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BUILDING UP AND IMPROVEMENT OF THE INSTITUTION OF THE SOCIALIST ORIENTED MARKET ECONOMY IN VIETNAM

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1. Background and concepts

The market oriented economic reform direction has been officially affirmed since the VI Congress of the Vietnamese Communist Party (1986) with the approval of the economic reform plan towards "doi moi". This direction was then legalized in the Constitution (1992) and further developed in official documents of Communist Party Congresses and legal documents of the Government of Vietnam . In the past years, to specify this political direction, the Government and people of Vietnam have made endless efforts to establish a new economic institution system called the socialist oriented market economy.

In Vietnam, *the market economic institution* is currently understood as an integrated part of the social institution system which exists alongside others such as the political institution, family institution, culture institution, religion institution, and so on. Elements forming that institution system include: (I) rules and norms on economic behaviors taking place in the market; (ii) all market participants playing as market actors; (iii) mechanism to implement of market rules and norms in order to achieve goals set by market players; and (iv) the system of factor markets acting as place, or "playing field", where transactions take place or commodities and services are traded based on supply- demand principle and the "rules of game" (Table 1).

Vietnam has chosen the socialist oriented market economy model because the classical socialist economic model characterized by the centrally planning economic system proved to lack economic vitality and self-development after decades of existence. The market economy as a production mechanism has proved its usefulness for effective resource use and allocation. So, this is not the only asset of the capitalism. However, the actual development of market economies always contains implicit failures as it conflicts with traditional values, which intensifies social instability and poverty gap. Consequently, the State's role as a creative and powerful actor of the society who supervises macroeconomic processes to mitigate market failures for achieving development goals should be efficiently used. Institutions of the socialist oriented market economy in Vietnam, therefore, have been built and implemented with an aim to make the "market" and the "State" become two *mutually supplementary* elements, rather than *substitutive or mutually exclusive ones*.

Table 1: Elements forming a market economic institution

Elements	Description
◆ Rules forming the market economic “playing rule”	<ul style="list-style-type: none"> ○ <i>Legal framework on economics;</i> ○ <i>Social rules and norms on or related to economics, inclusive of informal rules and norms;</i>
◆ Actors participating in the market economic “game”	<ul style="list-style-type: none"> ○ <i>State economic management agencies;</i> ○ <i>Enterprises;</i> ○ <i>Organizations under the “civil society”, people communities and citizens;</i>
◆ Mechanisms to implement “economic playing rules” in the market	<ul style="list-style-type: none"> ○ <i>Supplementary mechanism between the Market and the State;</i> ○ <i>Economic management decentralization mechanism;</i> ○ <i>Coordination mechanism;</i> ○ <i>Participation mechanism and so on.</i>
◆ “Economic playing fields” or system of “hard markets”	<ul style="list-style-type: none"> ○ <i>Commodity market;</i> ○ <i>Capital market,</i> ○ <i>Labour market,</i> ○ <i>Real estate market,</i> ○ <i>Others</i>

The following part will brief on the development and improvement of the institutional system of the socialist oriented market economy in Vietnam in recent years.

2. Development and improvement of the economic legal system

2.1 - Achievements

Right after the economic reform process started, the Vietnamese government has formulated and issued a number of legal documents in form of codes, laws and ordinances directly linked with market economic development and business sector encouragement. Since 1986, hundreds of laws and ordinances (including amended laws and ordinances) have been issued and implemented. The number of legal documents approved in the last three terms of the National Assembly (the VIII, IX and X) was many times more than that approved in the previous terms. This did not include hundreds of legal documents in form of decrees and decisions of the Government; decisions and

directives of the Prime Minister; decisions, directives and circulars of ministers¹. The economic legal documents have been more and more suitable with the market mechanism. The new legal framework has enabled initial moves of State behaviour from direct intervention to indirect influence over economic activities. The drafting, verification and issuance of legal documents have gradually gone into order, following a legalized unified procedure. The dissemination of legal documents has experienced positive changes, better satisfying diverse demands and raising the legal obedience attitude of citizens. Thanks to such efforts, the legal framework of the market economy has been gradually shaped and improved, which has been characterized as follows.

-Building the legal framework for realizing right of doing business by law , developing a multi-sector economy and efficient exploitation of social resources

With the issuance of *the Law on Foreign Investment* (1987), *the Company Law and the Private Enterprise Law* (1990), Vietnam has officially recognized the lawful existence of non-state economic sectors. *The Law on State-owned Enterprises* (1995) and *the Law on Cooperatives* (1996) were then issued, creating the basic legal framework for various types of businesses in the multi-sector economy, as well as gradually restricting the State's intervention in daily operation of businesses.

