

# **ECONOMIC RESTRUCTURING: ONE YEAR OVERVIEW**

## **I.CONCEPT OF ECONOMIC RESTRUCTURING AND CONTEXT OF ECONOMIC RESTRUCTURING IN VIETNAM**

### **1. Concept of economic restructuring**

The two concepts of "economic restructuring" and "growth model transformation" have been widely used in the media, economic research and policy making for a long time.

According to Dr. Nguyen Dinh Cung<sup>1</sup>, the transformation of the growth model will require changing the dynamics of economic growth so that improved labour productivity and resource-use efficiency replace the amounts of investment, labor and natural resources to become the driving forces of economic growth. More specifically, economic restructuring is the process of reallocation of resources (primarily capital) across the country to improve and enhance the efficiency of resource allocation, as well as the economy in general (including technical efficiency and allocative efficiency). *As such, institutional changes and changes to create an appropriate incentive system are the beginning of economic restructuring.*

### **2. Context of economic restructuring in Vietnam**

From 2008 up to now, Vietnam's economy has undergone many difficulties, and the level of difficulty seems to increase year after year. Apart from external causes, the current situation of the economy is exposed to three layers of internal causes. The first internal cause is the increasing focus on curbing inflation and stabilizing the macro-economy. The second internal cause is an excessive increase in investment to promote growth since 2006. Fiscal policy and monetary policy were expanded to support investment and growth. That policy adjustment combined with excessive capital inflows increased the money supply, resulting in the overheating of the economy with high inflation and greater macroeconomic volatility. The third internal factor – the underlying cause - is related to structural weaknesses and backwardness of the growth model. Here, institutional systems are no longer appropriate, leading to “rent-seeking” behaviors instead of the encouragement of profitable investment and the development of value added products. These shortcomings create even more distortions in resource allocation. Finally, the global economic crisis has also had a strong impact on Vietnam’s economic growth.

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In light of these factors, the government decided to restructure the economy. The overall goal of economic restructuring to 2020 is to improve the efficiency of resource allocation, improve labor productivity, total factor productivity and competitiveness of the economy and, on that basis, to form an appropriate and dynamic economic structure with higher competitiveness and greater growth potential. Additional aims will be to comprehensively promote model growth transformation which contributes to achieving targeted socio-economic development indicators set forth in the Socio-economic Development Strategy for the period of 2001-2010. The transformation of growth model is to be based primarily on factors of improved productivity and efficiency, relying on continued strengthening and sustainable development of these factors up to 2020, paving the way for the economy to move to a higher development level by late 2030.

Economic restructuring centers around three pillars: (i) restructuring of investment with a focus on public investment; (ii) restructuring of state-owned enterprises (SOEs), primarily corporations and economic groups; and (iii) restructuring of banks and financial institutions, primarily commercial banks. Each component of restructuring was assigned to a relevant Ministry to take charge of developing a respective restructuring scheme. So, the apparatus of economic restructuring has started working bringing with it the hope of economic renovation and expansion.

## **II. STATUS OF ONE YEAR OF ECONOMIC RESTRUCTURING IMPLEMENTATION IN VIETNAM**

### **1. Policies related to economic restructuring and growth model transformation**

Policy documentation relating to economic restructuring and growth model transformation over the past year include the following: Resolution No.13/NQ-CP dated May 10, 2012 on a number of solutions to solve difficulties for production, business and market support; Resolution No. 01/NQ-CP dated January 7, 2013 on key measures of implementing the socio-economic development plan and state budgeting of 2013; Resolution No. 02/NQ-CP dated January 7, 2013 on a number of solutions to solve difficulties for production, business and market support, and to handle bad debts; Decision 704/QD-TTg dated June 11, 2012 approving the scheme for innovating corporate governance in accordance with market economy practices; Decision No. 929/QD-TTg dated July 17, 2012 approving the scheme for restructuring of SOEs, with a focus on state-owned corporations and economic groups for the period 2012 - 2015; Decision No. 339/QD-TTg dated February 19, 2013

approving the Master Plan on economic restructuring in association with transformation of the growth model towards improving quality, efficiency and competitiveness for the period 2013-2020; and Directive No. 11/CT-TTg on a number of tasks to be carried out in the three years from 2013 to 2015 for implementation of the Master Plan on economic restructuring in association with transformation of the growth model towards improving quality, efficiency and competitiveness for the period 2013-2020.

