.19 points out of 10), other indices were evaluated at only around 6 points and particularly, indicators like the "Local leadership proactivity" was only 4.47 points in 2014. This shows that even at the provincial level, there is much room left to improve the business environment, institutions and regulatory quality.

3.5.3 Evaluation of Provincial Public Governance and Public Administration

To evaluate the Provincial Governance and Public Administration Performance we use PAPI (Provincial Governance and Public Administration Performance Index) conducted by the UNDP in collaboration with the Center for Community Development Studies (CECODES) under the Vietnam Union of Science and Technology Associations annually from 2011 to present. This index represents the people's assessment of governance capacity and the supply of public services by the provincial government.

Structurally, the PAPI of a province consists of 6 dimensions, 22 sub-dimensions and 92 sub-indices of the performance of public governance and administration of all 63 provinces/cities. Six dimensions include: Participation at local level (D1); Transparency (D2); Vertical accountability (D3); Control of corruption (D4); Public administration procedures (D5) and Public service delivery (D6). Each dimension includes various sub-indices.

Figure 44: The national average PAPI

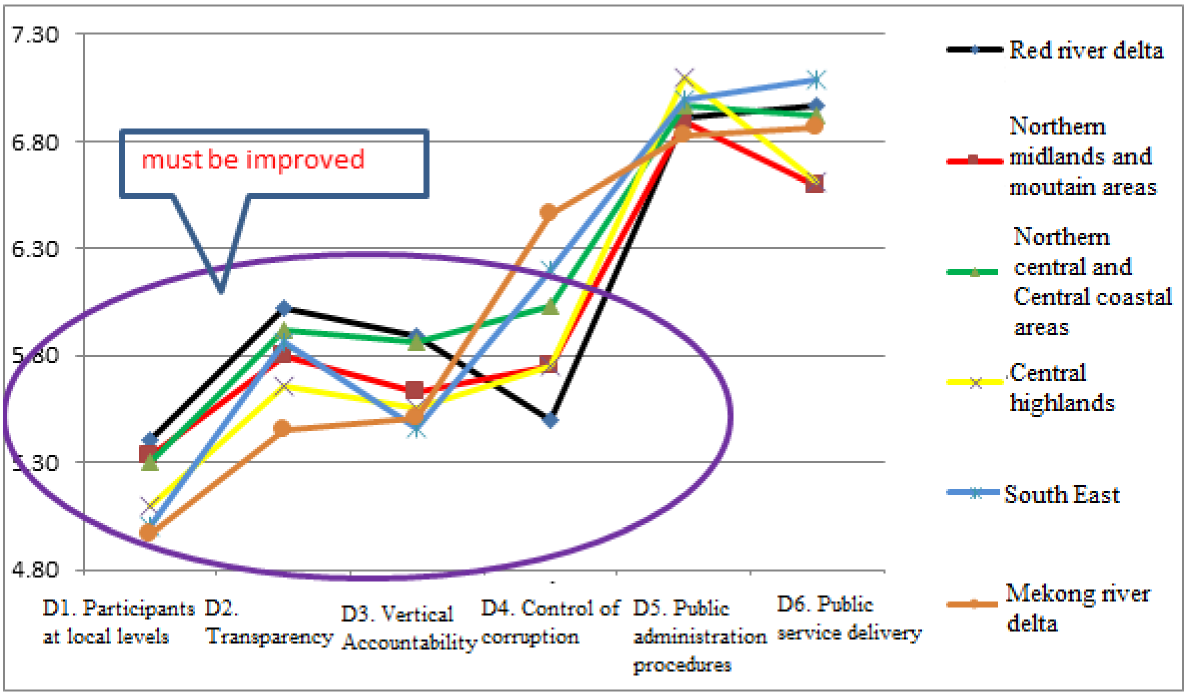


Source: Calculated from data of the PAPI http://papi.vn/gioi-thieu-ve-papi.html

We calculated the national weighted-average PAPI in which the weight is the proportion of the population of each province in total national population. The results in Figure 44 shows that the index has actually improved in 3 years from 2011 to 2013 and decreased slightly in 2014. Among 6 dimensions, only the Public service delivery and the Public administration procedures are always the most highly evaluated dimensions and in upward trend despite a moderate level. The Accountability dimension constantly improved despite low scores. This represents people's recognition of government's efforts to reform administrative procedures. The decline of the PAPI is mainly because of the decline of "Participation at local level" dimension.

Similar to the PAPI of the country, we also calculated the average PAPI for six economic regions of the country and found that in no region has the overall PAPI increased continuously over the years). Nearly all regions saw lower PAPI in 2014 than in 2013, except the Mekong River Delta whose PAPI has significantly improved over the years, and the South East region whose PAPI has generally improved despite fluctuations in some years.

Figure 45: The PAPI by region from 2011-2014



Source: Clculated from data of the PAPI http://papi.vn/gioi-thieu-ve-papi.html

Note: Good:> 6.50; Fair – Fairly good: 5.45- 6.50; Poor <5.45.

The common point between all the regions is the very weak Participation at local level index (Figure 45). The Transparency, Accountability and Control of corruption indices are still low, most ranging from the poor level to fairy good level. As such, the coming process of economic restructuring should further enhance the participation of citizens in policy-making processes, strengthening transparency and accountability through which to control corruption. There is much room for these indices to improve: even small improvements in these indices will have positive effects on the business environment and economic activity of the entire economy.

Therefore, the PAPI has contents which, if paid proper attention, can quickly improve and are less complex than the remaining indices such as the issues related to administrative procedures or public service delivery. Conversely, some indices related to the awareness of authorities about the role of the people, of which the most important one is the quality of people participation in political life and local development, tend to decline significantly, with the index on "opportunities for participation" suffered the biggest declines.

The Government has made strong effort in providing public services, reforming administrative procedures and thereby somewhat reducing corruption in state agencies. These efforts have been recognized by people thus, contributing to the improvement of economic and institutional environment of the country.

3.5.4 Assessments from the Doing Business database

Capacity of the business environment creation of Vietnam is reflected through the Doing Business Index. The index made by the World Bank based on surveys in many countries worldwide, including Vietnam. In order to rank the distance of each economy to the best performer (DTF Distance to Frontier), the business environment of each economy is ranked from 0 to 100 score where 0 represents the worst level and 100 represents the implementation of the best economies. For example, when an economy has a score of 70 in the Doing business index in 2014, it means that the business environment of that economy is 30 percentage point apart from the most developed economy. In 2015, if the score of economy reaches 75, there is an improvement[31].

Regarding the overall DTF index from 2008 to 2013[32], the business environment of Vietnam has continuously reduced the gap with the economy having the best business environment. In 2008, the business environment of Vietnam was evaluated only at 59.4%the level of the economy having the best environment; in 2013 this indicator was 64.4%. This means that the score gap of the business environment of Vietnam with the best rate has narrowed from 40.6 percentage points (2010) to 35.6 percentage points (2013).

[31] For further information of Distance to frontier DTF access to http://www.doingbusiness.org/data/distance-to-frontier

[32] Report of the Business Environment Indicators is 2 years late. Report 2015 is based on data from the survey in 2013.

