



# The State-Owned Enterprises Reform in Vietnam



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## [ *Abstract* ]

The economic renovation in Vietnam has shown promising achievements. The process of reforming and equitizing state-owned enterprises, and reducing subsidies from the government have made significant progress since 1986. However, this policy has not received the adequate valuation from leaders. Big companies have not been equitized, and are still managed and subsidized by the government, resulted in budget losses. Corporations have been dominated by political interests. This has led to arguments for better and more feasible measures which could save national budget. Corruption in Vietnam mostly originates from state-owned enterprises, for the monopoly was given by government to those enterprises as foreign partners continue to compete under market-oriented mechanism and transparent supervision. Therefore, renovation of the business mechanism, as well as speeding up equitization and minimizing people's properties, have become crucial in the regional integration trend. This is entirely a vital factor in the renovation process. This study

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explores plans, as well as the merits of the renovation process in Vietnam, ultimately envisioning to overcome current consequences and motivate Vietnam's economy.

**Keywords:** State-owned enterprises, government, corruption, equitization, interest groups

## **I. State Owned Enterprises in Vietnam**

Before the Doi Moi (reforms) in 1986, central planning was the basic organizational form in Vietnamese society. The principles of central planning are: to identify needs, to distribute production resources, and to determine output targets and performance indicators relying on bureaucracies to administer and to decide (Vasavakul 1996). Managers of production units were usually involved in the negotiations of the plans and implementation. Such shortages, according to Kornai, were the consequence of reduced supply and excessive demands due to unrealistically low prices enforced by the Government and this type of administrative system. This is said to be the underlying cause of eastern European shortages during the 1980's (Kornai 1980). A systemic culture of murky dealings, misinformation, and corruption is further compounded by wasted labor resources, substitute products, and biased data in order to fill the central planning quotas.

Under central planning, other remarks are in order. Firstly, it was not the goal of enterprises under the planned system to make profits but rather to produce according to the "planned needs", to protect employment and thus social security for the workers. The enterprises received production targets and raw materials necessary for the production from the state planning committee. If the enterprises make losses, they would be expected to be subsidized with credits doled out from state banks—an effect of the monopoly—while commercial and private banks are marginalized. State banks play a secondary part in the budgeting process of the government. Enterprises had tight relationships with each other and were under supervision of the ministries in charge of setting production plans and raw materials delivery as

well as output distribution. The directors of the enterprises were considered "duty achieved" when they met the requirements of the state planning committees. Secondly, the bargaining process for plans took place in a stable system—compared to a market environment—where managers could expect to negotiate with the same persons starting with the old plans as the initial situation for a new round of bargaining. Thirdly, prices of goods and services were more or less only of an accounting requirement rather than based on the system of market mechanism. Additionally, because of the centralized and ineffective system, local actors at the firm level were able to elaborate a lot of non-planned products in order to exchange them with other enterprises, in exchange of missing inputs. Therefore, alongside the centralized system another one existed, consisting of local initiatives, informal relations, and alternative products.

Evidently, the centralized administrative system, notwithstanding its flaws, has left some legacies into the market mechanism: state owned companies are coordinated and supervised by the government's plans; and social welfares are assured with infrastructures being built to improve local residence.

A different situation exists for an SOE if it is allowed operational liberty while the budget constraints are still soft i.e. losses and credits are accepted and guaranteed by the state while profits can be used either for reinvestment or have to be transferred to the owner state. This started before 1986 and has remained unchanged until now. In Eastern Europe such a policy occurred at the end of the 70's when the Soviet type system met huge economic difficulties. Hungarian authorities were the first in the Soviet bloc to allow the managers to manage their production by "privatizing" some parts of the firm in order to extract some profits they could use for their own interests once the planned duties were fulfilled. In Bulgarian state farms, it was possible for some peasants to use collective inputs for their own private plot. In Poland the reform of 1983 pursued the same goal. All of these "reforms" aimed at strengthening local initiative, upgrading productivity. In this case because of agency problems, the incentives for managers and workers are not the same as in a

market environment. As in the case of a government property economy, there is no incentive to report profits; rather, managers and workers would have to cooperate to draw out resources (e.g. to pay too high salaries or bonuses) for their benefit while letting the state pay for their apparent or real losses. Moreover this behavior may be justified against supervising authorities by goals different from profit maximization i.e. by preventing unemployment or by avoiding bankruptcy. This is especially true for large companies, for those directly financed by the central authorities or for strategic sectors. However, if there is enough freedom to organize the economic activities of the firms, as well as the technical possibilities, there may be incentives for managers to organize production more efficiently. If the increase in production can be distributed among the insiders of the firm it is in their interest to follow such a strategy. Another strategy, however, is to cooperate with other companies in order to create book losses which are then paid by the government or by state-owned banks.

