Restructuring process in Vietnam: THE ROAD MAP AND INITIAL RESULTS

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Abstract

Restructuring in Vietnam has become a critical necessity to ensure efficiency and stability, especially in the context of long-lasting recession in the economy as a whole. This paper reviews Vietnam's economic growth model to point out the demand for restructuring the key blocks of the economy. The paper also discusses the road map for Vietnam's restructuring process and synthesizes the initial achievements of the process so far.

Keywords: *economic growth, restructuring, state-owned enterprises (SOEs), banking / credit sector.*

Introduction

Over the 25 years of Doimoi, Vietnam has gained significant outcomes. GDP per capita (in constant and PPP USD 2005) in 2012 was 3.46 times higher than the figure in 1990, reaching USD 3,133. The poverty rate declined sharply from 58% in 1993 to 9.6% in 2012[1]. The human development index (HDI) in period 1990-2012 increased by 50.55%, the highest rate among 5 ASEAN countries: Indonesia, Malaysia, the Philippines, Thailand and Vietnam. The life expectancy increased by 10 years from 65.6 in 1990 to 75.4 in 2012 (UNDP, 2013). These achievements are fundamentally resulted from institutional reforms towards market liberalization, expanding rights of doing businesses, and private ownership on assets.

However, Vietnam's economy has been now facing a hard time that requires radical policies and measures to overcome the challenges. Over the last 5 years Vietnam has been countered with serious problems: economic growth significantly slowing down,

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[1] Food poverty line: the cost of basic food requirements, equivalent to 2100 kcal/day/person

serious macroeconomic instability, weakening banking sector, low efficiency of investment, pilling up bad debts from state-owned enterprises (SOEs), etc. These problems need to be solved and Vietnam has to change her growth model to adapt to the changing of domestic and international environment, or in other words, restructuring should be the essential answer for all the economic problems in Vietnam.

The objectives of this paper are: (1) to review the picture of Vietnam's growth model and its outcomes; (2) to point out the bottlenecks in the economy that require for restructuring in the current context of recession; (3) to synthesize and analyze the initial results of restructuring process in Vietnam in recent years and to highlight several implications for better efficiency and effectiveness in Vietnam economy's restructuring.

1. Vietnam's economic growth model and its outcomes

1.1. Economic growth model

Over the last 25 years, Vietnam has pursued the economic growth model with the following characteristics:

- Consecutively increasing investment from three sectors: private, foreign and state investment, in which state investment dominates;

- Capital has been allocated mainly through the banking sector, stock exchange market and public investment, in which public investments are mainly allocated to SOEs without competition;

- SOEs play the leading role not only in providing public goods but also in many other sectors: petrol, electricity, transportation, ship building, tourism, banking, construction, mining, etc.;

- There is a dualism in the economy: non-state sector has to compete under market mechanism; SOEs are well-connected with state agencies (Line ministries, Provincial People's committees, etc.,) hence received favorable conditions in accessing credit from banks and state, in market access, land access, etc.;

- The economy is increasingly open and integrated deeply in international economy. The competitiveness of the economy in the international market is based mostly on static comparative advantages such as cheap labor and natural resources, cheap power;

- Banking sector plays a dominant role in providing capital for the economy, especially for the non-state sector.