## **2. Measures for implementation of objectives of economic restructuring and growth model transformation**

### ***a. Investment restructuring with focus on public investment***

The model of investment-based economic growth started in the early 2000s and is still continuing despite Vietnam's comparative lower economic development status, it is implementing an economic model of consumption abstinence for capital accumulation and investment that surpasses other East and Southeast Asian countries. Recent years has seen an apparent focus on public investment on economic activities and limited social investment. Public investment has also been used as an instrument to promote key industries in the economy. However, its impacts on modernization and structural transformation of the whole economy remain limited. In this regard, it seems that the State has failed to use public investment as a powerful tool for shifting economic structure on a long-term basis and for regulating social development.

In terms of the restructuring of public investment, so far there is no separate scheme but it mostly follows Directive No. 1792/Ct-TTg dated October 15, 2011 on strengthening investment management from state budget capital and government bond capital. After an implementation period, public investment restructuring efforts have achieved some initial results such as: reducing state investment both in terms of capital quantity and number of projects; greater concentration of investment allocation; and overcoming gradually the situation of "dispersed investment". However, existing institutions and approaches still dominate the allocation and use of state capital. Compared to earlier periods, the basic difference refers to the smaller scale of investment and the fewer number of projects, particularly with regard to new projects eligible for investment approval. Currently, MPI has been in the process of drafting a medium-term investment plan; and the draft Law on public investment has also been discussed as preparation for promulgation.

Initial assessments of investment restructuring in view of three major orientations of the approved master plan (on economic restructuring in association with transformation of the growth model) show that the mobilization level of gross

investment compared to the scale of the economy has reduced, which is considerable owing to tightening public investment in a proactive manner. However, efforts for improved efficiency of public investment through renovated mechanisms to prevent dispersed investment and waste are not really clear and efficient. Private sector investment in infrastructure was mobilised in 2011 and 2012 to complement public investment, especially in the transport sector. However, BOT and BT projects, especially transport projects, featured a huge debt ratio, implying that investors contributed a minimal level of equity to take risks.

#### ***b. SOE restructuring***

Benefiting from state support, state-owned economic (SOE) groups, have become monopolists with complete control of the market in some sectors. SOEs, in many instances, have not performed well in their leading roles and have failed to support and enable enterprises in other economic sectors to operate and develop. In effect, SOEs have crowded out the operation and development of other enterprises.

To ensure the economic performance of SOEs, the key issues relevant to the restructuring of SOEs are defined as follows: (i) the state economic sector still plays a key role in the multi-sector economy; (ii) in the long-term (to 2020), the State would just focus on macroeconomic stabilization and maintain infrastructure for development. The role of doing business should be left to real business entities; (iii) SOEs would not be given too many tasks but focus on some specified duties; SOEs would not be assigned a political mission; (iv) corporate restructuring is comprehensively done from thinking restructuring, institutional restructuring, operational pattern restructuring, investment restructuring, state management restructuring for SOEs and (v) SOE restructuring puts the focus on restructuring of state-owned economic groups and state-owned corporations.

After one year of implementation of SOE restructuring, the aforementioned shortcomings did not change significantly: notwithstanding the benefit of state's preferences, the contribution of state-owned economic groups and corporations to the economy as a share of GDP continued to fall, incommensurate with the State's investment in this area. Liabilities and bad debts of state-owned economic groups and corporations are an increasing concern and have become a major economic burden – what many experts call a "blood clot" to the economy. This additionally affects job creation as the state economic sector is increasingly shrinking in comparison with other economic sectors.

In view of the above-mentioned facts, overall comments on the existing situation of SOEs are summarized as follows: (i) the progress of reform of SOEs is generally

slow, especially equitization; (ii) the mechanisms and policies have improved somewhat but progress is slow; (iii) there have not been significant progress in the withdrawal of state capital invested in areas outside the main or inherent business of SOEs (e.g. investing in real estate) and in the reduction of state capital in equitized enterprises in which the State not need hold either dominant or any shares; and (iv) the approval of restructuring plans in some economic groups and corporations remains slow.