Even if state-owned companies are reformed in order to guarantee hard budget constraints, there may still be space for rent-seeking if the former state-owned enterprises are officially (as was the case in Vietnam for FDI or import-export licenses) or unofficially (because of "connections") preferred by the authorities. In addition, there may also be constraints such as limits on the salary of executives, and limits on laying off lower-skilled or inefficient workers that "seriously get in the way of real cost minimization in a comparative-static sense and of real cost reduction in a dynamic sense" (Harberger 1998). This means that regular incentives to be innovative will not be present for state-owned companies. The cases discussed in this section are relevant for development in Vietnam.

Vietnam experienced economic difficulties in 1980, with its declining growth and huge inflation. Starvation occurred in many regions of Vietnam, a result of the failure in transitioning into the Soviet type model in Southern Vietnam. Moreover, the northern border of Vietnam was invaded by China. Through these incidents, flaws of previous economic models manifested. Thus, the imperative for renovation. An existing challenge however is the continued

presence of state-owned companies. The lack of conviction of officials has become a hindrance to the renovation process.

## **II. The reform: The Doi Moi**

### **2.1. Reform Measures**

While reforms concerning the state sector were transpiring, corresponding measures were being undertaken in the private sector. Before 1988, the SOEs were subject to direct plans and directives issued by the government. While in theory the SOEs were under the supervision of "functional" government authorities like the Ministry of Finance, the administration was carried out by "line" ministries (Vasavakul 1996). During the 1980's, these line ministries gained importance and power. These middle-level government agencies were the driving force behind the change at the end of the 1980s, when they formed informal networks which pushed reforms, and at the same time exploited the opportunities of their positions and relations.

While SOEs were allowed to operate in part for their own account since 1986, it was in 1988 that SOE managers were granted more autonomy over the operation of their enterprises. Decisions on inputs, investment, production, and labor force, were no longer determined by centrally issued plans but by the directors of the SOEs. However, they were still obliged to pay their profits to the state budget in exchange for receiving investment funds. SOEs faced soft budget constraints throughout the pre-reform period and into the early 1990's, but by 1993, the government changed the policy, and there was no longer a case for subsidizing these state enterprises (Perkins 1994). At the same time private enterprises were allowed—at least in principle—for the first time. Together with price liberalization, the budget subsidy was cut. It remains, however, unclear to what extent the investment decisions of the SOEs depended on the government.

Several changes took place in 1991. The imports of inputs

at prices below world market prices ended as a result of the end of USSR aid. According to government decree, beginning November 1991, all state-owned enterprises (about 12,000) had to apply for new-registration until September 1994. At about the same time, a special Debt Resolution Committee was set up to clear inter-firm arrears and to settle the debts of liquidated firms with the banks. According to the World Bank (1994) approximately 1.7 trillion Dong of unrecoverable debt (approximately 5% of Vietnam's GDP at that time) were handled by the committee. Remaining debts though, are estimated to have been much higher.

In 1992 the privileged treatment of SOEs in the bank credit system was stopped due to inflation. In the same year, the government started unsuccessful attempts to privatize state enterprises. At the same time, the autonomy of SOEs was further strengthened by attempts to separate them from the influence of the line ministries, as an attempt to respond to criticism on conflicting local, provincial, or central authorities, corruption, and rent seeking. There was, for example, a law promulgated on the management of state-funded construction projects which required bidding for projects. In practice, there was little competition created by this law. "While sometimes the government agency selected the cheapest bid, there was usually much informal intervention from networks backing the bidders often producing no clear winners" (Vasavakul 1996).

As a result of the need for re-registration, thousands of small enterprises have been dissolved or transformed into private operations. At the end of 1993, about 7,000 enterprises had been approved for re-registration by the State Planning Committee, while 2,000 had been liquidated, and 3,000 had merged with other enterprises. In the manufacturing sector, 2,200 of the 3,000 firms remained. During the last years, the process of restructuring the SOEs has continued while at the same time, many measures were undertaken to end the discrimination of private enterprises, e.g. with respect to foreign trade or FDI. In addition, several laws concerning the business framework have been promulgated and there were attempts to simplify the administration procedures of business operations, e.g. by a "One Door" policy of creating

one-stop offices for FDI. One important move of the government—apart from continuing attempts to privatize SOEs—was the setting up of "economic conglomerates" after the model of South Korean chaebols. The first sectors to be organized in this way were the state-owned Union of Electric Enterprises of Vietnam and the Union of Coal Enterprises of Vietnam, early in 1995. Several other sectors were organized in a similar form afterwards. Although state-owned, the conglomerates obtained more operational and strategic independence. The ownership rights of the state are exercised through a "Management Council" and a Board of Inspection, while a general director, assisted by vice-directors, is responsible for running the business. Notably, the financial section of each conglomerate is organized by a bank under the supervision of the State Bank.