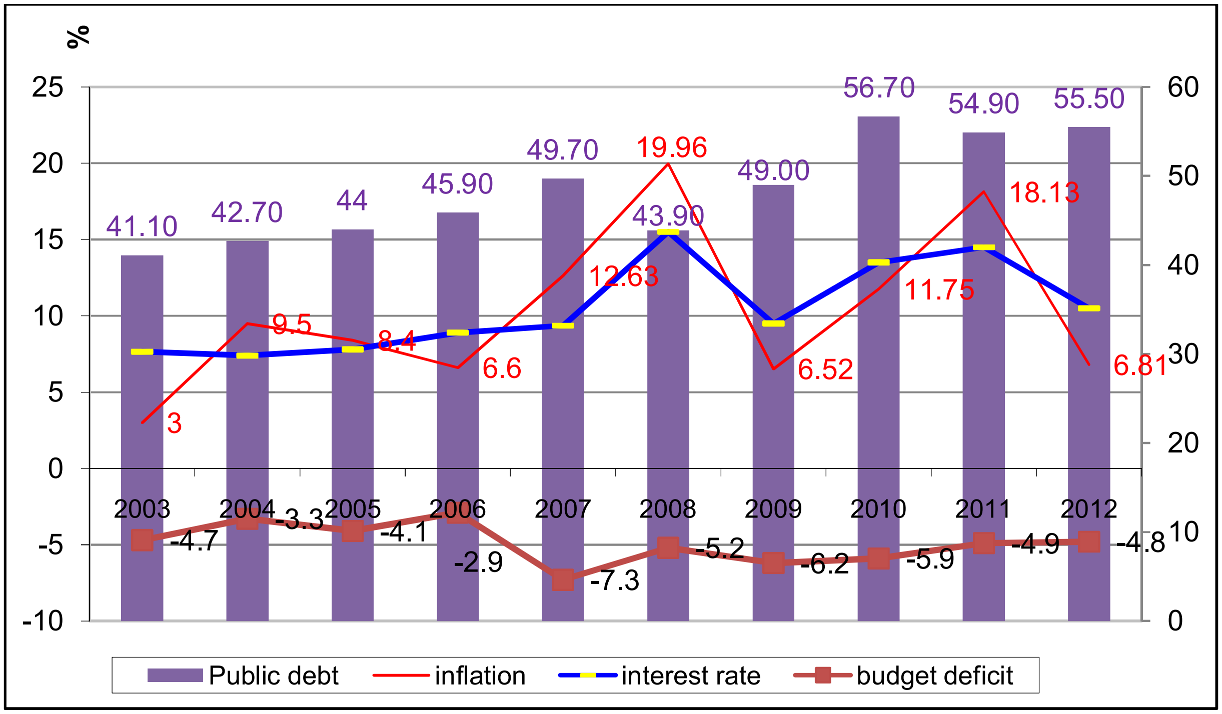
1.2. Outcomes of the growth model

In the initial stage of development when capital is relative rare in comparison with labor, the capital-augmenting model was highly effective for Vietnam: high growth rate, significant improvement in people's living standards, sharp reduction of poverty.

It seems that Vietnam has not gained substantial improvement in human capital and TFP[2], hence, increasing investment in capital has resulted in the decreasing efficiency of capital. To maintain the pace of economic growth, Vietnam needs more and more capital. Consequently, investment in the real sector declines on the one hand, and speculation

[2] In our calculations, TFP growth in Vietnam in period 2000-2012 on average is below 1% annually.

Figure 1: Macroeconomic instability



Source: General Statistics Office (GSO), Ministry of Finance (MoF) and State bank of Vietnam (SBV)

in the financial sector and real estate market escalates on the other hand. The economy has started falling into bubble and instability: prices of real estate, interest rates, public debt, budget deficits, etc. have been increasing since 2007.

The supervisory system has not kept pace with the expansion of the financial market. As soon as the financial market crashed with booming non-performing loans (NPL), banks' insolvency, escalating interest rates with very high inflation[3], etc., many serious problems in the banking sector have been gradually revealed. The supervisory system did not detect any premonition of the crash; many regulations in banking sector had been evaded; enterprises and banks had easily deceived the supervisory agencies by fraud accounting until default.

Overheating financial and real estate markets accompanying with negative impacts of the global economic crisis since 2008 has caused serious instabilities in Vietnam's economy. The economy has become less dynamic; economic growth has been decreasing and left behind many other economies in the region; inflation escalated up to nearly 20% and stayed high for long time; interest rates rose sharply from around 8% in 2006 to more than 20%

[3] According to Banking Supervisory Agency of State Bank of Vietnam, the rate of NPL in banking sector in Vietnam in March 2012 is 8.6% and in September 2012 is 8.82%, since then this agency stopped reporting their own figures of NPL but confirmed the rising trend of NPL.

in 2008 and 2011; trade deficit was high and obstinate for more than two decades; budget deficit broke the line of 5% of GDP; building up public debt, etc.,(Figure 1).