In addition, thanks to the *Law on Bankruptcy* (issued in 1993 and amended in 2004), the legal framework for businesses' market withdrawal has also been developed. creating an important condition for the efficient allocation of resources.

The biggest turnaround of the reform process in recent years was the issuance and implementation of the *Law on Enterprises* (2005). The enactment of this law resulted from the political commitment on creating a favourable and equal business environment relevant to the socialist oriented market economy and requirements of the international economic integration process. This aims at removing the fragmentation and separation by economic sector of (previous) legal system on enterprises which regulated similar legal business entities of different economic sectors by different legal provisions. Such discrimination were seen in various aspects, including business entry and exit conditions and procedures, internal corporate governance methods and so on². Now, thanks to the new *Law on Enterprises* (2005), the right of business freedom and equal which was stipulated in the 1992 Constitution has been realized and created a new atmosphere in the investment environment of Vietnam.

¹ Cited from “Improving the drafting quality of laws and ordinances prepared by the Government” – Dr. Pham Tuan Khai – Legislative Research Magazine – 3/2004.

² For example: SOEs operate under the *Law on SOEs* (2003), the *Enterprise Law* (1999) regulates private businesses. Foreign invested enterprises are subject to the *Law on Foreign Direct Investment* (1996).

Similarly, the (common) *Law on Investment*, replacing the Law on Foreign Investment and the Law on Domestic Investment Promotion, approved by the National Assembly in 2005 and to be enacted on 1/7/2006, has remarked an extensive advancement of investment environment, creating an equal “playing field” for both domestic and foreign investors. This Law also consists of new provisions simplifying investment procedures, creating favorable conditions for better attracting and utilizing investment capital, meeting requirement for the international economic integration.

- *The legal framework on the commodity and service markets has been facilitating the efficient operation of market mechanism*

The development of commodity and service markets, especially the market of consumer goods and export products, were one of important institutional reform steps and contributed to achievements in the initial period of Doi moi. This initially resulted from deregulation process through the removal of “closed-door or restrictive” regulations and/or controls, facilitating commodity circulation. Then the *Ordinance on Economic Contracts* issued in 1989 created a legal framework for economic transactions in the market. The Civil Code (1995) and the Commercial Law (1997) were also implemented, making market transactions more and more profound.

With regard to *exporting and importing* commodities and services, Vietnam has conducted reform since the beginning period of Doi moi with the removal of the monopoly regime in foreign trade. Since 1988 foreign invested enterprises were allowed to conduct export – import activities, followed by those in the private sector. The application for export – import license was also simplified step by step. The issuance of Decree 57/ND-CP in 1988 could be considered as a turnaround in the foreign trade liberalization process in Vietnam, because it officially affirmed the right to business freedom in foreign trade. In addition, the State also took many measures on loosening foreign currency control, creating better conditions for enterprises to make direct payment with foreign partners. Non-tariff barriers such as quota or export – import focal centers were also gradually removed, which facilitated the international economic integration process of Vietnam.

Alongside the above mentioned measures, in late 80s, Vietnam took strong reform measures in *pricing control* towards forming a single pricing system corresponding with the market price. In 1992, The Minister Council issued Decision 137- HDBT on pricing control. This was the first legal regulation on pricing in the economic transformation process. Ten years later the Standing Committee of the National Assembly issued the *Ordinance on Pricing* to create a legal framework for pricing control in the socialist oriented market economy. This generated positive effects on the economic transformation process. Subsidies through pricing previously applicable to most of commodities were

eliminated. Prices of commodities and services have reflected the supply and demand relationship and facilitated the investment decision-making for better utilization of social resources.

- Establishing a legal framework for the building and operation of markets of the most important production factors

In the last ten years, Vietnam has tried to develop a legal framework so that several markets of the most important production factors could be established and operated. Regarding the *labour market*, the Labour Code (1994) formed the first legal base for the labour market by recognizing the right to free job search and the right to free employee selection. These are the two basic factors creating the supply and demand relationship in the labour market. In addition, other legal documents were also issued to regulate behaviours in this quite primitive market³. With such background, transactions in the labour market were established and gradually developed, not only within but also outside the Vietnam territory. Regarding the *real estate market*, together with the issuance of the *Land Law* (issued in 1988 and amended in 1993 and 2003)⁴ and *the Construction Law* (2004), the State also issued and supplemented the legal document system with policies on specific issues such as land market, housing market and so on. *The legal framework for the capital market* was also improved. During the beginning years of reform, the Vietnam economy had to cope with hyper-inflation. The State Bank system had both currency printing and credit supply functions. Consequently the transformation from the one-tier to the two-tier banking system was a crucial step to curb inflation, as well as to create conditions for the implementation of a monetary policy corresponding with the market mechanism. In 1990, the Standing Committee of the National Assembly issued the Ordinance on the State Bank of Vietnam and the Ordinance on banks, credit cooperatives and financial companies. In 1997, the National Assembly passed the Law on State Bank of Vietnam and the Law on credit organizations in replacement of the above two ordinances. With such legal framework, four state commercial banks were separated

³ In terms of related legal documents, some notable documents are Decree 198/CP (on 31/12/1994) stipulating and instructing on labour contract; Decree 72/CP (on 31/10/1995) stipulating and instructing on jobs; Decree 03/CP (on 15/1/2003) stipulating the modification of salary, wages and social transfer. In addition there are some circulars on social insurance, working time, resting time and so on.