The draft political report "Privatization of Small and Medium Enterprises" offered a non-strategic range of activities with regards to the economy and the building of Economic Conglomerates". Presented at the Party's 1996 National Congress, it currently remains to be the basic strategy of the Vietnamese government.

## 2.2. Changes in the Behavior of the State-owned Enterprises

Although the Vietnamese government conducted several surveys of the industrial sector, only a little data has been published. Among them are studies by McCarty (1993), Beresford (1989), Ronnas (1992), Diehl (1995), considered most important.

McCarty and Beresford interviewed managers, government officials, and academic researchers in 1991 and 1992. McCarty found that soft budget constraints remained for the SOEs and that rent-seeking activity and production monopolies would tend to become more important.<sup>1)</sup> Beresford tried to explain the slow adjustment of the SOE by way of the "passivity of managers", for example, as well as their unwillingness to change output or suppliers which was explained by the attitudes of managers still benefiting from the planned economy system. In 1991, Ronnas

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1) This result has been proven by the further development in Vietnam.

conducted a survey for the International Labour Organization (ILO) in order to analyze small and medium enterprises with less than 50 workers. He study revealed that local authorities did not actively support the establishment of new enterprises. The enterprises complained mostly about shortage of capital and too much competition.

The study by Diehl (1995) is more interesting because it was conducted in 1994, i.e. after a sufficient period of gaining experience with the reforms and allowing for changes in behavior. Together with two other German scientists, Diehl conducted interviews with managers of enterprises, officials, and banks in order to get information on obstacles to real adjustment of enterprises, government interventions and business know-how of the managers. Diehl points out the following stylized facts:

First, the managers of the enterprises had very different entrepreneurial capabilities, and are often qualified technicians. Some firms—majority of which are locally managed SOEs—were hit hard in 1989 (some produced virtually nothing) but since then many were able to optimize production capacity or marketing strategies. Second, licensing requirements, taxation, and local factors were not regarded as major obstacles although for example, temporary blackouts in electricity were mentioned. Third, some SOEs still received investment funds directly from the budget or from the state-owned Industrial Development Bank at reduced interest rates. On the other hand, most private small firms had to rely on informal and expensive credits from friends or private money lenders. Fourth, land use rights were seen as a problem by private firms which often depended on SOEs charging excessive rates. Hence, one of the most important assets of SOEs is their real estate, often in attractive city locations. Sixth, Vietnamese entrepreneurs often felt discriminated against by the SOEs with respect to import-export licenses and FDI.

Diehl (1995) concludes that lack of capital and direct access to world markets were the main impediments for the private sector. He also thinks that the interviews provided anecdotal evidence for a continuing protection of the SOEs by the government.



He also finds, however, that some managers of the SOEs have adjusted to the reforms often in connection with joint ventures with foreign partners. Obviously, the state enterprises chosen by foreign investors are a positive selection from among the state sector with FDI usually enforcing this lead, e.g. by process innovations introduced by the foreign partners.

The World Bank (1997) reports the typical example of the inefficient rice trading of SOEs although they were receiving preferential treatment (e.g. Vinafood still holds the monopoly of selling rice to a number of markets such as Iran, Malaysia, and the Philippines). Expenses per unit of marketing activities of SOEs are 5 times higher than the private sector in terms of expenses. According to data published by the Ministry of Finance (Nguyen Sinh Hung 1998), debts contracted by SOEs have been deemed more important and raised to 13% in 1996. As a consequence, overdue debts of banks rapidly increased and many SOEs had to receive subsidies from the budget. This shows that budget constraints are still soft for many SOEs, especially if the managers have good relations with the government. Since Vinafood 2 won its export bid of 600,000 tons of rice to Philippines at a low cost, it has reinstated monopoly and regulations, squeezing rice farmer earning for an unprecedented low price. Some rice producers in the Mekong delta has rejected to supply Vinafood 2 due to the exceptionally rate of only 370.05 USD/ton (FOB HCMC), while the same type of rice is exported to other markets at 385-390 USD/ton, in the absence of the same restrictions rendered by the Philipines. The total quantity rejected by local enterprises amounts to 100.000 tons (Son Nhung-Ngoc Anh 2014).