Table 5: The DTF of 10 sub-indices of Doing business

	Total	D1	D2	D3	D4	D5	D6	D7	D8	D9	D10
2008	59.44	74.46	83.12	55.8	80.24	68.75	30.00	44.03	72.62	66.08	19.33
2009	60.24	76.33	82.46	56.99	81.4	68.75	30.00	47.36	73.01	66.08	20.02
2010	60.31	76.50	83.31	58.54	81.39	68.75	33.33	43.99	73.44	66.08	17.74
2011	60.84	77.75	83.5	61.09	81.42	68.75	33.33	46.72	74.92	65.89	15
2012	64.11	77.39	83.58	62.17	81.43	65.00	46.67	43.61	75.37	65.89	39.97
2013	64.42	77.68	83.66	63.38	81.44	65.00	46.67	43.61	75.56	65.89	41.27

Source: http://www.doingbusiness.org/data .Data are updated according to the latest calculation methods of the World Bank. The sub-indices is D1 = Starting a business, D2 = Dealing with construction permit, D3 = Getting electricity, D4 = Registering property, D5 = Getting credit, D6 = Protecting minority investors, D7 = Paying taxes, D8 = Trading across borders, D9 = Enforcing contracts, D10 = Resolving insolvency.

Although Vietnam has improved the gap with the best economy, the extent of improvement was lower than in other countries. Thus, the ranking of Vietnam has not improved and tends to deteriorate. For example, the DTF index of Vietnam in 2013 was higher than in 2012 but the rank of Vietnam has dropped 6 places, from 78 to 72 (out of 189). Similarly, the DTF index of "Starting a business" also increased in 2013 but then Vietnam's rank dropped from 120 to 125. As such, the common trend of economies is that their business environments will converge to the optimum level, so if the pace of improvement of Vietnam's indicators is slow, Vietnam's ranking will be difficult to improve.

The Doing Business Report 2014-2015 of the World Bank has updated the data according to the new ranking method, and there are many changes in the ranking of Vietnam. For example, as reported in 2014 under the old calculation, Vietnam in 2012 ranked 99 out of 189 but according to the new ranking, Vietnam ranks 72 out of 189. Currently, the World Bank only calculates the ranking for two years 2012 and 2013 (in the 2013-2014 report and 2014-2015 report). Because the ranking in previous years have not been recalculated, we don't have the data series over time to compare the progress of business environment of Vietnam.

The data in Table 5 shows that most of the indicators of Vietnam have improved compared to the best economy, except for two indicators: "Getting credit" and "Paying taxes". These two indices barely improved and showed a downward trend in both 2011 and 2012. The "Getting credit" indicator worsened in the two years 2011 and 2012, due to the direct impact of the restructuring of the banking system discussed in the previous section. In both

2013 and 2014, the banking system has basically stabilized, interest rates plummeted, credit balance began to increase therefore it is possible to believe that this index will continue to improve in both 2013 and 2014.

Regarding the indicators of "Protecting minority investors", "Paying taxes", “Resolving insolvency”, Vietnam is far behind the best performer of these indicators. Therefore, to improve the business environment, Vietnam should focus on these indicators to be able to quickly improve rankings.

The weakness of Vietnam’s business environment was fully recognized by the Government and on March 17, 2014 the Government issued Resolution 19/NQ-CP launching the main measures to improve the business environment of Vietnam, improving national competitiveness in the period 2015-2016 with the objectives of: “Improving the business environment, promoting the reform of administrative procedures ... reforming comprehensively regulations on business conditions, professional administration of goods and services exported and imported towards post-check”. The objective of the resolution is to strive for achieving and exceeding the average level of ASEAN-6 countries group in terms of business environment in late 2015 andASEAN-4 in late 2016. To achieve the above objective, the Resolution set out 13 tasks, the overall solution and 80 specific solutions for ministries, agencies and localities. Some achievements were:

- *Regarding the Starting a business indicator*: business registration time reduces from 10 procedures down to 5 procedures and only needs 3 days to finish, exceeding the required target (Resolution 19 set a target of 6 days). Accordingly, the time required to start a business reduces to 17 days and the ranking improved from the 109th place to 37th (increased by 72 places), much higher than the average level of ASEAN 6 (99).

- *Regarding the Protecting minority investors indicator*: in accordance with international standards and good practice, scores of Protecting minority investors increased from 3.33 points to 6.2 points thanks to the reform of the Law on enterprises in 2014 and the index’s ranking should rise 105 places (from 157th place to 52nd), reaching the average level of ASEAN-6 group as required by the Resolution.

- *Regarding Paying Taxes and Social Insurance indicators* (SI): In 2014 and early 2015, it is expected to reduce the time required for tax payment by 380 hours (from 537 hours per year, to 157 hours per year). However, paying taxes still fail to meet requirements of the Resolution; the time needs to be reduced by a further 35.5 hours.

Along with the tax reform, the process of social insurance payments has been shortened. The time required to pay social insurance is projected to decline 100 hours, from 335 hours, to 235 hours, per year. This reduction is relatively far behind the target of 49.5 hours per year, so the SI should continue to reduce further 185.5 hours.

The total time needed to pay taxes and social insurance is expected to fall by 480 hours and the ranking should improve 27 places, from 149th to 122nd. However, this position is still much lower than the average level of ASEAN-6 (67th).

- *Regarding Getting Electricity Indicator*: the Ministry of Industry and Trade, Electricity of Vietnam Group have issued documents to shorten the time for getting electricity. Thus, the time needed to access power has been reduced for about 30 days, from 115 days to 85 days, and the ranking should improve by 12 places (from 156th to 144th). However, the reduced time fails to match the requirement in the resolution which requires a further reduction of 15 days.

- *Regarding Trade across borders indicator:* the Ministry of Finance, the General Department of Customs have reviewed and amended some related regulations and policies, addressing problems related to customs procedures for businesses. However, import and export procedures for goods are not just the responsibility of the Ministry of Finance, the General Department of Customs but also the responsibility of line management ministries and agencies. In 2014, not many ministries focused on improving line management procedures, so this indicator has not improved markedly.

The new Investment Law and the Law on Enterprises have now drastically improved the investment climate. Under these laws, 3,299 business conditions prescribed in 170 circulars and decisions of ministries will be abolished from July 1, 2016.

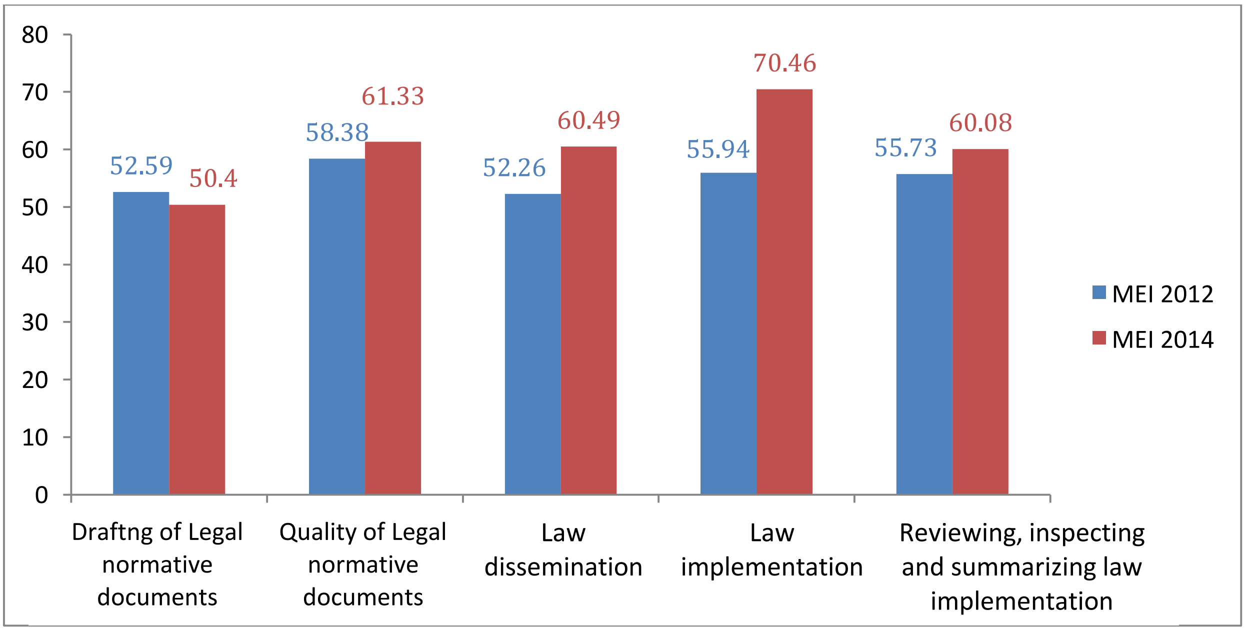
3.5.5 Ministerial Efficiency Index on business law development and implementation in 2014

Since 2011, the Vietnam Chamber of Commerce and Industry has held surveys to collect opinions of 228 national and provincial-level business associations on the Efficiency Index of 14 ministries on business law development and implementation. The survey focuses on a set of 5 independent indices, namely: Drafting of Legal normative documents (LND); Quality of LND; Making information available to public, law dissemination; Law implementation; Review, inspecting, and summarizing law implementation.