⁴ The basic principle of the Land Law in Vietnam is that land belongs to the whole people (this principle was also stated in the 1980 Constitution that “*land belongs to the whole people*” – a totally new institutional foundation on land). The Land Law has established the long term land use right, inclusive of the right to use land, the right to own products collected from land, the right to transfer the land use right, the right to mortgage the land use right. This Law also divides land into different categories such as agriculture land, forest land, residence land, urban land, special use land and unused land. The Government stipulates land rent quotation for individual categories of land, which is then used by provincial People’s Committees to identify detailed prices.

from the State Bank and series of joint stock banks, joint venture banks and foreign bank branches appeared in the Vietnam's financial market.

Regarding the *science and technology market*, it was the first time the protection of intellectual property right was input in the Civil Code (1995). In the last decade, with the direction of “considering science and technology as a momentum for growth”, a number of mechanisms and policies facilitating the operation of the science and technology market have been legalized. This legal system regulates behaviours, participation and interactions among organizations participating the science and technology market. It is necessary to name some important legal documents relating to the operation of the science and technology market: The Law on Science and Technology (2000); the Civil Code (1995); the Criminal Code (1999); and the Commercial Law. In addition another hundreds of under-law documents were also issued. Especially, the two important laws on Intellectual Property and Technology Transfer were issued in 2005 and 2006, respectively.

- *Building and harmonizing the legal system to enhance the international economic integration process*

After the *Law on Foreign Investment* was adopted, it was amended and supplemented four times in 1990, 1992, 1996 and 2000 to accelerate foreign capital attraction and to harmonize the Vietnamese legal framework with the international one. In addition to the Law on Foreign Investment, Vietnam also amended and supplemented other important laws such as Land Law, Labour Code and Competition Law .

In regard to international relations, the Government of Vietnam has actively signed and endorsed many bilateral and multilateral trade agreements with foreign countries and territories⁵, as well as participated in regional and international trade organizations. Many commitments in the above mentioned agreements such as removal of discrimination between domestic and foreign consumers in terms of price and fees of several commodities and services⁶; gradual reduction of restrictions on technology transfer, foreign currency control, land use and so on have both mitigated trade and international investment barriers and created “foundation” for the ongoing improvement of the legal system on foreign investment in Vietnam. At present, in order to obtain positive results on WTO accession negotiations, the Government of Vietnam has quickly developed and

⁵ To date, Vietnam has signed 47 Agreements on Investment Encouragement and Protection with foreign countries and territories, in which the Bilateral Trade Agreement between Vietnam and the USA has brought about many new opportunities for enterprises.

⁶ The agenda to eliminate the two-pricing regime has been accelerated. The domestic air ticket price was unified from 1/1/2004. Under the WTO accession negotiation, Vietnam committed to remove discrimination on electric charges for production in 2005.

amended the current legal system and policies towards further market opening, satisfying WTO's requirements. At the same time, the active participation in international agreements and efforts of harmonizing international rules and norms have significantly contributed to the enhancement of the market characteristics of economic institutions in Vietnam.

2.2 – Weaknesses and shortcomings

Despite the above mentioned efforts, the Vietnam's economic legal system has generally remained weaknesses and shortcomings and could not catch up with demands for socio-economic development. This was clearly showed in the following practical issues: (i) *The legal system is incomprehensive, asynchronous and unable to satisfy the requirements for national management by law.* Many important issues related to socio-economic reform have been slowly legalized, inclusive of state management over state – owned assets; registration of real estate business; fair competition; monopoly control and so on; (ii) *Several important legal documents were issued but of low enforcement.* For example, the Competition Law which was issued in 2004 had poor enforcement due to the existence of loopholes abused by some enterprises to dominate the market, which harmed benefits of the society in general and small enterprises in particular; (iii) *The levels of detail, transparency and clarity of many laws were poor:* Mistakes on document format remained. The announcement, publication and instruction of legal documents have not been followed by state agencies in a timely and strict manner; (iv) *The legal drafting procedures lack democratic and public participation:* There remained a number of stiffness and shortcomings. The assignment and implementation of document drafting have easily led to local benefit orientation attitude of ministries and provinces, rather than for the mutual benefits and citizens' convenience.