### **c. Financial market restructuring with focus on commercial banks**

The Government of Vietnam has identified four underlying goals of restructuring the banking system as follows: (i) cleaning it up to develop a healthy banking system, (ii) building a banking system which is competitive both at home and abroad and adaptive to an increasingly volatile environment; (iii) restructuring the structure and operation of the banking system to ensure the supply of credit to the economy; and (iv) the banking system must meet requirements of Vietnam's increasing international integration into the world economy.

Given the current situation of the banking system and goals for its development, the restructuring of the banking system is facing three major challenges that need to be handled simultaneously, namely: (i) improving the monetary market regulatory role of SBV, moving from a passive to an active position, to make SBV become a real coordinator of the market based on the rules of fairness and in accordance with development trends, (ii) consolidate and improve the efficiency and effectiveness of the supervision of competent authorities, (iii) clean up to develop healthy commercial banks and other financial institutions.

Bank system restructuring has achieved initial results after 1 year of implementation. The safety of the credit system has significantly improved; the risk of collapse in the banking system have been alleviated; the properties of the State and the people have been guaranteed, and people's deposits have been paid normally, even in ailing banks. The weak and fragile credit institutions have been tightly supervised by SBV and gradually addressed through necessary measures, As such, the monetary market has gradually been stabilized. Credit institutions have gradually been restructured. Credit institutions have also paid attention to strengthened management, supervision and internal audit systems. Another good sign is that credit institutions have proactively cleaned up their financial situation through increased equity to improve financial soundness and operational safety indicators.

However, experts have indicated that there has not been much improvement in the role of the system of credit institutions for normal functioning of the economy.

Initial results achieved after one year of bank restructuring are less than satisfactory owing to the absence of the expected comprehensive reforms. Reasons for these shortcomings include: First, the legal framework for restructuring of financial institutions is generally incomplete; Second, the restructuring of the system of credit institutions and the handling of ailing credit institutions are very complicated and highly sensitive, especially as they relate to the rights, obligations and interests of many parties. Furthermore, they take much time for inspection and auditing to assess the financial situation of each bank with a lot of procedures and regulations; Third, the lack of cooperation or opposition from major shareholders of the ailing joint stock commercial banks makes it difficult to restructure these ailing commercial banks, Four, there are a lack of public financial resources to support settlement of bad debts, clean up and improvements of the financial capacity of the system of credit institutions, slowing down the process of restructuring of credit institutions.

### **III. GENERAL ASSESSMENT AFTER ONE YEAR OF IMPLEMENTATION OF ECONOMIC RESTRUCTURING AND LESSONS LEARNED**

In general, it is necessary to continue concretization and focus on implementation of policies and goals set forth in the master plan of economic restructuring in order to create a new system of incentives to reallocate resources for more efficiently and sustainably. Economic experts say that the proposed solutions just address the "tip" not the "root" of the problems and still follow the old state-led approach, which ultimately only benefits corporate groups rather than the entire economy. Furthermore, solutions implemented to date are in their nature favourable to administrative rather than market rules and show no sign of the "sacrifice and trade-offs" necessary to achieve meaningful restructuring of the economy. In addition, there is no competition improvement and no accountability to require businesses and investors to pay the price for their mistakes. Obviously, these solutions will not succeed as expected both in the short term and long term. On the contrary, these solutions will only prolong the stagnation of businesses and the economy, fail to create innovative opportunities and "open up" investment and business opportunities, inevitably slowing down the economic restructuring and growth model transformation.

#### **• *Policy recommendations:***

##### **Public investment restructuring**

With regard to public investment restructuring, it is essential to gradually apply the medium-term fiscal framework and medium-term budget to tighten discipline in public spending and enhance the viability of public investment programs.