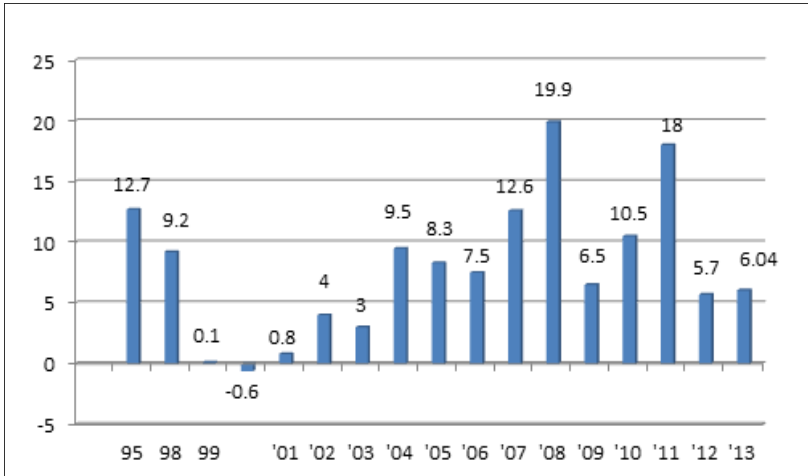
Also, the incentives to abuse this situation are strong. A typical case is that of the General Electricity Corporation which reported wrong business results and efficiency to the government in order to request the government to allow them to raise their prices. According to the report, if prices were not increased, the company would lose VND 298 billion. Actually, the company was making a profit of VND 1,445 billion, using higher prices to increase the turnover and the salary fund of their branch. According to data from the State Inspection Commission, the

discrepancy amounted to VND 743 billion in 1995 and 1996. Against regulations, salaries paid by the company increased by 150% which in total amounted to over VND 96 billion and which resulted in low tax collection or VND 24 billion (Le & Ha 1998).

These shortcomings of the State administrative system might result in: the government's lack of knowledge on the actual financial situation of SOEs; increased heavy budget loss in the expenses of SOEs, which leads to a draw on the GDP of approximately 30-35%; corruption within the state apparatus; and unfair treatment to investors, business people, and even citizens. Any enterprise having "connections" with government officials can evade tax and get away with it. This does not encourage people to engage in business.

### **III. Investment in SOEs: Inflation and Incremental Capital Output Ratio (ICOR)**

With better achievement of economic development over a long time, Vietnam considered continuing to promote growth with investments in economic corporations to create resilience for catching up with regional countries. However, issues of money and overcapacity, credit growth, and the provision of financial resources for state enterprises and other economic groups in the absence of control—with expectations of high growth—hounded the economy and consequently increased dramatically the international balance of trade deficit. Vietnam faced inflation of up to 18% in 2011 as shown in <Figure 1>. The expansion of corporations' influence can be said to be an important cause of high inflation in Vietnam (Vu V. Q. 2013).



**Figure 1.** Inflation Rate 1995-2013

**Source:** General Statistics Office of Vietnam

On the issue of anti-inflation, the Politburo of the Communist Party of Vietnam had specific measures in "The conclusion on a number of socio-economic problems," published on April 4, 2008 (22/KL/TW) (SGGP 2008).

The document presents the following causes of inflation:

The rate of investment spending from the public sector (the state budget for SOEs) was large but inefficient. Egregious investment resulted in the tardiness of many incomplete projects, Loss through ineffective investment has existed for many years at both governmental and local levels. This has been slowly resolved; the ICOR of the economy is increased more and more.

Meanwhile, at the official levels of the state, "... the current priority is to control inflation, maintain macroeconomic stability, while maintaining economic growth at a reasonable level, especially focusing on social welfare support to help the poor employees who are influenced by the inflation."

According to the Politburo, the economy still presents uncertainties. In fact, the higher the ICOR, the lower the productivity of capital. The ICOR can be thought of as a measure

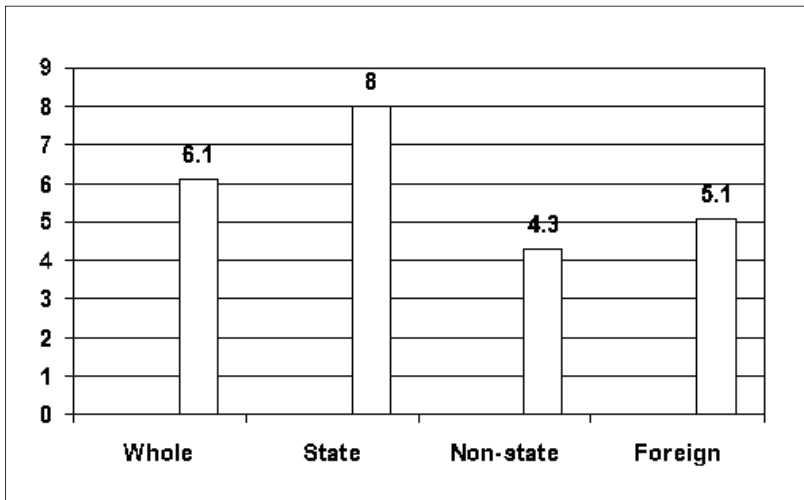
of the inefficiency with which capital is used.

**Table 1.** Comparisons on ICOR and GDP

	ICOR	GDP
Vietnam (2000-2007)	5.2%,	7.7%.
China (2001-2006)	3.9%,	9.7%.
Korea (1961-1980)	3.0%,	7.9%.
Thailand (1981-1995)	4.1%,	8.1%.
Malaysia (1981-1995)	4.6%,	7.1%.