Survey respondents were business associations, therefore the survey may not directly reflect the assessment of business community, but to a certain extent it still shows the business community's perception towards the effectiveness of the governance of ministries in the government apparatus.

A 2014 survey shows that there has been a positive change in the direction of ministries in the legal normative documents development and implementation since 2012. Particularly, the average score of the 14 ministries in 2014 has increased in 4 out of 5 indices, with an average increase of 10.1% compared to the corresponding the average score in MEI 2012. Only the Drafting of Legal normative documents index reduced compared to 2012 (Figure 46).

Figure 46: Comparison of results of MEI 2014 and MEI 2012



Source: http://mei.vibonline.com.vn/Surveys/Index.aspx.

It is notable that the index on making information available to public and law dissemination and the law implementation index clearly improved in all 14 ministries surveyed. The latter has made significant progress as recognized by the business associations, increasing by 14.5 percentage points compared with 2012 survey. The index on reviewing, inspecting, summarizing law implementation also increased in 13 ministries. The Quality of LND Index increased by 8 percentage points and 13 out of 14 ministries are recognized as having made progress, in which strong improvement was recorded in the State

Bank, Ministry of Planning and Investment, the Ministry of Industry and Trade, and the Ministry of Transport.

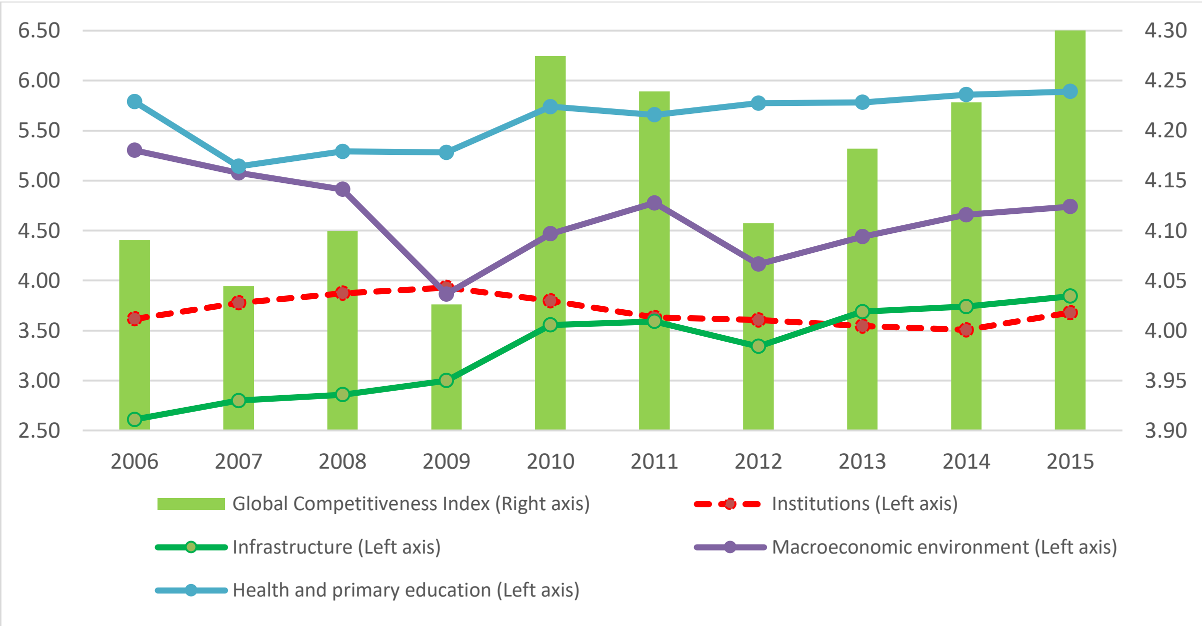
The positive change in the assessment of business associations on government agencies shows that there have been positive changes in the administration and operation of the line ministries.

3.5.6 Competitiveness Index

As reported by the World Economic Forum, the National Competitiveness Index of Vietnam has continuously improved in 4 years from 2012 to 2015 in both ranking and score. The National Competitiveness Index of Vietnam in 2015 was ranked 56, improving 19 places compared with 2012.

In terms of scores, in 2015 Vietnam has surpassed the level in 2009 - the best ranking ever of Vietnam (Figure 47). With the significant progress and economic recovery in 2014 and 2015, it is reasonable to believe that the competitiveness of Vietnam will continue to improve.

Figure 47: Score of national competitiveness (scale of 7) and the basic components

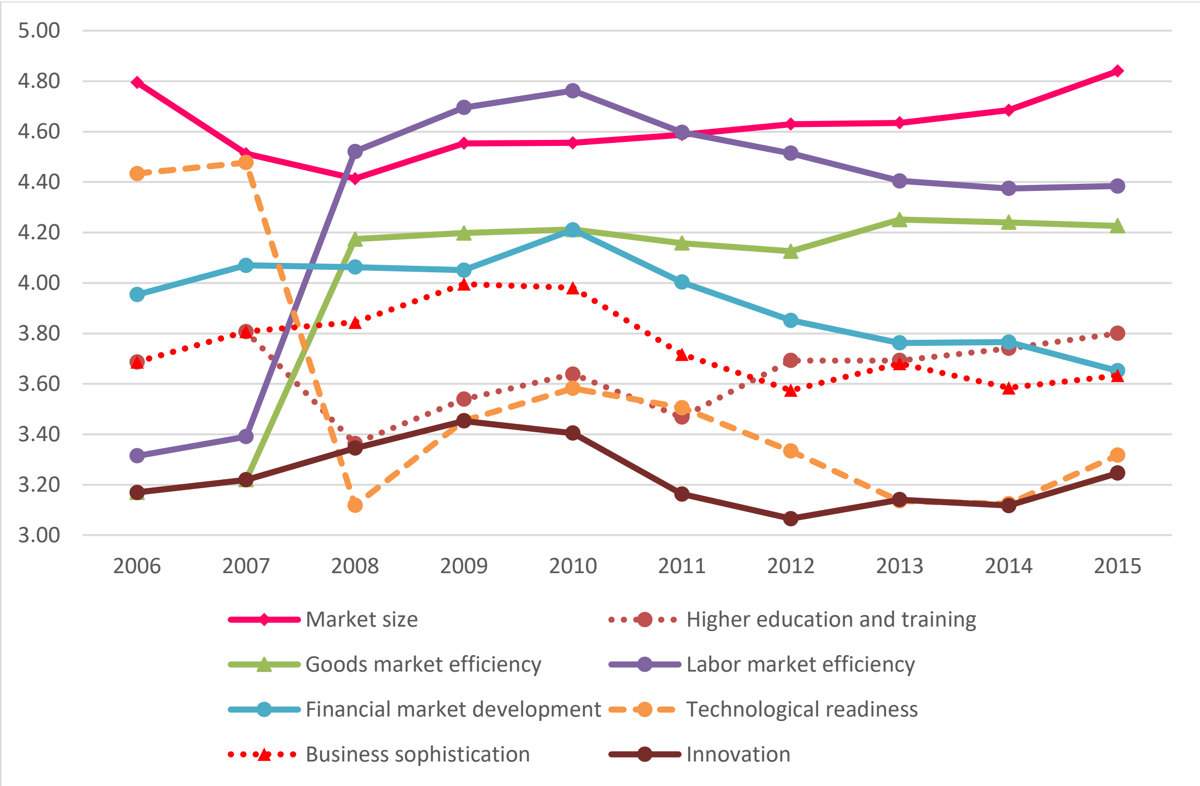


Source: World Economic Forum, Annual reports of The Global Competitiveness Index GCI. National competitiveness index referenced to the right axis.