To ensure sustainable development in the coming years, a number of restructuring orientations with regard to policies of growth, public finance and public investment are recommended as follows:

(i) Abandon the "hot" growth model which is based mainly on increased investment, and transform to the in-depth growth model which is based on further improvement of productivity, quality, efficiency and competitiveness;

(ii) Change budget expenditure structure towards reducing state interference in the business sector and at the same time strengthen state involvement in taking care of welfare activities;

(iii) Concentrate public investment for investing in key areas that can create breakthroughs and extensive spillover effects;

(iv) Change public investment institutions towards ensuring the consistency of national development strategies; and

(v) Enhance efficiency of public investment on social, economic and environmental aspects. Eliminate subsidy mechanisms through investment from the state budget for operations of SOEs. Promptly promulgate the Law on Investment with the inclusion of regulatory standards that could ensure overall efficiency of public investment. In addition, it is necessary to renovate public investment management through further improvement of appraisal, bidding, reporting and supervision).

### **SOE restructuring solutions**

For SOEs, do not use SOEs as a tool for macroeconomic stability. Instead, SOEs should "pave the way" for development in sectors and areas that businesses in other economic sectors are unable to achieve, for instance in capital intensive or technological intensive industries so as to create a basic foundation for development of modern technology industries with high added value. To achieve this goal, it is necessary to carry out a variety of concrete measures as follows:

(1) Review, research and re-evaluate the state-owned multi-disciplinary and multi-sector economic group model. State-owned economic groups should focus on assigned main lines of business. The subsidiary companies which are established should only play the role as supporting industries;

(2) Remove banks, finance companies, venture capital funds out of state-owned economic groups;

(3) Withdraw state capital which was invested by SOEs in financial institutions. This matter should be promptly resolved to remedy and prevent the flow of "unjustified credits" that could cause bad debts for economic groups;

(4) The Government should designate as the owner representative for restructuring SOEs to a single authorized agency or entity;

(5) Establish a system of close supervision and separate regulatory functions from ownership functions of state agencies at SOEs;

(6) Improve scale, management capability and capital resources of SOEs that need to be maintained and developed; Establish a SOE governance model that complies with corporate governance rules;

(7) Promptly establish a financial supervision system which is strong and effective with regard to capital use management to ensure provision of adequate information on a regular basis to management and supervision agencies;

(8) Continue improvement of mechanisms and issuance of regulations on representatives and supervisors of SOEs. These regulations should establish clear rules, strict powers, obligations, and benefits to strengthen supervision efficiency. Empower management and supervision agencies with sanctions strong enough for improved supervision efficiency; and

(9) Continue acceleration of arrangements and equitization of SOEs and conduct comprehensive and diagnostic assessments of the effectiveness and overall health of the State Capital Investment Corporation (SCIC).

### **Financial market restructuring solutions**

With regard to financial market restructuring, the recommended actions are as follows:

(i) Pay due attention to solutions on psychology, information and communication in order to mitigate excessive impacts of "inflation expectations";

(ii) It is essential to develop comprehensive policies and measures to build confidence in the stock market. The stock market should be strengthened through additional legislation and reliable supervision regimes. The State Securities Commission and the Ministry of Finance should have tools which are effective and should act in a more timely manner to keep up with rapid developments in the stock market; Continue improvement of the more detailed regulations to facilitate M&A



transactions in the stock market to reduce the number of securities companies to a maximum of 30-40 companies which would be able to operate efficiently and sustainably in the market;

(iii) Overall solutions for the gold market need to be put in place promptly. Moreover, extreme administrative measures (such as prohibition of buying and selling) should be replaced by market-oriented measures, including in relation to economic laws;

(iv) For the commercial banking system, it is necessary to develop policies to encourage M&A activities to establish bigger and stronger banks and eliminate ailing banks. Strengthening risk management in commercial banks, securities companies and finance companies must be considered as one of the most important factors for financial institutions. Risk management in commercial banks needs is required with a particular focus on handling bad debts and high-risk debts. Furthermore, there is a need to diversify foreign exchange reserves and reduce its heavy dependence on the U.S. dollar; and

(v) Bank restructuring and SOE restructuring need to take place simultaneously and in a coordinated manner. Consistent with this recommendation, "close and effective cooperation in running monetary policy and fiscal policy, as well as in implementation of other policies such as trade and investment policy, is a fundamental principle in macroeconomic management and essential to achieving macroeconomic stability and to balance the economy".