3 – SOE reform and rearrangement

3.1 Achievements

One of the most important business reforms was the implementation of rearrangement and gradual introduction of the modern corporate governance mechanism over SOEs. The most notable achievements in this field were as follows.

- *Transformation of SOEs to operate under the same legal framework with other types of businesses* has been undergone. Legal regulations stipulated in the Enterprise Law are being reviewed to ensure their practicability and suitability.
- The SOE corporate governance model is being reformed to ensure rights of owners, economic efficiency of enterprises and fair competition with enterprises of all other economic sectors. The state ownership has been further distinguished from the state management.

- The legal rights of co-owners of SOEs in which other economic sectors make investment are more and more respected and guaranteed. The intervention of state management agencies over lawful and charter-obedient decisions of enterprises has more and more reduced, especially in joint stock companies established from SOE equitization.
- Stakeholders are more and more paying attention to the transformation of state general corporations into holding-subsidiary companies; the establishment and development of different business groups, mainly multi-ownership groups formed by mutual cooperation and investment among subsidiaries or equitization of general corporations; the encouraged development of various business groups formed by private joint stock companies, limited liability companies and sole proprietors.
- Legal regulations on economic coalition and cooperation contract to improve the enterprise professionalism and specialization; transparency of the business information system to minimize risks and opportunity costs for enterprises in the establishment, signing and implementation of economic coalitions via contracting have been reviewed and amended; creating conditions for the establishment and development of economic cooperation modes.

3.2 Weaknesses and shortcomings

However, the SOE reform has still faced with **a number of difficulties and shortcomings** which need to be solved, notably:

- *Large but inefficient SOEs:* In reality, SOEs are holding 75% of national fixed assets, 20% of total social investment capital, nearly 50% of total state investment capital, 60% of total domestic banking credit and over 70% of total foreign borrowings. More than 90% of SOEs cooperate with foreign partners and possess high quality human resource. Despite holding such huge resources, in 2003, less than 40% out of 77% of profitable SOEs had the profitability equal to or higher than the borrowing interest rate of commercial banks. If the land use right value was calculated as cost and state subsidies were cut, the number of profitable SOEs would be even smaller. The corporate income tax was just VND 8,000 billion compared with the total state budget contribution of VND 87,000 billion in 2003, which showed the low performance efficiency of SOEs.

In the last couple of years, the industrial production value of the SOE sector was on decrease in comparison with that of the non-state enterprise sector (the respective figures were 12% and 18% in 2003; 11.8% and 22.8% in 2004 and 7.9% and 25.5% in the first quarter of 2005). High industrial production cost limited the increase in added value. The annual production value in recent years increased by 15%, while the annual added value only increased by less than 10%. In the first quarter of 2004, the industrial production value increased by 14.4%, while the industrial added value only increased by 8.5%. It is

clear that previously a 1% increase in added value required 1.5% increase in production value, while this ratio for the first quarter of 2005 was 1.7%.

- *Many SOEs have technology lower than the average levels of the world and the region:* machinery, equipment and production line are 10 to 20 years outdated than those of the world and 38% of equipment are awaiting liquidation. Technology renovation was slow (around 10% every year); industries with high and modern technology such as electronics only accounted for few percent of the total industrial production value; services with high intellectual value were not of high number.

- *Job creation has not met the social demand:* in the last 11 years (between 1992 and 2003), the whole economy generated another 9 million jobs, while the state sector only absorbed 200,000 people.

- *Industrial productivity has not made remarkable progress:* Figures on social productivity announced by the General Statistic Office in 2002 showed that the productivity between 1996 and 2001 increased by 4.8% per annum, slower than the GDP growth rate of the same period (7%). The productivity in 2000 was worth of VND 12 million, or USD 832, lower than that of Indonesia (USD 1705), China (USD 1517), Thailand (USD 3701) and the Philippine (USD 2690). Compared with other economic sectors, the productivity of SOEs halved that of foreign invested companies.⁷

- *The competitiveness of SOEs remained weak:* The report on "Global competitiveness" by the World Economic Forum in 2004 ranked the competitiveness of 104 countries in 2003-2004, in which Vietnam's country competitiveness and enterprise competitiveness were ranked as 77 and 73, respectively. Notably SOEs could not prove that they had more distinguished competitiveness than enterprises of other economic sectors.

Obviously SOEs have been quite unable to hold the leading position in science and technology application; SOEs' productivity, quality, socio – economic efficiency and legal obedience have not been an example for other economic sectors. Low performance efficiency and competitiveness compared with those of enterprises in other countries become a big challenge when our country deeply integrates into the world and regional economies.