These problems have been mainly ascribed to internal weaknesses of the economy, in which the sluggish change of institutions plays an important role. Nowadays, Vietnam has fully exploited her static advantages of cheap labor and natural resources. Vietnam now is in the urgent need of improving productivity, hence investment efficiency[4]. Current institutions distort market signals in resource allocation; low efficient SOEs sector received more resources than the more efficient one - the private sector; vested interest groups have a strong influence in preventing institutional changes towards a market-friendly transparent and accountable one.

1.3. Current resolutions

By the end of 2011, the National Congress of Communist Party issued the resolution of "changes of economic growth model from resource-based model (in-width economic growth model) towards a model that combines appropriately both in-width and in-depth dimensions, growth is not only based on expanding resources but also gradually derived from improved quality, efficiency and sustainability". The economic restructuring in Vietnam is to recover macroeconomic growth; to enhance economic performance and competitiveness; and to maintain high and sustainable growth rates to avoid the middle income trap. Specifically, Vietnam aims to achieve the following goals:

- Accelerating the renovation of business administration and development strategy; and enhancing product, business, and national economic competitiveness;

- Improving investment and business environment to help businesses get integrated deeper and more effectively into the international production chain to achieve higher added values;

- Developing the diversification of industries for job creation and income generation.

Economic theories indicate that the new growth model requires minimizing the distorted interference from state agencies on the one hand, and establishing efficient institutions to enable market mechanism working well and to correct market failures on the other hand.

2. Road map for economic restructuring in Vietnam

2.1. Objects of economic restructuring

Restructuring the overall economy of Vietnam aims at the following objectives:

- First, gradually and consecutively improving the efficiency of using resources; enhancing productivity, total factor productivity (TFP) and the economy's competitiveness; then shifting economic model from resources-expanding-based to efficiency, labor productivity and TFP augmenting.

- Second, maintaining macroeconomic stability sturdily with low inflation and strong macroeconomic foundation; advancing the

[4] Vietnam's ICOR keeps increasing since 2006. If GDP is calculated in constant price of 2010, the calculated ICOR consecutively increased from 5.18 in 2006 to the peak of 6.82 in 2009, then slightly decreased to 5.46 in 2012. It is worth noting that the world norm of ICOR is around 4.3.

capacity and potential of the country in coping with instability and fluctuations in international and domestic market; partially contributing to the security of national finance.

- Third, establishing properly balanced development between localities and regions on the basis of utilizing comparative advantages of each locality and each region; combining, coordinating and complementing of regional localities' advantages with selective and efficient supports from central government.

- Forth, step-by-step and consecutively improving and upgrading industries' and economy's development levels; whereby high-tech and high value-added industries gradually replace low-tech, labor-intensive and low value added industries and then become principal industries of the economy.

- Fifth, improving the independence and self-determination of the economy; maintaining political stability, ensuring national security and social order.

- Finally, establishing a proper and more pro-active economic structure which is of high competitiveness and greater growth potential; helping to achieve socio-economic development targets which are set forth in the Strategy for socio-economic development in the period 2011-2020.

2.2. Directive viewpoints on economic restructuring

Economic structure, in general, is not a division or a separation of economy into "the less developed and the developed", "the obsolescent and the modern", "agriculture and industry", but it is a range of continuous points of structure from the low to the high. Consequently, economic restructuring is a long-run process, gradually alters and shifts from resource exploitation, less capital-intensive, labor-intensive, low-tech, low value-added industries towards capital-intensive, higher value-added and technological industries; whereby the economy gradually shifts from the first stage of development to the second and then the third[5].

Vietnam has well recognized that the economic restructuring in association with growth model renovation is an ambitious and complicated task. It requires synchronistic implementation in all sectors, in governmental agencies, in all fields within the country, in each locale, and in basic units for a long time. Vietnam's economy needs not only restructuring but also rapid shifting economic structure, enhancing technological capacity, improving efficiency and competitiveness, upgrading development level.

The process should be conducted in a clear road map and consecutively. The general road map of the process:

- Analyzing and clarifying reasons of failures of old economic growth model;

- Preventing macroeconomic instability;

- Maintaining macroeconomic instability;

- Changing institutions in managing market economy with three fields: public investment, banking sector and SOEs.