Figure 47 shows that among the basic factors, despite low score, the Infrastructure index has increased continuously from 2005 to present and from 2012 it has surpassed the average score of 3.3. The Health and primary education index is always among the good performing group of the world and still shows the progressive trend over the years. Only the Macroeconomic environment index fluctuated erratically in 2008 and 2012, but from 2012 to present, this index has shown a stable upward trend despite its modest increase.

Regarding efficiency enhancers, only three pillars tend to rise from 2006 to the present: Market size; Goods market efficiency and Higher education and training. However, three pillars significantly reduced in scores were: Financial market development, Labour market efficiency, and the Technological readiness (Figure 48).

Figure 48: Efficiency-driven factors



Source: Calculated from WEF database.

These are limitations of Vietnam's economy which need to be improved in the coming time. Among them, the Financial market development pillar depends on the restructuring process of the system of credit institutions and securities markets. Recent changes in the banking market and the amended Decree 58 providing regulations on the stock market are expected to improve the scores of this index. Labour market is inefficient as long as wage is not a signal of the scarcity of skills in the market. The market for highly-skilled workers has not developed, thus failing to meet market demand. Linkage between education institutions and businesses remains weak; consequently, the quality of trained labour does not meet the requirements of the market. The labour market does not give signal or put necessary pressures to minimize the discrepancy between skills trained in schools and the skills that enterprises need. Similarly, the readiness of technology cannot change quickly while production in Vietnam is still fragmented and largely based on cheap labour, without linkage in manufacturing value chain to form clusters from which to develop supporting industries.

Two pillars on Innovation and Business sophistication of Vietnam plummeted from 2008 to 2012 and from 2012 to the present have only improved slightly. The process of economic restructuring should change towards shifting from production based on unskilled and cheap labour, low productivity to that based on skilled labour, higher productivity, thereby gradually improving the readiness of technology, the level of innovation and the sophistication of business.

4 CONCLUSION

4.1 Remarkable results

Vietnam’s economic restructuring process recently has achieved some remarkable results. The macroeconomy has been stabilized. The sovereign risk index has increased, the business environment has improved. Market response has been quite positive. The trend of economic growth is steady. The investment efficiency, labour productivity and total factor productivity have improved noticeably. The contribution of shifts in economic structure on improvements in labour productivity improvement is now measurable. Business environment and investment environment have been strongly improved through the approval of the Law on Enterprises and the Law on Investment, as has been recognized by many international organizations. It is likely that the ranking of Vietnam will continue to improve in the following years. Activities of public investment, of state-owned enterprises, and of commercial banks have been more transparent with stronger monitoring. State budget’s revenue structure is experiencing positive change; revenue has been increasing sustainably despite the decreasing contribution from the economy , thus creating better condition for enterprise development. Resource allocation still depends on the banking system; however, the role of stock exchange market has been increasing even in the most difficult time of the economy. The shift of investment in the stock exchange market is remarkable. The high value-added sectors are well-received by the market in terms of the number of transactions and their sizes.

4.2 Weaknesses

The biggest objective of restructuring the economy is to improve the efficiency of using available resources and to create new resources in the development process. To achieve this, the most important solution is resource allocation based on market signal and market mechanism. Although the achievements of the restructuring process are very encouraging, the system of resource allocation is still strongly affected by the hand of the state; therefore, the achieved efficiency has not met the expectations.

4.2.1 Restructuring commercial banks

First, the credit system is still a bottleneck in the banking system; the high demand for public investment is “crowding-out” private investment: Capital in the banking market is being transferred vigorously to the bond market; private investment is crowded out by public investment.

Second, using VAMC as a mechanism to reduce NPLs seems inefficient because NPLs remain, and the banks have to push the cost of reducing NPLs to the public (enterprises and depositors). Consequently, the real lending interest rates are too high, limiting the access to credit of enterprises; at the same time, because the banks do not have to pay the prices for the process of addressing NPLs, although NPLs are still high, the profits of commercial banks have continuously increased. A number of important issues have not been addressed: how large are these NPLs and where are they? Where are the financial sources to handle NPLs and offset the lost capital of credit institutions? It is necessary to form market institutions for selling and buying debts so that sellers can sell and buyers can buy based on market mechanism. In the coming time, there should be comprehensive solutions to address the problems of non-performing loans and to reduce lending interest in order to free the resources of the enterprises and the economy.

Third, the operation mechanism of VAMC lacks transparency and resources to address NPLs. The lack of transparency of VAMC is limiting the formation of a true NPL selling and buying market. Because in this market, VAMC have the information asymmetry advantage while buyers of NPLs do not have access to sufficient information. Therefore, it is difficult for sellers and buyers to meet each other. Once they are not provided enough information, the buyers will find it difficult to offer reasonable prices because the market cannot form mechanism of identifying the price of NPLs.

4.2.2 Restructuring public investment

First, restructuring public investment has stopped only at increasing public discipline, and has not focused on the solutions of enhancing the efficiency of public investment and avoiding waste. The Law on Bidding and the Decree on Public Partnership have created an important legal platform able to apply the market principles in public investment allocation. However, till now, those laws have not gone into practice because of lack of guiding documents. Ministries, sector agencies, local authorities have not formed consistent criteria in order to allocate, monitor, and evaluate the source of public investment; hence, till now, the efficiency of public investment is still an issue that has not been addressed.

Second, public investment discipline is still loose. Although there are legal documents providing strict and clear stipulations on this issue and numerous directives of the Prime Minister have been issued continuously in a short period of time on the same matter, many local authorities have been violating and not implemented those directives. The public investment procedures based on efficiency have not been formed.

Third, the standard public investment steps as described in Figure 12 have not been implemented fully and strictly. Regarding the first step, for the Central level, the most significant basis for the decisions of public investment is the Socio-Economic Development Strategy, the Socio-Economic Development Plan, and the 5-year Socio-Economic Development Plan. For ministerial, ministerial-equivalent and local levels, the main basis is the local socio-economic development master plan, and the local 5-year and annual development plans.

The strategic guidelines and orientations are usually vague and thus almost all public investment projects can be argued to be consistent with the strategic directions. For socio-economic development master plan, there is still no Law on Planning. Consequently, disruptions and amendments of planning occur frequently. This means that the basis for applying investment policy is not fixed as planned but can be flexibly tailored towards applicants' desires. Thus, the second step of initial assessment which should remove public investment proposals that are not in line with the basis in the first step, is often very loose. Moreover, we have yet to have the criteria to assess whether a project can call for investment from private investors or not. The principle that only when private investors do not invest the state will, is hardly raised in public investment decisions.