Source: Vu V. Q. (2009).

In comparison with other countries, Vietnam's ICOR is the highest; it indicates that the economy is less efficient in its use of capital. In the investment sector, the public sector ICOR coefficient outnumbered all, at 8 % compared to the FDI sector and private sector, in the 2006-2008 period as shown in <Table 1>. Furthermore, the ICOR of the economy based on capital investment had increased to 6.8% in 2006-2010, according to Bui Trinh (2011).



**Figure 2.** ICOR by Sectors, 2006-2008.

Source: General Statistics Office of Vietnam.

The restructuring of businesses in order to promote sustainable growth and healthy economic environment was also planned by the government.

**Table 2.** ICOR in Vietnam, 2001-2007.

	2001	2002	2003	2004	2005	2006	2007
ICOR	5.14	5.28	5.31	5.22	4.85	5.04	5.38

Source: Calculated from data of the General Statistics Office of Vietnam (Vu V. Q. 2013).

Nowadays, the problem of state enterprises, particularly corporations, was raised as a socially imperative one, as more and more defects manifest through the ineffective use of capital. People have lost faith in groups due to their poor management of capital, which has resulted in huge losses nationwide. The Party Central Committee has issued a resolution on reform and the Prime Minister has outlined an implementation program. According to the report by the Committee of Business Reform and Development-Central Research Institute for Economic Management, by the end of 2010, there were 1,207 State Enterprises which are one-member limited companies and 1,900 state enterprises controlling shares. SOEs now receive 70% of Vietnam’s total investment, 50% of state capital investment, 60% of commercial bank credit, and 70% of ODA, though the SOEs contribute only about 37-38% to GDP of Vietnam.

Since 2000, the state sector has created 4 million new jobs, which is only about 9 to 10% of the total employment. The number of employees in state enterprises has been reduced enormously. To create additional employment, the public sector was prioritized with a huge investment. The public sector accounted for more than 45% investment of the entire economy. In 2007, the private sector created 80% of the new jobs in the entire labor force.

Although the reform process has presented many impressive achievements, its practical consequences have revealed that the current model of the Vietnamese economy is no longer suitable, resulting in many implications for society and the economy. In

fact, many enterprises—including state corporations—have poor production activities. Trading with less efficiency, labor productivity is not high and competition is limited, wasting industry investment. Besides, the current model of state management of SOEs and the business administration model are conflicting and overlapping; many enterprises lack transparency in their business affairs, failing to record losses and profits of the business (Kim 2011).

State restructuring of enterprises sought to break monopolies and influence peddling to create equal opportunities among other sectors and international businesses, achieving financial transparency that does away with give-and-take mechanisms and state subsidies (Pham D. V. 2012). Unfortunately, as larger state-owned enterprises expanded their scope, the less effective their operations became. So far, none of the big state-owned enterprises shown success. Their expansion into state-owned corporations proved to be nothing but utter failure.

An economic reengineering that meets the demands of modern society in growth and sustainable development is urgently required. Recently, the Central Conference 3 term XI of the Communist Party of Vietnam has affirmed the implementation strategy of economic restructuring on three key points as: the monetary system, public investment, and state enterprises. On October 10, 2011, at the closing session, the General Secretary of the Communist Party of Vietnam Nguyen Phu Trong stressed that what is currently needed are the following:

“Strict control of public debt, bad debt of state enterprises, repayment of foreign loans, foreign investment, especially investment in real estate, the stock market and the other hot capital; gradual reduction of the rate of supply of capital for development investment from the commercial banking system and promoting the quality of banking activities.”

In the process of restructuring SOEs—the focus of which is interest groups and state corporations—it is important to reflect the implementation of views, goals, tasks, and innovative solutions to improve efficiency of State enterprises. This has all have been

identified in the resolutions of the Party.

It is vital to halt the economic sector and the state owned general company which have investment spread outside of their sectors of production, main business in 2010” (Nguyen T. P. 2011).

Prior to July 16, 2010, Tuoi Tre Daily also published an article by Prime Minister Nguyen Tan Dung, who emphasized that effective measures must be put in place, “to implement multi-ownership, transparency and improve corporate governance.” He also reiterated the importance of putting “state enterprises on an equal competitive environment amongst all economic sectors in the market mechanism. Only that can improve the efficiency of state enterprises and the development of the new state which will not dominate resources used for developing the private sector—a major driving force of growth” (Nguyen D. T. 2010).

Thus, restructuring of state enterprises must be a consistent, determined command in the overall restructuring solution, improving operational efficiency of SOEs, especially that of groups and general companies.