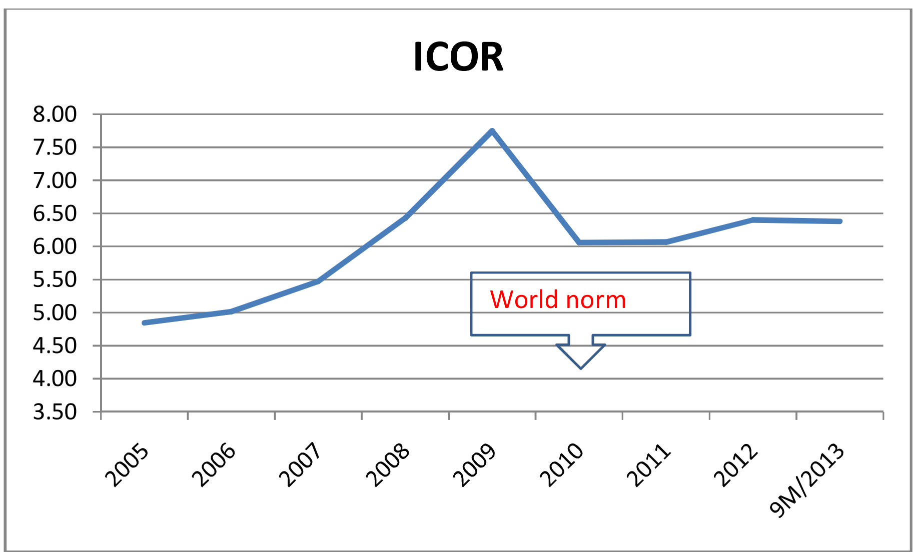
Macroeconomic instability in 2011 and tightening monetary and fiscal policies exposed clearly the economy's setbacks:

[5] Pre-industrialized, industrialized and post-industrialized stages.

loose regulations and weak compliances to these regulations in financial sector and SOEs causing serious bad debts in many enterprises and commercial banks; public investments had been misallocated and approved far over the available state's resources; weak corporate governance, especially in SOEs and commercial banks; financial institutions (including stock markets) failed to efficiently channel idle capital for the real sector, etc.

Hence, the process of economic restructuring concentrates on improving the efficiency of resources allocation: (i) restructuring the crucial channel of providing capital for enterprises: the system of credit institutions which focuses on commercial banks; (ii) restructuring the mechanism of public investment including: allocating, supervising, and assessing; (iii) restructuring SOEs in parallel with strongly developing the scope and quality of private businesses; and (iv) restructuring economic activities and economic regions in the direction of reorganizing industries and services to be suitable with specific regions; adjusting market strategy; rapidly increasing added and domestic value.

Figure 2: ICOR in period 2005-2013



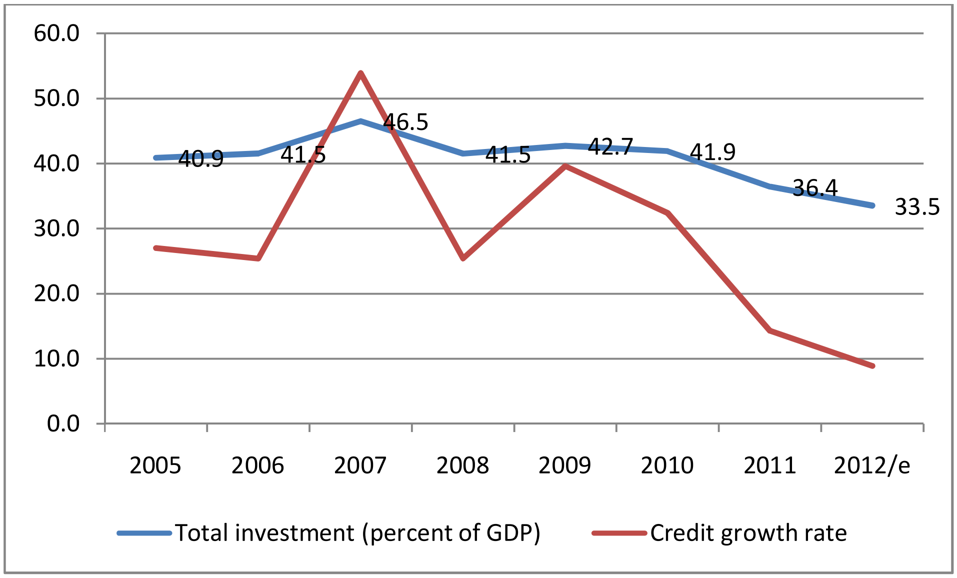
Source: Calculated by authors based on the data of GDP and investment from GSO. GDP is calculated on 1994 price.