Regarding the third step on evaluating the socio-economic efficiency of the project, public investment projects are often supervised and appraised by the Department of Supervision and Appraisal of the Ministry of Planning and Investment. However, it is virtually impossible for this Department to ensure strict supervision and appraisal for large-scale public investment. Moreover, at this stage there is no appearance of contractors, thus there is still no bidding costs offered by contractors. Without bidding costs, the appraisal of the socio-economic efficiency of a project is merely procedural and not based on scientific basis. Therefore, the review of appraisal results in step 4[33] is often easily bypassed. Consequently, public investment was implemented in a very fragmented manner, and beyond the capacity of the government, public debt

[33] Usually approved by National Assembly if it is a national-level important project, or by the Prime Minister if the project belongs to group A, and by the People's Councils at all levels or heads of minitry-level bodies.

increased continuously with huge unsettled debts from infrastructural development.

After dividing the investment quota to managing agencies, these agencies select contractors and appraise projects. Most public investment projects are run by state-owned enterprises, while the agencies select, approve, supervise these projects are the governing bodies of these enterprises. This creates the chance for collusion between the authorities and enterprises for profit. Also, enterprises do not have the pressure required to reduce the cost of the project. This pushes up the implementation cost of public investment projects.

For the project implemented in the form of public-private partnership (PPP), due to the lack of a specialized agency for appraisal, assessment of investment efficiency, cost of the project, enterprises tend to declare higher investment costs for large profits. Recently, commercial banks have increased their lending to PPP projects because of the super profits from these projects.

Finally, public investment projects have so far hardly undergone the step of project supervision, performance evaluation, and comparison between actual and appraised socio-economic efficiency. This is an extremely important steps in order to point out the weaknesses and loopholes in the implementation process of public investment, and to point out accountabilities in cases of wasteful and inefficient investment projects. Unless the country performs and publicizes post-investment results, it is very difficult for Vietnam to restructure public investment successfully.

Third, the risk of macroeconomic instability is still there especially resulting from the quickly increase in public debt. Factors promoting public debts are very visible:

- A viewpoint that the state directly intervenes into the economy through public investment remains visible. The ratio of budget revenues/GDP has decreasing trend while the demand for public investment has not decreased.
- Public investment does not focus on the investment efficiency and cost saving factors. The investment approval process, especially between the managing agencies and affiliated enterprises, is under no independent monitoring and thus opens opportunities for corruption and pushes up investment costs. Table 6 shows that the cost of building 1km of road in Vietnam is among the world's highest.

Table 6: Cost of building 1km of 40-59 mm-thick asphalt road in some countries

Country	Cost/1km	Implemented year	Country	Cost/1km	Implemented year
Paraguay	31.2	2005	Philippines	60.8	2006
India	45.6	2006	Bosnia and Herzegovina	61.9	2006
Bulgaria	40.7	2006	Nepal	63.1	2006
Ecuador	41.6	2005	Botswana	68	2006
India	45.6	2005	Nigeria	73	2007
Burkina Faso	48	2007	Argentina	76.2	2006
Brazil	55.2	2006	Georgia	84.9	2005
Thailand	59.5	2005	Vietnam	85.4	2005

Source: Paul Collier et al (2015), Table 2, page 31.

- The state budget has to fund for a cumbersome and ineffective state apparatus, therefore state budget revenues cannot meet the demand for current expenditure, creating the risk of budget deficit more serious in order to offset the increasing public debts.
- Liquidity surplus, high lending interest rate have resulted in narrowing the private investment in order to promote the growth based on the expanding view of that the state leads public investment (the government bonds), while the public investment efficiency is not improved, public debts will increase.
- Public investment discipline remains loose; the high liability of paying remaining debts for basic construction investment results in increased public investment costs and liability.
- The ratio of state budget revenues to GDP is declining; increasing current expenditure to GDP is consuming an increased share of revenues, while the state must continue pay for development investment.

4.2.3 Restructuring state-owned enterprises

In terms of restructuring state-owned enterprises, the pace of equitization is still slow. In addition, the quality of equitization still has many problems. Some enterprises have been transformed formally from state-owned enterprises to joint stock companies. However, the equity sold to private sector is very small; either there are no strategic investor who are strong enough to change the management mechanism of the enterprises, or the buyers are also state-owned enterprises. That means at enterprise level, they are joint stock companies but for the whole system of cross-ownership among enterprises, the whole group is still state-owned enterprise. The key reason for the slow equitization process of state-owned enterprise is the mechanism in which managing agencies are also state management agencies. The enterprise owners do not focus on making profits for enterprises, but rather using them for political objectives. While managing agencies are supposed to ensure fair business environment and monitor the legal regulation compliance of the enterprises, in fact, they have motivation to create unfair advantages for those enterprises. Management ministries and provincial people's committees benefiting from state-owned enterprises will not support the separation of state-owned enterprises from their management scope. Therefore, as long as the functions of ownership and state management are not separated, the process of restructuring state-owned enterprises is only formal.

The biggest limitation and weakness of state-owned enterprises currently is that the operation mechanism of state-owned enterprises in general and management institution of state-owned enterprises in particular are not completely in line with market mechanism. This severely affects the efficiency of state-owned enterprises and the process of forming a full market economy in Vietnam:

First, the current institutions still create many advantages for state-owned enterprises in access to resources compared to private enterprises. State-owned enterprises, although few in number, receive large flow of resources from the state. Therefore, they hold the dominant position in important markets, such as: energy, extraction, telecommunication, infrastructure service supply, etc.; The lack of competition not only fails to create the pressure to improve the competitiveness of state-owned enterprises, but also negatively affects the interests of consumers of those markets. Further, the current dominant position of state-owned enterprises as well as the support from the state owners help state-owned enterprises to easily access financial resource and other resources[34], creating market distortions of production inputs. Many studies in Vietnam have shown that unfair access to resources, which creates the dominant position of state-owned enterprises, have not only failed to re-allocate resources more efficiently in the process of restructuring, but also made the current weaknesses of economic structure more serious.

Second, in terms of competition, some activities of state-owned enterprises have not been in line with market mechanism. Many state-owned enterprises have the price advantage because their cost calculation does not reflect the full cost of using resources. In many cases, the principles of financial discipline and hard budget constraint of state-owned enterprises have not been fully implemented, particularly that (i) some state-owned enterprises which are not able to pay their debts have been written off, cleared, transferred, paid for(including even tax liability); (ii) most state-owned enterprises do not have to face the pressure of paying dividend like normal enterprises and only need to make profit; (iii) the capital cost for state-owned enterprises is lower than the market prices; (iii) thorough consideration of opportunity cost is rarely paid attention;... This has negatively affected the efficiency of the market and the market relationships of other business sectors.

Third, although Vietnam has made efforts in issuing quite numerous regulations, enterprise management still have a lot of problems, namely: (i) The monitoring system on state-owned enterprises has yet to become a tool for state owner, relevant partners, and the people to be informed the operation status of state-owned enterprises in time in order to make timely and reasonable decisions to address the weaknesses and improve the business efficiency of SOEs; (ii) current monitoring mechanism lacks warning and preventive system for state-owned enterprises' weaknesses in production and business as well as for risks caused by SOEs, especially the risks of concentrating too much resources on some large scale SOEs, creating market distortions and the problem of "too big too fail"; (iii) Price setting mechanism and cost calculation lack transparency in information, especially in the markets that state-owned enterprises that hold monopoly or dominant position, raising market transaction cost and creating distortions in business and competition relationships; (iv) state-owned enterprises are constrained in their rights of autonomy and and self-responsibility; (vi) the regime of management by public staff has not created

[34] May 2014, the state borowed the ADB 320 million USD to restructure financial status for 3 state-owned enterprises, including Song Da corporation, No 1 Construction corporation, and Vietnam Garment and Textile Group.

motivation to improve state-owned enterprise management; (vii) the accountability of people who protect the interests of state owners at state-owned enterprises is still low, etc.

The main reason of the above mentioned problems is the improper mindset and behavior of the state, especially from the organization model of implementing ownership function of the state.