## **IV. Restructuring SOEs: an economic and social imperative**

### **4.1. Restructuring SOEs:**

In the process of market-oriented reforms, the Vietnamese government has seen the shortcomings of the economic model of state enterprises. Since 1990, the Council of Ministers issued 143 decisions on reorganizing the state-owned sector, which will be dissolved—a model transformation and reducing inefficient loss. However, in 2002, the new clear separation of state and private sectors was made. The list of criteria and classification of SOEs and corporations was enacted. This reform process was slow and failed to meet the deadlines set. The state had 46 business sectors and dominated 47 sectors. In 2004, SOEs owning 100% of capital had fallen to 29 sectors in which 8 SOEs withdrew

completely. Then, in 2007, the State continued to reduce its market share to 100% equity in 19 sectors. In the spirit of greater changes in corporate law promulgated in 2005, the state enterprise model was dismantled, ushering in the model of limited liability companies and shareholding companies with a July 1, 2010 deadline. However, the law did not reflect reality.

Pham Duc Trung, Deputy Director of Enterprise Reform-Central Institute for Economic Management (CIEM), stated that “the restructuring of SOEs specifically by selecting target units is only short term. The key point must lie in the strategic direction of SOEs. For years, the budget was too large for SOEs investment because we had given to this group an impossible mission, which was to lead the economy. But until now, the position of SOEs and the role of SOEs in the economy to some extent needed to be reset more appropriately” (Pham H. 2011).

Numerous subsidiaries were established after the Vietnamese government introduced an experimental model of parent companies and subsidiaries. Although the rate of profit has not been published, a congressman once expressed his opinion: “It is essential to evaluate the effective use of over 23 billion USD that the Prime Minister said had been distributed to businesses, as some voters said that the capital or property of the State may have brought more savings than profit derived from SOEs” (Xuan 2008).

The impact to the industry sector has also been shown in the report of the Committee of Innovation and Enterprise Development on February 15, 2011. By the end of 2010, the scale of equity corporations and state-owned companies was 540,701 billion VND (up by 11.75%, compared to 2009) with total earnings before tax of 70,778 billion VND; earnings before tax on equity reached only about 13.1%, lower than the interest rates of commercial banks in 2010. In particular, up to 80% of the total pre-tax profit came from four groups: Petroleum, Military Telecommunications, Telecommunications, and Rubber. For state owned corporations and other corporations, the rate of capital-based profit ownership was even lower (Kim 2011).

However, the potential risks of state owned corporations



have also been resolutely mentioned in the Conference on SOEs' Reorganization and Renovation on April. 23, 2008. At that time, as reported by the Ministry of Finance, these groups had invested about 7.3 billion USD or 117 trillion VND (about 10% of GDP and 26% of the capital raised by the 70 corporations and the general companies) outside the enterprise, where 1.4 billion USD or 23 trillion VND were invested into the finance, banking, and real estate sectors. Moreover, during that time, the state banks pumped more credit for these "investors" into these areas. With such numbers, it has formed a bubble of housing and stock. When the stock market and real estate are "exaggerated" by speculation, shares of companies in the finance, banking and real estate sectors became very popular. A few hundred billion VND invested by these company in these areas can return as much as a thousand billion VND. The group found easy and fast money in these risky areas. Now the stock bubble has deflated, and the real estate bubble has burst (Nguyen T. 2008).

The State knew the causes of inflation, and proposed several measures to restore macroeconomic stability, calling once again for resolute reform of state enterprises. On January 28, 2008, during the first live broadcast of the National Assembly debate on the evaluation and review of economic tasks in 2008 and development plans for 2009, Congressman Trieu Si Lau (Cao Bang) said: "Inflation is not just from banks but also from the widespread investment by corporations and the State Corporation... it is necessary to immediately review and correct the operations of corporations and state companies; otherwise our efforts to fight inflation in the past time are meaningless" (National Assembly 2008).

#### 4.2 Vinashin case study

Until 2009, the Vinashin ship building corporation was composed of one mother company and 200 subsidiaries, embracing a variety of industries beyond its major activities aside from ship building and related fields. However, this corporation has encountered several failures. Its total debt was equal to 89% of its general value (80 thousand billion VND out of 90 thousand

billion).

According to the supervising report of the Parliament, “the total overdue debt of Vinashin since 2008 has amounted to 3,812 billion VND, which accounted for 91% of the total overdue debt generated by all corporations.” In other words, in 2008 Vinashin has failed to pay its debt, or gone informally bankrupt, despite the fact that creditors did not push Vinashin to declare its bankruptcy as mentioned in the Law. Vinashin also earned its debt of 1,835 billion VND to PetroVietnam Finance Fund Management Inc., with an overdue debt amounting to 1.300 billion VND.

From the two figures mentioned above, it is evident that Vinashin became bankrupt two years after its establishment. The Government did interrupt in restructuring this corporation.