2.3. Preventing macroeconomic instability

Capital-augmenting economic growth model without improvement of human capital and technology will sooner or later face with the law of diminishing return. Vietnam had enjoyed high economic growth in period 1990-2008, however, the efficiency of investment declined significantly in period 2005-2009 and slightly improved in 2009-2013 (Figure 2). However, the ICOR index remains far above the world norm.

Low investment efficiency requires more and more capital to maintain economic growth rate as planned. The Government had

Figure 3: Credit growth and investment rate to GDP



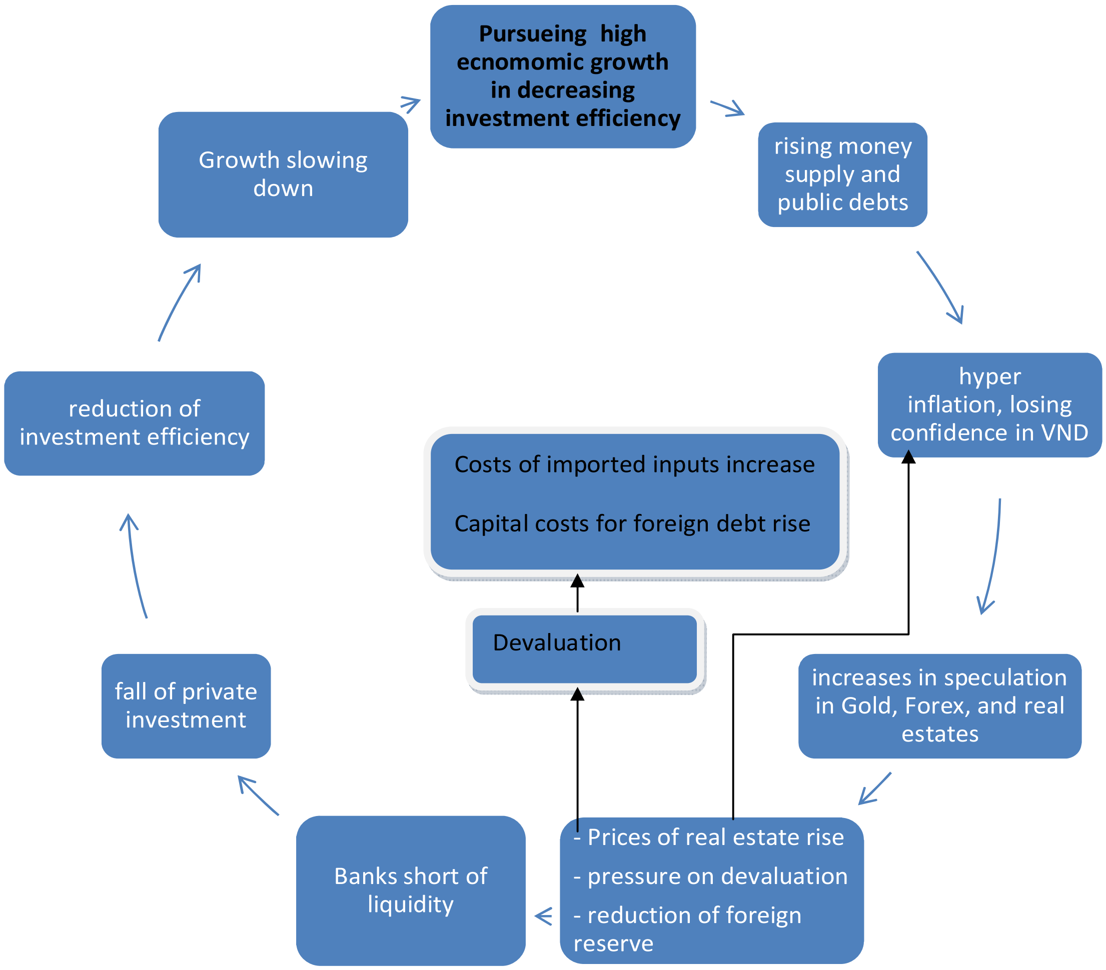
Source: SBV and GSO

to loosen the monetary and fiscal policies. As a result, credit supply and public investment soared up to the record level in 2007 (Figure 3). These policies together with the loose regulations in the financial sector, in SOEs' governance, and in allocation of public investment triggered the longest period (from 2008 up to now) of macroeconomic instability since 1986.

Figure 4 describes the cycle of macroeconomic instability in a high dollarization economy. In pursuing high economic growth in the context of decreasing investment efficiency, Vietnam had to increase money supply and public investment. These policies lead to high inflation and reducing of people's confidence in VND. People started speculate gold, foreign exchange, and real estate which cause uprising prices in these markets and loss of foreign reserves. Holding VND became riskier and less profitable than USD, gold and real estate. Banks started seeing shortage of liquidity and then increasing interest rates. Consequently, investment from the private sector, the most efficient sector, fell down. Investment efficiency and economic growth slowed down further; more investment (mostly from the State) is needed to meet the target of economic growth. Moreover, the increase in demand for gold and foreign exchange puts pressure on exchange rates. As soon as foreign reserve shrank to the critical level, the State Bank of Vietnam had to devalue the VND. As a result, inflation increased further due to the rise in prices of imported goods and in foreign debt.

In order to stop this cycle, Vietnam needs to cut down public investment, tighten monetary policy, and hinder speculation in foreign exchange, gold and real estate markets. On 11th February 2011, the Government of Vietnam issued the Resolution 11/NQ-CP to stabilize the economy with the following measures:

Figure 4: Cycle of Macroeconomic instability



- Requiring commercial banks to cut down all credit to "non-productive activities"[6] down to 21% by 22nd June 2011 and to 16 by the end of 2011;