4. Institutional reform to enhance the development of all economic sectors

4.1- Institutional reform efforts to boost the development of domestic private sector

⁷ Figures in this part are cited from the presentation by Dr. Ngo Van Diem, Vice Chairman of the Prime Minister's Research Committee in the seminar entitled "Building market economic institution in Vietnam" organized by CIEM in Hanoi on 29/4/2005.

- The review of current business licences and conditions for doing business in conditional business fields is continued to reduce the number of business fields under the forbidden and conditional lists.
- Regulations related to business fields, capital borrowing, land and market opening in electrics, telecommunication, aviation, cinema, press, advertisement and business intelligence, have been continuously reviewed for removal or amendment in order to remove any competition restriction and discrimination provisions and those are not suitable with the market economy and international commitments. Administration procedures directly linked with the business community such as tax reimbursement, custom clearance, land, construction, and notarization have been more and more improved towards simplification, publicity and transparency;
- The need of establishing a single business registration agency for all kinds of enterprises and strengthening its capacity for “pre- and post-registration monitoring and checking” enterprises have been actively considered;
- The right to export has been further expanded. Conditions and procedures for enterprises and households doing export and import have been further reduced. Enterprises are allowed to export directly commodities that are not banned or quantitatively restricted;
- Mechanism and policy to create conditions and dynamics for active business expansion via self capital accumulation, capital mobilization in the stock market and joint stock company establishment have been actively amended and supplemented. Regulations on cooperation contract among enterprises, inclusive of subcontracting, have been improved.

As a result, the private sector has been encouraged to develop. At present, more than 200,000 enterprises have registered their business. The growth rate of this sector is the highest in the economy. In 2005, the private and household sector contributed around 39.9% of the gross domestic product. More importantly, this sector has generated most of jobs, ensuring the social stability and order.

4.2 – Foreign invested enterprises

- Investment licencing procedures for foreign invested enterprises have been more and more simplified. Investment registration regime (instead of licencing) is applied to projects located in high-tech or industrial zones and to projects which are not under the forbidden and restricted investment lists.
- Foreign capital attraction models have been diversified into indirect investment, acquisition or merger; legal forms of foreign invested enterprises have also been added. The attraction of transnational corporations (TNCs) to do business in Vietnam has been considered as an important objective. The forbidden investment list has been shortened,

conditions for granting licence for conditional investment fields; specified, and services with low competitiveness; opened for foreign investment.

- Special regulations on foreign investors and enterprises have been gradually reduced and removed. The Investment Law and Enterprise Law which are issued in 2005 and come into effect on 1/7/2006 create solid foundation for the establishment of a single legal basis and fair business conditions among foreign and domestic investors/enterprises.

Thanks to such efforts, *the foreign invested sector* has been developing, really becoming an important part of the national economy.

4.3 - Agriculture economic actors

A number of measures to improve the economic institution for economic actors in rural area have been taken.

- The first economic institution reforms in agriculture were reforms on *agriculture land use right*. The “contracting 100” mechanism in 1981 helped agriculture cooperatives to transfer land use right to farming households who had the right to their produces after “produce contribution”. Although this policy was just limited to annual land transfer, this “stone – throwing” institution reform has helped remarkably increase the agriculture productivity in the following period. The “contracting 10” reform conducted in 1988, i.e. right after “Doi moi”, gave Vietnamese farmers more rights on land (i.e. seven rights such as right to use land based on specified objectives, right to collateral, right to transfer, right to inherit, right to lease and so on) and right to decide on their produces, which really “untied the knot” for farmers. As a result the agriculture productivity rocketed. Within several years, Vietnam was transformed from a yearly rice importers to one of leading rice exporters in the world. It was estimated that over 80% growth in the 1990s resulted from these reforms.⁸

- *The Land Law* which was enacted in 1993 and amended in 2003 was a big advancement on reforming institutions related to land ownership and land use right of market actors. Specifically farmers and other agriculture economic actors became direct and key beneficiaries. Together with land use right reform, the right to free agriculture product transaction in both domestic and foreign markets has significantly encouraged productivity increase in agriculture.

- *Credit institutions* serving the agriculture and rural area have also been significantly improved. The Agriculture Bank was established to serve agriculture and rural households and enterprises. In addition the Housing Development Bank in the Mekong Delta also came into operation to support special target groups in this economic area.

⁸ Cited from:” Which institutions are important for maintaining long term growth in Vietnam”, published by ADB in 2004, p. 140

Credit policies have also been basically reformed. In order to facilitate the investment expansion in the agriculture and rural area, the Prime Minister issued Decision 67/QD/TTg regarding some credit policies on agriculture and rural development with new provisions on *loosening regulations on banking borrowing guarantee, borrowing target groups and borrowing purposes*, which played an important role in creating more favourable conditions for farmers to access to and use banking credit.