Undoubtedly, the Government has favored Vinashin and it was due to this favoritism that it loosened budget requirements. Obviously, ineffective management resulted in the collapse of Vinashin.

Vinashin is among the top state-owned enterprises engaging in various fields aside from ship building and sea ports. It also had interests steel manufacturing, cement, beer, aviation services, insurance, banking, and even motor imports. The enormity of its interests lead to its failure in utilizing capital. Its projects were not completed due to lack of capital and escalating debts. Also, it was notorious for abusing loan stock, which consequently lead to a fiasco that exposed its lavish investments in the public sphere, among them, an unused Lotus Ship costing 60 million Euros, and an international loan that purchased 9 used ships amounting to 200 million USD.

It also lost in its stock investments. The mother company became a share holder of Bao Viet Corporation, with the total investment of 1,462 billion VND. In this transaction, one stock costs 71,918 VND, making them control 3.56% of the charter capital of Bao Viet. However, the stock price of Bao Viet declined to 37.100 VND. Vinashin lost 700 billion VND and withdrew its

share from the executive board. The government directed Vinashin to transfer its projects to other two corporations, Petro Vietnam and Vietnam Airlines.

Pham Viet Muon, Head of Innovation of state enterprises noted the level of risk of this kind of set up, during a conference on renewing state-owned enterprises on July 10, 2006. According to him, "debt- capital ratio of SOEs is too high. Many companies have debts to pay five times higher than the state capital in the company. Some companies have loans of 20 times higher than their capital, putting the company at great risk with low debt solvency."

A report by the Ministry of Finance dated November 20, 2011 and submitted to Congress indicated that state corporations investment beyond given sectors reached nearly 22,000 billion VND. Of the amount, 3,576 billion was in securities, 2,236 billion in the insurance sector, 5,379 billion in real estate, 495 billion in investment funds, and 10,128 billion in private banking. Among the investment groups outside the industry, Petrolimex leads with 6,708 billion VND, followed by the rubber industry with 3,848 billion VND.

In retrospect, this case is best examined by way of an opinion from Deputy Minister of Planning and Investment Dang Huy Dong. According to him, in looking at the investment field and absolute numbers, great value and investment should be reconsidered. For him, investment areas are mainly situated in finance, banking, securities, real estate, and insurance. These are consequently sensitive and high risk areas. For example, the electricity sector of Vietnam invests only 5 billion in power plants, and 2,100 billion such other areas as insurance, securities, banks and investment funds, which accounts for 99.8%. PetroVietnam has a 6,708 billion VND of beyond-sector investment and the figure for the main sector was 5,636 billion (over 84%) (Vu and Dang 2011).

Despite being held largely by the state, economic corporations until now work without a proper legal framework for its specific operations, resulting in poor protection of ownership rights, and

little accountability to owners of state capital. This is a serious loophole.

The establishment of a interest group will bring about extensive benefits to its members. Subsidiaries under the control of corporations will benefit in having loans from the state bank. Being the backbone of the economy, subsidiaries may easily be given the state public land. Under the law of land ownership, the state can take over farmers' land; they are usually given a low-value price as compensation. The subsidiaries may use this land for equitization then sell stocks in the stock market. Usually, companies holding shares of equitized subsidiaries usually have crony relationships with managers of corporations. This brings about mutual benefits; the bank officials facilitate loan capital. As a result, it is easier to legalize assets from public ownership, turning them into private ownership. Moreover, the establishment of subsidiaries encompasses many construction projects, procurement of equipment... it is an opportunity for managers to receive a commission of the sale. The salary received by administrators when setting up new subsidiaries also provided significant resources for these members. Although suffering from loss, some CEO board chairmen received payments of up to 3,500 USD to 4,000 USD per month (Thu Hang 2011).

Since December 2007, the Treasury had been warning the public of the debt/equity ratio of Vinashin reaching too high at 21.8 times. Finally the Government Inspectorate intervened in 2009. Vinashin had a deficit of nearly 5,000 billion VND of state capital, facing the risk of losing around 8,500 billion VND. Upon inspection, must-be paid debt amounted to over 86,000 billion VND (4.2 USD billion). At the end of the investigation, Vinashin was found as "deliberately violating State's regulations on economic management causing serious consequences". The Security and Investigation Agency of the Police Ministry recommended the prosecution of nine defendants and pegged the financial losses to nearly 907 billion VND (Minh Quang 2011). The Office of the Government Inspector General released a post-collapse report outlining its findings of various violations and recommendations never heeded. Financial reports were apparently inaccurate to

camouflage their activities.

For Ha Van Hien, chairman of the National Assembly's Economic Committee, decentralization caused the collapse of Vinashin. He also pointed out the ineffective management of Vinashin and corporations. In the enterprise reform, it is important to clarify the functions of state management and ownership; he says there must be agencies that are to be made accountable (Lam Son 2010). Euro Charm CEO Dr. Mathis Duhn agrees and says that "promoting equitization of state businesses will also be the vital factor for further developing of Vietnam's economy" (Khanh Linh 2011).