State-owned enterprises have not fully operated based on market mechanism mainly because of the mindset and behavior of the state, which gives preferential treatment to and loose financial disciplines without close monitoring for state-owned enterprises. These mindset and behavior stem from the incompatible positioning of state's functions and mandates in the context of reforming market institutions (the state has assigned state-owned enterprises to ensure the leading role of state economic sector in the economy; using the state-owned enterprises as a tool for stabilizing the macroeconomy and a material force for the state to operate the economy).

In order to help the state implement the above role, the state has supported and created advantages for state-owned enterprises to access financial resource, land, and other resources. This is also the reason for not applying financial discipline and market discipline for state-owned enterprises. At the same time, the mindset that views state-owned enterprises as a tool for the state to operate the economy has made state-owned enterprises become a part of state management function. In addition, state-owned enterprises in general always get crucial position in the system of economic institutions, having been assigned to hold the central role in implementing strategies, master plans of all national economic sectors. This has created a vested interest between the state apparatus and state-owned enterprises, making this apparatus not concentrate and not specialize in implementing the role of state management effectively and efficiently.

On the other hand, the model of implementing the function of ownership in Vietnam, compared to international practice, has 3 big problems:

First, there has not been a separation between the function of ownership and the function of state management, operating the market of state administrative agencies.

Second, there has been no concentration or consistency in implementing the function of state ownership at state owned enterprises.

Third, the apparatus and staff implementing the function of ownership representative of state are not specialized and are unprofessional. The above problems have resulted in that the preconditions for a level playing field for every enterprise have not been formed; they are direct reasons of continuously reducing the effectiveness and efficiency of state owner’s management and the operation mechanism of state-owned enterprises has not been fully under the effect of market mechanism.

4.2.4 Regional restructuring

The restructuring of regions and industries has neither been relevant in practice, nor complied with the market principles of regional linkage. We need to change the approach to construct regional linkage following the market principles: enterprise must be willing to change with the support from state. Issues such as the distribution and input markets for agriculture still do not have any specific solutions. The Ministry and other agencies of industry and trade were fairly generic without specific monitoring criteria. The strategy for cooperation between trading and industrial sectors in order to create the strong linkage for clusters is the important competitive tool in the globalization era that has not been mentioned.

The urbanization and megacity issues have been putting a great burdened pressure on the capacity of the infrastructure in the two major cities including Hanoi and Ho Chi Minh City. The continued development of these megacities will increase the living cost and the production costs there. The model of developing megacities will also lead to many social issues such as disparity. Thus, the process of economic restructuring must be done in parallel with the regional institution building in order to strengthen the regional links, reduce the burden for megacities and promote the balance development of all regions in the country.

4.2.5 Revising economic institutions

The recent institutional reform has only scratched the surface through administrative reform, and the reform of specialized laws, etc. We have achieved some successes in creating a better business environment with less state intervention. However, comparing with other countries in the region, our reforms are not enough to create a conductive business environment. The indexes of business environment and governance administration in Vietnam are still very low.

The institutional problems of adjusting the internal relations of the state apparatus have not been discussed. Currently, Vietnam is facing a major challenge of fragmented decision-making process. Therefore, when a decision negatively affects the economy, it is hard to hold anyone accountable. Moreover, regarding the interdisciplinary issues, the coordination between state agencies is very ineffective, thus the decision-making process is always slow and overlapped.

The decentralization process lacks effective supervision and the overall coordination from the state, which leads to the dispersed and duplicated investment as well as failure to take advantage of each other's findings. For example, the budget allocated for science and technology departments in all 13 provinces of the Mekong Delta is equal; therefore, if all provinces did the research for aquaculture, they would find 13 similar findings. In order to promote the application of science and technology in locality, it is necessary to reorganize the State management agency on science and technology vertically. The dispersed investments in economic zones, industrial parks, airports, seaports are another examples for the consequences of decentralization without efficient supervision.

The Vietnamese government is not organized under the “3 separate branches of power” model; therefore, monitoring systems and cross-examining each other is unclear. Market economic institutions require fairness and transparency in the state operation. Thus, it is necessary to have suitable monitoring and supervision system to the political institutions of Vietnam. Organizations with oversight functions such as the Central Inspection Commission of the Communist Party, government inspectorates, the state audit, and internal audit for local governments need to have independent regulations to prevent their monitoring and inspecting results from being influenced by public agencies.

The Ministry of Finance’s survey in the period 2006-2014 showed that approximately 1800 units of the Ministry of Finance used the state budget but only 5% of them underwent annual internal audit. The proportion of these units monitored by external bodies (Government Inspectorate, the State Auditor, Inspector of the Ministry of Finance) from 2010 until now is always below 4%. These data show that the monitoring and supervision from the state is very low (Table 7).

Table 7: Percentage of monitoring and supervision at Ministry of Finance’s units

	2006	2007	2008	2009	2010	2011	2012	2013	2014
Interal	1.85	2.62	3.22	2.98	3.51	3.50	4.51	3.91	4.33
External	0.00	2.90	9.56	5.48	3.13	3.39	1.72	3.48	3.80

Source: Nguyen Duc Tho (2015).

Even at the state management agency on budget and public debt, the rate of monitoring and supervision is still below the statistical significant level[35]. The shortage of effective monitoring mechanism in state agencies is very common. This seriously weakens the institutions of a law-based state and the fact that local authorities ignore the Prime Minister's directives is a clear example.

4.2.5.2 Some weaknesses

Market participants: Although market participants in Vietnam are completely similar to most other countries', including social market economies or free market economies, enterprises and people highly evaluate the level and the right to do business freely, but there still remains some problems: First, there is an overlap in the contents of the regulations on business in the Enterprise Law which significantly restrict the freedom of doing business of related enterprises; Second, doing business conditions are still quite complex, fragmented, scattered in many different documents, adding to risks, increasing costs and significantly restricting the access to business opportunities of people and businesses.

Sustainability of Policy Environment: Policies and laws are constantly changing, instable, lack of transparency and fairness, unprecedented, making it difficult for businesses, creating tremendous legal risk for with investment, doing business; etc.

Regarding freedom of contracting and commercial dispute resolution: It can be said that market participants in Vietnam now have rights and are guaranteed freedom of contracting. However, stability, certainty and the validity of the contract as the means to carry out commercial transactions is weak. In particular, the effectiveness and efficiency of contract enforcement and dispute resolution is relatively limited. Effectiveness of commercial contracts dispute resolution is one of the 10 indicators of the quality and competitiveness of the business environment. Court or arbitration is not currently a priority tool to use in resolving disputes, including trade disputes.

Land ownership and allocation, usage: Although there have been many important innovations on land law and the law enforcement on the ownership and usage of land in Vietnam has three bottlenecks. First, the provisions on

[35] According to statistic principle, if the rate of monitoring is under 5%, we can condsider that there is no inspection with 95% reliability.

ownership and land ownership is unclear and unspecific; enforcement and protection of property rights of land ownership to the people, especially for farmers is very weak and ineffective; Second, there is no primary market for land use rights; land allocation, land lease, etc. are implemented by administrative measures; and third, the secondary market for land is very limited, misleading and often prone to speculation, etc.

About SOE: Compared with the basic requirements of a modern market economy, the SOE, the ownership regime and the way of the implementation of state ownership in the enterprises remains some shortages need to be "filled": Firstly, the SOE sector in Vietnam is still very large and is investing and operating in almost all lines of the economy; Second, the purpose, role and mission of the SOEs in the economy is unclear, some are incompatible with the basic requirements of full and modern market economy institutions; Third, the way the state uses SOEs as a tool for macroeconomic stability is not only incompatible with market economy institutions, but also can create macroeconomic volatility over the medium and long terms; Fourth, SOEs are closed company, have priority access to loans for investment and development; not driven by competition for capital markets access and not be punished by the market competition; Fifth, SOEs still enjoy A "soft budget constraint" mechanism, not fully governed by market rules and discipline; Sixth, the regime for SOE ownership, investment capital and the method of implementation of the state ownership rights in enterprises is unclear, dispersed and fragmented.