5. Administrative reform

5.1. Reform in Government apparatus

Once the reform process started, on 16/12/1987 the State Council issued Resolution 782-NQ/HDNN7 on strengthening bodies under the Minister Council. Accordingly many operational ministries were merged to have more general functions⁹. Especially, according to this Resolution, the Committee on Foreign Economic Relations was established based on the Law on Foreign Investment to conduct the state management function over foreign investment activities.

In the following years, the State Council and the National Assembly issued some other decisions on streamlining the administrative apparatus, making it neater and more generally-managerial. For example, Resolution 66/HDNN8 on 24/3/1988¹⁰; Resolution 244 NQ/HDNN8 on 31-3-1990 of the State Council¹¹. Hence in the first period of the

⁹ For example, Ministry of Agriculture and Foodstuff Industry was merged from three ministries: Ministry of Agriculture, Ministry of Foodstuff Industry and Ministry of Food; Ministry of Energy was merged from two ministries: Ministry of Electrics and Ministry of Coal and Mining.

¹⁰ According to this Resolution: 1- Establish the Ministry of Foreign Economic Relations by merging Ministry of Foreign Trade and the Foreign Economic Relations Committee, 2- Establish (new) Ministry of Construction by merging Ministry of Construction and the State Committee on Basic Construction, 3- Merge the General Department of Electronics and Computing Techniques into the Ministry of Mechanics and Metallurgy.

¹¹ According to this Resolution, there were a number of changes as follows.

- Establish Ministry of Culture – Information – Sport and Tourism based on Ministry of Culture, Ministry of Information, General Sport Department and General Tourism Department to unify the state management on culture, information, radio broadcasting, television broadcasting, press, publication, sport and tourism;
- Establish Ministry of Education and Training based on Ministry of Education, Ministry of University, Professional High School and Vocational Training to unify state management on education and training;
- Establish Ministry of Trade based on Ministry of Foreign Economic Relations, Ministry of Domestic Trade, and Ministry of Materials to unify state management on commercial and service activities;
- Rename Ministry of Mechanics and Metallurgy as Ministry of Heavy Industry to unify state management on mechanics, metallurgy, electronics, mining, geology, petroleum and chemicals. Approve the dissolution of the General Mining and Geology Department and the General Petroleum Department;
- Rename Ministry of Transportation as Ministry of Transportation and Post Office to conduct state management on post office industry responsible by the General Post Office and the civil aviation. Approve the dissolution of the Vietnam Civil Aviation General Department;
- Rename the State Science and Techniques Committee as the State Science Committee to unify state management on natural and social sciences. Approve the transformation of the Vietnam Social Science Committee into the Vietnam Social Science Academy for social science research;

economic transformation process, the state management apparatus had a few changes to gradually satisfying the new state management methodology suitable with the market mechanism. In 1992 the National Assembly passed the new Constitution, basically changing the operation mode of the State of Vietnam. On 30/9/1992, the National Assembly passed a Resolution stipulating the government apparatus with *20 ministries and seven ministerial-level agencies*.

On 25/12/2001, the National Assembly issued Resolution 51/2001/QH10 amending and supplementing the 1992 Constitution. According to this amended Constitution, the National Assembly issued Resolution 02/2002/QH11 on 5/8/2002 stipulating the government apparatus with *20 ministries and six ministerial-level agencies*. Due to changes in government apparatus and ministry functions, in the following two years, the Government issued a series of decrees reorganizing and modifying functions and mandates of ministries and agencies. The government organizational structure was also changed: some new ministries and ministerial – level agencies were established (Ministry of Natural Resource and Environment, Ministry of Post and Telecommunication, National Committee on Population, Family and Children); some ministries and ministerial – level agencies were modified and renamed (Ministry of Science and Technology, Ministry of Home Affairs, Government Inspection, Ethnic Council). The internal apparatus of ministries and agencies was also strengthened to satisfy new functions and mandates.

All these above changes were aimed at establishing an efficient public administration apparatus, better facilitating the participation of citizens and other market actors in the socio-economic development. The economic management apparatus in the legal executive system was initially reorganized to form generally managerial ministries and reduce the number of government bodies; the decentralization among government levels in economic management has gradually been reformed; some new institutions and organizations have been developed; administration procedures have been simplified, creating favourable conditions for both domestic and foreign investors; business intervention functions were narrowed and business support functions; increased.

5.2 - Reform of state economic management

In parallel with the organizational reform in the state management apparatus on economics, the Government of Vietnam has gradually modified economic management function to make it closer to the market mechanism. As a result, the State function of economic management has had basic changes in both theory and practice.

- Assign the state management function over the rubber industry to Ministry of Agriculture and Foodstuff Industry. Approve the dissolution of the General Rubber Department.