In the Central Conference 3, term XI, of the Communist Party of Vietnam, the restructuring of state enterprises is to be done to avert the following: irrational investment; lack of concentration and determination for massive key projects; mismanagement; lack of transparency; closure; corruption; local interests; factionalism; localization; short-term thinking; lack of control and timely remedies; unclear strict liabilities and consistent policies at all levels, considering the absence of an Investment Law in the country. Economic restructuring of state enterprises demands clear objectives for businesses to overcome the pressure of crisis, high interest rates, and changes in input costs (Kim 2011).

For Le Doan Hop, former Minister of Information Resources and Communications, in a *Tien Phong* article of Jan. 26, 2012, the Central Conference 3, term XI, sets the directions by identifying the three biggest obstacles to restructuring the economy—interest groups, and short term, and local thinking. But this campaign is not simple. A state-owned enterprise today has too many top managers. When problems arise, they have to mobilize their capital for maintaining their major company. Additionally, businesses should be given full market freedom, and should not managed by the state. Restructuring is authentic when it transcends being just lip service (Nhat Anh-Pham Tuyen 2012).

Regrettably while the reconstruction process of SOEs is delayed, there remains the continuing prospect for interest groups to mushroom and become once again a burden to the economy.

Such interest groups have flourished while becoming more powerful within SOEs, hindering tremendously the restructuring process (Nguyen T. 2013). Those who work in SOEs traditionally carry out their jobs only to satisfy their higher ups.

Jonathan Pincus of the Vietnam Program, Harvard Kennedy School, once complained to the *Financial Times* that, “ Vietnam has routinely invested more than 40 per cent of GDP largely a product of the easy access to state land and credit afforded to state companies and local authorities. He observed that not only is it easy to turn a profit when land and capital is cheap or free, but earning profits may not even be the main aim. When public officials have a term of five years or less, and can potentially earn much money in signing contracts, investment becomes a more lucrative transaction than a long-term procedure” (Pincus 2011).

An effective mechanism should be set up to monitor financial affairs of businesses. Financial reports should be posted in websites and public communication channels for a healthier trading environment. These measures will prevent distorted and veiled information from thriving in businesses. The equitization of remaining business requires the determination of all business leaders, including administrative and party members, in order to halt lost compensation from the state. It is necessary to seek strategic investors from inside and outside the country to participate in management. In this set-up, shares would be sold rather to major shareholders than to many minor shareholders. In particular, the requirement to keep the state capital ratio of over 51% should be eliminated as it is actually a trick of business leaders and local authorities to avoid equity.

## **V. Conclusion**

The renovation of state-owned enterprises of Vietnam is now at the period of resolutely winning back equity. After more than 25 years of economic reform, the achievements of the country are

encouraging, although the rich-poor gap has become bigger and bigger each day, and the impact of interest group benefits has aggravated the plague of corruption. More than ever, the state has increasingly shown its determination to maintain sustainable economic development to benefit all citizens.

The role of the state and the policy-makers has an important significance. Stricter laws of land ownerships should be launched, which limit the rights of state-owned enterprises in using lands of local people for their own purposes. Farmers should be entitled to the ownership of their lands. Additionally, the state should create a healthy and open environment to all economic sectors; this will facilitate business activities and raise state taxes. It is necessary to avoid bias in favor of state enterprises, which may deviate from the competitive environment, causing disadvantage for private enterprises as well as farmers engaged in production.

To protect the assets of the state, the state needs to recruit people with business ability, legal knowledge, and market wisdom for corporate management. State contracts must be signed only if the business leaders can complete their responsibilities. If incompetent candidates are selected, their relationship with interest groups will sow the seeds of corruption. When these interest groups collude with each other, there will surely be more Vinashin-like cases in the future.

The big contradiction in Vietnam's economy is in the mentality of integrating with the remaining models of the SOEs-dominated mechanism. In a social perspective, it is difficult to attain a sustainable economy under the supervision and direction of SOEs and the state. The collapse of Vinashin and Vinalines, among others, are illustrative failures in the fiercely competitive market. Giant corporations may experience financial disasters if they continue to be subjective and hasty in their expansion, especially in the absence of clear guidelines.

The ultimate thing is that the state has to change its thinking in the renovation process and restructuring of state enterprises.

Who will benefit the changes? Why do we need changes? Only when people sincerely welcome the new changes the restructuring could succeed. The State should disseminate the idealism and impose discipline on state enterprises and local authorities for the effective application of state policies. To achieve this goal, collaboration among related agencies and bodies is needed along with serious punishment for those who fail to meet the required process of equitization.

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