Mobilization and allocation of public investment: Despite the fact that state investment capital mobilization has already been implemented in line with the market, but the allocation is still administrative and does adequately not take into account the principles and laws of the market; distorting the allocation of not only the state capital but almost the entire social capital.

4.3 Economic restructuring in the period 2016-2020

4.3.1 Macroeconomic Stability

So far, the restructuring process has only been implemented the first pillar of the three focuses of the economic restructuring process as shown in Figure 1 on the basis of macroeconomic stability. However, macroeconomic stability is now only in the financial and monetary markets, whereas the stability in three remaining pillars of macroeconomy which are fiscal stability, market stability and policy environment stability have not yet been achieved.

During the period 2016-2020, macroeconomic stability should continue to be maintained in all four pillars: monetary stability, financial stability, market stability and policy environment stability. For monetary stability, the system of credit institutions should continue to be restructured towards increasing the efficiency and safety coefficient of the system, diversification of financial products and maintain low inflation and moderate interest lending around 5%. The risk of financial instability is very high while public debt has continued to increase, the need for regular expenditures exceeds revenues, and the room for development investment narrowed sharply. In the period 2016-2020, fiscal discipline should be emphasized, regular expenditures should be reduced, budget deficit should be maintained by 4% of GDP and public debt below 65% of GDP.

Regarding market stability, export and import markets should be diversified to avoid excessive dependency on a certain market, especially the Chinese market. Developing the market for the products of supporting industry as a prerequisite to the development of supporting industries, increasing autonomy in terms of machines and equipment, input raw materials for the production process in Vietnam.

For policy environmental, it is necessary to be fully aware of the viewpoints to change policy only in favor of enterprises and investors, limiting the operating state management through volatile bylaws. This policy must be linked to the process of institutional reform of economic management in the period 2016-2020.

4.3.2 **Continuing to restructure public investment, credit institutions and SOEs**

*4.3.2.1 **Public Investment***

Performing the allocation of public investment in the framework of the medium-term investment. Renewing the supervision and appraisal organizational apparatus towards organizing specialized councils advising for supervising and appraising agencies. Expanding the supervision and appraisal function in criteria such as investment efficiency and economy rather than just focusing on supervising the compliance with investment process.

Dealing with capital construction debts more drastically, strengthening discipline of the implementation of instructions, decisions, decrees and other legal documents in the terms of implementation of public investment and budget laws country. Widespread budget violations, ignorance of the instructions of the Prime Minister in public investment are manifestations of capacity weaknesses of the government apparatus in policy implementation.

Due to public investment using tax paid by the people, so people have the right to know that how that money is used. For public investment, it is necessary to publicize online the specific norms for public investment projects. The investment projects are required to audit and the audit results must be publicized on the internet. These rules are mandated also apply to projects implemented in the form of public-private partnership....

Developing mechanisms of open competition of public investment between agencies using public investment capital. Also forming the mechanism to assess the socio-economic efficiency after the project went into operation compared with expected efficiency in the project file and comparisons between localities, agencies using public investment capital. From which we can find out the holes in public investment processes and screening the ineffective public investment capital users.

4.3.2.2 Credit institutions

For the restructuring of credit institutions: there is a need to quickly resolve NPLs outside commercial banks' balance sheet system and to be able to pull down interest rates to the average level of developed countries which is about 5%. Quickly applying the standard system of commercial bank administration under the Basel II standards. Developing trading market of financial derivatives products such as futures market, hedged foreign exchange market, hedged interest rate, debt trading market etc ... Increasing the transparency and publicity of activities of the state bank to ensure adequate supply of information for the participants in the market while ensuring the safety of the system.

*4.3.2.3 **Promoting regional linkage***

Building regional links, industry clusters as an important competitive instrument for enterprises in the globalization era. Innovating the approach of regional linkage towards encouraging the enterprises first and support them with the government policies. The linkage should come from the enterprises themselves and the state only serves to minimize risks and costs of forming regional linkages and industrial clusters that are newly formed by enterprises....

*4.3.2.4 **State Owned Enterprise***

SOE reform in the coming period should focus on reforming institutions and the governance of SOEs and state management on SOEs must fully comply with market principles and fair competition with enterprises of other economic sectors. Applying strictly the principle of hard budget for SOEs. Proceeding the equitization of SOEs essentially with the participation of the private sector and foreign investors, not only including the cross-ownership among SOEs. Specifically, the institutional innovation orientation of SOEs governance are listed below.

4.3.3 Institutional renewal towards modern market economy institutions

Market economy institutions are the institutions that promote principles and rules of the market; from which, the market will perform better its role in allocating resources from surplus to deficit area, from less efficient usage to more efficient usage. Under that interpretation, market economy institutions include institutions of property and property rights, institutions on market entry, market transactions, market orders and disciplines, and finally, the institutions of the market withdrawal.

In the market economy, the government has a number of functions, but the most important is the creation of institutions for the effective and orderly operation of markets; arbitrating and supervising the market for transactions between household and business sectors is conducted fairly and effectively. The difference among types of various market economy primarily are in the role of state and market and the relationship between these two factors. Regarding the role of the state, not only scale but the objectives, the tools and the way to intervene, the way to perform the role of the state are more important. The role and behavior of the State must be "normalized" in accordance with requirements and rules of the market, especially in resolving the relationship between markets, people and businesses. "Standardisation of state behavior" is measured or determined through three contents: the scale of state, the degree of state intervention and how the the state intervenes. Institutional reform is the establishment, supplement and revision of the system of rules, first of all the official rules to implement the transition mentioned above. Thus, institutional reform is conducted fast or slowly, in the large or small scale depending on whether the state really wants to change its role, position and functions. Institutional breakthroughs needed for the transition to a market economy when there are "bottlenecks" or "knots"; and institutional breakthroughs only happen when appropriate institutions are established in a timely manner, with sufficient scale and strength to remove these bottlenecks and congestion points.

4.3.3.1 *Institutional development of modern market economy*

Reform the awareness and clarifying the contents of some of the basic concepts of the next reform process, including the concept of a socialist oriented market economy; political reform must be consistent and accompany economic reforms; with institutional reforms and institutional breakthroughs.

Reform and remove institutional bottlenecks which distort the market and creating room for bribery, corruption and crony capitalism, including: First, ensuring the freedom of business and facilitating business activities; Second, ensuring the transparency, consistency and predictability of the law; applying directly the provisions of Constitution, laws and ordinances; minimizing the risks for people and businesses; enhancing the trust of citizens and businesses for the law and policies; Third, enhancing the stability, certainty and predictability of commercial and civil contracts; Fourth, enhancing the effectiveness and efficiency of the settlement of contractual disputes.

Apply fully market mechanisms and principles in allocating state investment capital, including: First, reforming the institutions in allocating state investment capital cannot be separated from the role of reform of state in general and the role and functions of each particular state agencies in particular; from decentralization between the central and local government towards narrowing the role and functions of the state; Second, reforming the motivation, criteria and methods of assessing the performance of local government;

Thirdly, define and implement strictly budgetary disciplines (hard budget constraints) at all levels, for all expenditures, including capital expenditures for development; Fourth, reduce and tighten regular spending of government agencies; reducing the budget deficit down to less than 4% of GDP and continuing to reduce the rate in the medium and long term; stepping up national financial reserves to cope with the big "shock" from the outside;

Fifth, determine and apply strictly criteria for evaluating socio-economic efficiency of investment projects, including the capital cost and the opportunity cost of investment to choose tasks and priority order of projects; assessing the benefits and costs of each project and only selecting and approving the projects with highest socio-economic efficiency among the proposed project consistent with the balance of funds in the medium-term investment plan;

Sixth, prescribing the minimum level of tendering value and the minimum value must be sufficient to take advantage of economies of scale, reducing management costs; Seventh, establishing the united nationwide information management systems of public investment; providing open and transparent information on state investment in general and each state investment projects in particular.