- Tightening public investments by Directive 11/CT-TTg;

- Setting up the ceiling for credit growth for all banks;

- Devaluating VND by 9.36%, which was overshot the expectation to clear the pressure of expectation on devaluation in the short-term;

- Shutting down parallel markets for foreign exchange, which put more risks on holding foreign exchange;

- Enlarging the spread between deposit rate on VND and USD to encourage people holding VND and selling USD to banks;

- Increasing interest rates to curb down inflation;

- Increasing expenditures on social security plans.

These measures have been effective in stopping the recession cycle: inflation roared

[6] This terminology refers to investment in real estate and securities.

up to peak in August 2011 and then firmly decreased to around 7% in 2012 and 2013; easing the liquidity in banks, then steadily reducing the deposit interest rate to around 8%; exchange rates have been roughly constant since 2011 with changes less than 3% over two and half years; foreign reserves increased from below USD 10 billion at the beginning of 2011 to around USD 32 billion so far[7]; trade balance in 2012 showed the first surplus over the last 20 years and a minor deficit in the first 9 months of 2013.

2.4. Focus of economic restructuring

2.4.1. Restructuring system of credit institutions, stock market and financial institutions

The objective of this focus is to eliminate the risks of insecurity to the financial system in particular and to the whole economy in general. This also creates favorable conditions for the financial system to sustainably develop, to well function as financial intermediaries whereby to effectively transmit the impact of monetary policies to business and household sectors.

Restructuring the system of credit institutions focuses on the following specific contents:

- Overcoming difficulties and weaknesses and proactively confronting with challenges; concurrently, strengthening and developing system of credit institutions which are diversified in scale, ownership, and type and appropriate for current characteristics and level of development of Vietnam in order to better meet requirements for the nation's socio-economic development.

- Upgrading Vietnam credit institutions' role, influent and market-leading position, ensuring that commercial banks are capable of competing domestically and internationally.

- On the basis of assessment on financial situation, operation and governance, especially on quality of assets, debts, equity capital and capital adequacy ratio, credit institutions are categorized into three groups, including healthy institutions, institutions are in contemporary shortage of liquidity, and weak credit institutions to customize solutions for.