- *Regarding the theory*, the VII Party Congress set the duty that “the state apparatus should gradually change into state management function, reducing intervention into business operation” and outlined the direction that “the State should manage the economy by directing and creating favourable conditions for business activities, ... ensuring the harmony between economic and social development...”. The VIII Party Congress both requested for “improving economic management capacity and efficiency of the State” and outlined the direction that “the State shall prepare the development direction, directly invest in some fields, establish the legal framework, develop synchronous policies, redistribute income, mitigate negatives of the market mechanism...”. The IX Party Congress instructed to “continue reforming macro management tools of the State over the economy. To further reform the planning activity, improve the preparation of socio-economic development strategies and plans”.

- *In reality* a number of measures on reforming the state management function to make it more specific and suitable with the market mechanism have been taken. The main reform on the state economic management was to separate the state function on economic management of state agencies, i.e. the state ownership over SOEs was separated from enterprise's corporate governance; to transform from detailed management over economic activities to indirect intervention via the legal system, plans, policies and macro regulation tools. Box 1 summarizes specific reform measures taken in all aspects of state economic management in recent years.

Box 1: Some measures to reform the economic management function of the State

(1) Reform state management modes over the economy

- Issue, amend and supplement a number of laws and ordinances suitable with the operation of the market economy. Especially the Enterprise Law (1999) with the breaking spirit of changing from the fact that citizens were only allowed to do business under “State permission” to the fact that citizens are free to do business in any fields “not forbidden by law”. This has helped remarkably improved the relationship between the State and the market.
- Create a legal and policy framework to expand the domestic and foreign markets for Vietnamese goods and services, expand domestic circulation channels; extend the right to do export and import and trade promotion; expand foreign trade activities; conduct regional and international integration and so on.
- Gradually transform from detailed and physical planning to directive planning with the focus on building the overall 10 year socio-economic development strategy, 5 year plans and further focusing on economic forecast, inclusive of monthly and quarterly forecast.
- Reform financial policy: The tax system will be reformed so as to create the equality

in tax payment among various types of businesses; restructure and reform state budget spending policy so as to combine state finance with other citizen sources for economic development by implementing the socialization policy in education, healthcare, culture and so on. However this direction still lacks suitable mechanism;

- The monetary – credit policy has been gradually reformed towards further market orientation, reducing direct administrative intervention of the State. The banking system was reformed from the one-tier system to the two-tier system, separating the state management function of the State Bank from the business function of commercial banks and other non-banking financial institutions; establishing a system of credit organizations with the participation of various economic sectors; gradually applying a more flexible interest rate and foreign exchange rate policy corresponding with market supply and demand, combining with preferential credit (for development investment) and interest support policy for encouraged development targets.

(2) *Reform the “entrepreneur/investor” function of the State*

- The State will dramatically replace its direct intervention in business activities with investment in SOEs providing public services or operating in very important business fields;
- Strengthen and develop State economy by focusing on key areas and business fields to ensure the leading position of state economy (For example: the Government issued criteria and lists of business fields as well as goods and services where the State should hold 100% charter capital);
- State investment is directed to infrastructure development and areas where the private sector does not want to or has not been able to make investment, further creating favourable conditions for the smooth operation of the market mechanism.

(3) *Reform in welfare provision function*

- The distribution policy has had initial progress with the transformation from mean and physical distribution method to diverse distribution methods: distribution by working result and economic efficiency; distribution by contributed capital; distribution by social welfare. The income redistribution policy has been initially implemented but within a narrow scope.
- The repayment in kind and social policy has been better conducted. The joint contribution mechanism between the State and people has been initially applied in healthcare, education, rural road system and rural electrical distribution network. A social insurance system for employees of all economic sectors was formed with an aim at separating responsibilities of participants and removing various subsidies of the State; National programmes have been successfully implemented; More efficient measures have been taken to prevent and protest social evils like drug or traffic accidents, and so on.

Despite *weaknesses and shortcomings* (demonstrated in unclear identification of state management role in the market economy; or in the limited capacity of the state economic management apparatus), such above mentioned efforts have helped basically change the

State – market – enterprise relationship whereby the State makes macro regulation and the market regulates enterprises.

4.3 Reform in planning activity

The planning activity has also experienced a number of reforms. This has improved the role of the State in the market economy and boosted the overall economic reform process. Regarding the legal aspect, the Government of Vietnam is drafting *Law on Planning* for the National Assembly's approval. If it is approved, this Law will become an important legal framework for the operation of planning agencies. In reality, despite a number of problems related to the content and procedures of strategic planning as well as some shortcomings in plan implementation, basic achievements in planning have been clearly showed in the following aspects.