Removing basic bottlenecks in institutions to form, and operate normally, a competitive land use rights market.

Reforming SOEs through both mandatory measures and the provision of favourable conditions for SOEs to manage and operate in accordance with law and disciplines of the market, which continue to: First, change the mindset on the role and functions of SOE; Second, reform the implementation model of state ownership rights through the establishment of specialized agencies, implement directly state ownership rights in enterprises, perform the role of investors, shareholders or members in companies having state ownership consistent with the ownership structure of companies similar to other shareholders and members. Other organs of the state do not directly involve in the decision-making and governance in SOEs; respect the autonomy and professionalism of the Management Board; not interfere in any manner in investment and business activities of the enterprise; Third, the state must have a clear, detailed, transparent and consistent ownership policy. This is necessary to identify and separate "ownership" policy with other policies of the state; Separate the business goals with social missions; in case the governing bodies assign the SOE one or several social missions, the missions must be accounted separately, openly and transparently; Fourthly, adopt adequate market disciplines and hard budget regime for SOEs; Fifth, establish an owner management information systems separated and differentiated from the state management information system; Sixth, conduct multidimensional and multi-level performance monitoring for the SOEs sector in general and for each SOE in particular; Seventh, reform the mechanism and manner of state inspections for SOE, tackle the overlapping, duplication and conflict between inspection of the state management function and inspection of implementation of the right of state ownership; Eighth, publicize and disclose information of SOEs, especially the economic groups, state corporations according to the good standards and practices, similar to listed joint stock companies; Ninth, change the mindset and method of payment of salaries and other benefits for the management of SOEs.

Establish competitive energy market institutions, enhance the supervising capacity of the state for natural monopoly by restructuring the Ministry of Industry and Trade, splitting EVN into 3 parts (power generation, transmission and distribution of electricity), and implement the mechanism to competitively negotiate prices using market mechanisms, and liberalize fuel and oil markets, etc.

Reform the fundamental role, functions, organizational structure, and working methods to improve the capacity of government.

4.3.4 Break through two important bottlenecks

Besides building market economy institutions, two important bottlenecks in economic growth in Vietnam it is the quality of human resources and the status of social infrastructure which has yet to produce significant breakthroughs. In the coming period, the country should accelerate the implementation of public private partnership mechanisms to mobilize the participation of all economic sectors in the construction of social infrastructure. Building the necessary legal framework to perform securitization of investments in infrastructure to mobilize idle resources from all people, not just for potential investors as under PPP

Strengthening linkages in training activities: Improving the quality of human resources, both physically and mentally, is the long-term strategic objectives and continuously to be implemented. In the coming period, promoting linkages between business, education and training centers and research institutions to bring training contents associated with the needs of enterprises and the market. Strengthening mechanisms for direct and regular tripartite dialogue with representatives from institutions providing educational and training services, students, and employers (businesses) to assess the existing limitations from different aspects. This will help to train qualified human resources to meet the demand of labour using agencies (businesses), and also solve the questions faced by education and training centers today of: what to train; and training for whom.

Strengthening the autonomy of education and training agencies: Improving the system of legal documents on the autonomy of education and training agencies, accordingly education and training agencies should be provided comprehensive autonomy in three major aspects: task performance autonomy, personnel autonomy and financial autonomy. The effectiveness of the mechanisms for giving education and training agencies autonomy for requirements under social needs is obvious if the agency is independent in enrolment of professions according to social need, creating pressure to make these agencies to associate with the organizations, corporate using labours as well as being the pressure for education and training agencies to improve the quality of teaching, autonomy in recruitment and personnel arrangement and require them to renew the curriculum to suit the requirements of human resources for development.

Building national human supply and demand forecasts information system. This system is designed to update regularly on a national scale in labour supply as well as demand-side, giving a specific forecast on labour requirements by industry, by occupation and by level, skills.

Encouraging organizations and individuals, businesses to be involved in the training of human resources. Building a training school model inside enterprise in order to improve the effectiveness of training and usage in accordance with the needs of society. This model helps to improve enterprises' responsibility in the training of human resources and to connect demand and supply of labour to meet the needs of society.

It can be said that the results of the restructuring of the economy is very encouraging, although some aspects have not been as expected. But these are important platforms to strengthen market confidence, the political will to further strengthen the innovation process, especially institutional reform.

REFERENCES

Vietnamese

1. MOF. Online. Accessed at: http://www.mof.gov.vn
2. Cafef.vn, Cổ phiếu hủy niêm yết năm 2014: Ra đi trong mức giá "rau dưa trà đá". Online. Accessed ad: http://cafef.vn/thi-truong-chung-khoan/co-phieu-huy-niem-yet-nam-2014-ra-di-trong-muc-gia-rau-dua-tra-da-20141224115511108.chn
3. Provincial Governance and Public Administration Performance Index. Online. Accessed at: http://papi.vn/gioi-thieu-ve-papi.html
4. CIEM 2015, "Report on hard budget constraint, unreasonable management framework and market disorder caused by state-owned enterprises" ["Báo cáo ràng buộc ngân sách cứng, bất hợp lý trong khung khổ Quản trị và xáo trộn thị trường tạo ra bởi DNNN"] prepared by the Enterprises' Reform and Development Department, CIEM under the financial and technical support from RCV Project.
5. Lawsoft . Online. Accessed at: http://thuvienphapluat.vn/
6. SBV. Online. Accessed at: www.sbv.gov.vn
7. Nguyen Thi Tue Anh et al. (2014), *Sector restructuring and contribution of sector restructuring to the quality of economic growth in Vietnam [Chuyển dịch cơ cấu ngành và đóng góp của chuyển dịch cơ cấu ngành vào chất lượng tăng trưởng kinh tế ở Việt Nam]*, Ministerial-level Project, MPI, 2014.
8. General Department of Customs. Online. Accessed at: www.customs.gov.vn
9. GSO. Online. Accessed at: www.gso.gov.vn
10. The Provincial Competitiveness Index (PCI) Project. Online. Accessed at: http://www.pcivietnam.org
11. CIEM (2014), *Macroeconomic Report QIV and 2014*. Finance Publishing House. Hanoi.
12. CIEM (2014), *Macroeconomic Report Q1-2015*. Finance Publishing House. Hanoi.

English

1. IMF (2014), *World Economic Outlook - Legacies, Clouds, Uncertainties*. October.
2. IMF (2014), *World Economic Outlook - Recovery Strengthens, Remains Uneven*. April.
3. International Monetary Fund. Ebibrary. Online. Accessed at: http://elibrary-data.imf.org
4. S&P Capitalid. Online. Accessed at: https://www.capitaliq.com
5. Paul Collier, M. Kirchberger, M. Soderbom, 2015, *The cost of road infrastructure in low and middle income countries*, World Bank report. http://documents.worldbank.org/curated/en/2015/09/24989040/cost-road-infrastructure-low-middle-income-countries
6. World Bank. Doing Business Data. Online. Accessed at: http://www.doingbusiness.org/data
7. World Bank. World development indicators. Online. Accessed at: http://data.worldbank.org/data-catalog/world-development-indicators
8. World Economic Forum. *The Global Competitiveness Report*, all years. Online. Accessed at: www.weforum.org/gcr