- Weak credit institutions will be restructured in four dimensions: vitalizing financial status by controlling bad debts, improving governance, restructuring portfolio, owners and ownership. All other credit institutions have to be comprehensively restructured their financial portfolios, activities, and governance by clear road maps, forms and approaches which are appropriate with specific conditions of each institution.

- Encouraging banks to take M&As (mergers and acquisitions) on the voluntary principles; ensuring the interests of depositors, and rights and responsibilities of related parties in compliance with legal stipulations. To assure the safety and stability of banking and financial system, credit institutions of high risks which are dangerous to the system security will be applied special solutions as speculated by laws.

- Underpinning banking system from being collapsed and insecure; assuring full and on time repayment for depositors; minimizing

[7] Or equivalent to 2.8 months of imports (reported by SBV)

losses and costs of adjustment in the system of credit institutions.

Restructuring stock market and related financial institutions will be implemented in four dimensions, including diversifying and enhancing quality of products in stock market; restructuring investors in the direction of diversifying investors, enlarging number of institutional and professional investors; rearranging organizations that do business of security and insurance in the direction of improving financial ability, quality of services and risk management; finally restructuring stock markets towards markets that are of united criteria for listing, transactions, information supply, risk management and system of governance.

2.4.2. Investment restructuring

Investment restructuring particularly focuses on public investment in order to improve the efficiency of investment and using current use of resources[8] in the state sector, partially helping to upgrade the general efficiency in the economy as a whole.

- The essence of restructuring investment is to fundamentally renew the mechanism and the way of capital mobilization and social investment allocation and usage in accordance with the following orientations:

- Properly mobilizing total social investment and concurrently assuring macro balances in the economy including the balances between savings and consumption, domestic savings and investments, budget balance, balances of payment, public and foreign debts.

- Maintaining an appropriate proportion of public investment in the total investment in company with strengthening the investment from other economic sectors and enhancing investment efficiency, particularly the efficiency of public investment.

- Clearly identifying the fields that are of priority for state investment. Immediately, the concentrations are investment for building synchronized infrastructure with some modern works, traffic system and infrastructure in metropolitans, development of human resources, especially high quality workforces, industries that are crucial for socio-economic development but out of interest of the private sector. At the same time, the management mechanism must be renovated to ensure that within the fields of priority, the highest socio-economic efficiency projects will be invested and implemented effectively.

- Enlarging the scope and opportunities for private investment, particularly for domestic private investment. Encouraging the private sector to invest in the fields that they are not very interested in; facilitating and promoting the private sector to involve in the fields that are currently out of their capacity. The state sector does not directly compete or crowd out the private sector in the sense of business opportunities and development. At the same time, renovating regulations on encouraging incentives, preferences, and investment promotion for enterprises, orienting investment to focus on development of priority industries and driving economic regions.

2.4.3. SOEs restructuring

SOEs now are using a big share of social resources, namely 27% of total credits, 39% total working capital, 45% of total fixed capital in enterprises. The capital efficiency in SOEs

[8] Or equivalent to 2.8 months of imports (reported by SBV)

is, however, much lower than that of enterprises in other sectors; the SOEs' contribution to the economy is not corresponding to the resources that are currently under their management. Bad debts in SOEs have induced serious problems for banking system and budget burden.

In period 2012-2015, restructuring SOEs would be concurrently implemented on three following dimensions:

- Firstly, rearranging, categorizing, restructuring portfolio investment and involved businesses, concentrating on core businesses, equitizing and diversifying the ownership of SOEs that the State needs not hold 100% equity.

- Secondly, renovating, developing and applying modern governance frameworks in accordance with internationally best practices for state owned economic groups, State owned corporations.

- Thirdly, altering the business environment to impose completely legal regulations and market disciplines on SOEs to force them to operate under market mechanism and competing equally with other enterprises.

- Fourth, equitizing and diversifying the ownership of SOEs could basically generate three changes mentioned above. This is the most sensible solution for enhancing resource using efficiency in SOES and also their operational efficiency.

3. Initial results of the restructuring process

Although the economy is still growing at a low rate, the macroeconomic instability has been controlled. Inflation in 2012 reduced to 6.8% and remained low about 6.3 % - 7% in 2013. Exchange rate is almost unchanged since February 2011 while foreign reserves increased by more than 3 times from the beginning of 2011. Credit growth is still in lag behind the target, however, lending interest rate steadily declines from around 25% in 2011 to about 11.5% in September 2013.

Numerous proposed laws and legal documents have been submitted to the National Assembly and the Government to change the institutions towards a more market-friendly environment: amendment of laws on corporate income tax, personal income tax, and tax on added value to reduce taxes for enterprises and individuals; amendment of Land Law to give more rights to land users; compliments and amendment of the Law on bankruptcy, etc.

The economic growth has not recovered to the expected rate (around 7% - 7.5% annually). However, the confidence of investors has been consolidated. Registered FDI capital in 2013 is estimated to be about USD 20 billion, which is 30% higher than 2011.The economy competitiveness in 2012 (reported in 2013) increases by 5 ranks[9]. According to the assessment of S&P, credit default swap (CDS) for 5 years mid PAR spread, a measure of the sovereign risks, have been declined sharply from 466.8 bps in the end of third quarter of 2011 to around 200 bps in the beginning of 2013, and stayed around 240 bps in the end of second quarter of 2013. The economic growth has slightly recovered from quarter to quarter: 4.76% in first quarter, 5% in second quarter, 5.54% in third quarter and estimated to be around 6% in fourth quarter of 2013.

[9] World Economic Forum, The Global Competitiveness Report 2013-2014

3.1. Public investment

The proportion of public investment in the total social investment has declined steadily from 38.7% in period 2005-2010 to 37.4% in 2011-2012 and 37.1% in 9 months of 2013. The investment for development from State budget also decreased from 8.5% of GDP in 2010 to 6% of GDP in 2012 and 4.71% in 9 months of 2013. Public investment now prioritizes for finishing uncompleted projects to bring these projects into production in soonest manner.

The ministers, presidents of provinces have to hold responsibilities for using efficiently public investments. The allocation of public investment has to comply with the Directive 1792/CT-TTg and Medium term of Investment Framework. These instruments have helped improving the transparency and accountability in using and supervising public debt in provincial and ministerial levels. Additional break-throughs in this field will be stipulated in the Law on Public investment, Law on investment for SOEs, Law on Public Procurement and Bidding, and amended Law on construction. These laws are expected to be approved in on-going National Assembly Meetings.

3.2. State-owned enterprises (SOEs)

The government has determinedly restructured SOEs and issued legal documents to specify principles, views, and general solutions to restructure SOEs. Based on these instructions, SOEs have to build their own plans. So far 100 out of 101 National Corporations and National Economic Groups have submitted their plans of restructuring and these plans have been approved by the Prime Minister. These SOEs are trying to withdraw their investments in non-core businesses and restructure debts and portfolio to vitalize financial status. In the mean time, these SOEs are gradually changing their model of governance towards the best practice. These SOEs are now also conducting corporate valuations for equitizing their subsidiaries.

In regards to state management of SOEs, recently the Government has issued around 30 legal documents to tighten the supervision of SOEs operation and to force these enterprises to become more transparent and accountable.

3.3. Credit institutions

The problem of serious shortage of liquidity in commercial banks has been eased; the threat of banking collapse has been repelled. Lending interest rate is still rather high (about 11.5%) but keeps on going down.

Weak banks have been restructured by either merging into a strong one, merging with each other under close assistance from SBV, or calling for additional capital from other investors. Bad debt remains high but under control. According to reports from credit institutions, by the end of August 2013 the total bad debt accounted for around 4.64% of total credit. In addition, the State Bank of Vietnam has established Vietnam Asset Management Company (VAMC) to buy bad debts from banks. So far VAMC has bought about USD 300 million of bad debts from banks to help banks to have more resources to provide credit for the economy.

In brief, restructuring process in Vietnam has been receiving great attention and determination from all levels of government authorities. The process has brought certain initial achievements which indicate the correct direction of the economy toward efficiency and stability. The road map of restructuring the key blocks of the economy should be respected and abode by, but necessarily in a smartly flexible and adaptive way and with strong commitments from all related parties to ensure the highest potential success.❑

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