- o Five year development plans have become the centre of the planning activity and have been devised based on the long term socio – economic development strategy with detailed designs for particular development period;
- o The system of planned targets was basically changed by reducing number of targets in physical terms while increasing number of the valued ones. ;
- o The planning process has been made more democratic and public, with more participation of citizens and stakeholders;
- o The plan monitoring has also been changed from micro intervention into macro balance maintenance by using indirect tools; the planning methodology based on target programmes to solve the most urgent socio – economic issues has been further improved;
- o The plan monitoring has been directed to more practical results: timely identifying and better resolving unusual problems arising due to influences of the world and regional economies as well as different socio – economic situations in various regions in Vietnam;
- o The development planning has been strengthened, creating favourable conditions for the development of selected industries, economic sectors, regions and provinces.
- o The role of the State and that of the planning activity in the socialist oriented market economy have been gradually renovated and firmly strengthened.

6. Building and development of production factor markets

In the last decade, a number of efforts to lay the foundation for the system of factor market institutions in Vietnam have been done. In addition to efforts on developing the legal framework (the above part 2.1), many practical activities have been actively conducted, which helped establish and operate markets of basic production factors.

6.1 Labour market

This is the production factor market firstly formed and operated in Vietnam, starting from efforts to *basically change the awareness on the labour market*: In the centrally planning economy, labour was not regarded as goods and the existence of a labour market was not accepted by law. However the labour market is now officially considered as one of the most important production factor markets. The next step is to *build the “infrastructure” system for the labour market*: from job broker centers (in 2004 there were nearly 200 job introduction centers under agencies of MOLISA or social organizations), to labour supermarket, “labour markets” and so on. This is the place where job seekers and employee seekers “meet” to conduct labour transactions, or where vocational schools can identify demands for each profession and call for enrolments. At the same time, many exported labour broker companies were established, bridging labourers who wanted to work abroad for higher salary with foreign enterprises who wanted to recruit Vietnamese employees. Some specific measures to improve the labour market are summarized in the following Box 2.

As a result, the labour market officially came into being and has gradually developed, both inside and outside Vietnam’s territory. The human resource, hence, has been used more efficiently.

Box 2

Some specific measures to support the development of the labour market

- Issue and implement legal documents creating conditions for labour transactions in the market; protect the rights of both employees and employers in all economic sectors;
- Establish an unemployment insurance fund for employees with the contribution of the State, enterprises and employees;
- Initially encourage all economic sectors to develop the labour goods (For example: provide training or conduct labour export);
- Enhance State inspection and supervision and timely resolve labour violations;
- Improve the representative role of Trade Union in developing and implementing the legal framework on labour;
- Establish and diversify types of “hard labour market institutions” such as labour markets, job exhibitions, job introduction centers and so on as well as other favorable market mechanisms to support workable people, especially young and trained people, to find reasonably paid jobs.

6.2 Real estate market

In recent years, a number of changes have been done for the real estate market in Vietnam. In addition to reform on the legal framework, there were other positive changes

in *state management* over this market. In 2004, Ministry of Natural Resources and Environment was officially established with an important function of implementing the state management over the real estate market, inclusive of land, resident houses and other construction works on land. To date, a number of measures and initiatives have been taken to make the real estate market serve the economic growth and social equality (See Box 3). As a result, the real estate market has become one of the most effervescent markets in recent years.

Box 3

Some specific measures to support the development of the real estate market

- Identify rights to land of land users as well as measures and sanctions to ensure these rights; Create a legal base for land rent and land use right transfer.
- Apply the mechanism that all land – needed enterprises have to buy land use right or rent land;
- Deeper decentralization on land management to People's Committees of different levels;
- Improve publicly and transparency in land planning, ensuring the legality of the approved land planning;
- Unify the registration regulation on real estate and real estate-related documents.
- Remove a number of regulations restricting the real estate movability.

However, a number of institutional issues relating to the real estate market should be reviewed. The first noted issues were the related legal system, the execution apparatus and the lack of a “hard market institution” officially recognized in Vietnam. The lack of a bill on real estate registration and business – the crucial legal basis for regulating the operation of this very sensitive and complicated market – has also been the current big shortcoming.

6.3 Financial market

The Vietnamese financial market has had encouraging development. Specifically: (i) basic elements of this market have been formed. A series of new institutions such as securities companies, financial companies, life insurance companies, and so on were established and operated; (ii) the banking and banking credit system has had basically changes. The role and capacity of the State Bank and commercial banks have been gradually improved with the application of modern business types; (iii) the domestic financial market has gradually gone in line with the international market. Advanced financial management principles as well as international standards on transparency,

accounting and auditing have been gradually legalized and applied and (iv) state management agencies and financial institutions (State Bank, Ministry of Finance, State Securities Committee and so on) have been gradually legalized and had closer cooperation.

However, in overall the Vietnam financial market has not caught up with and satisfied socio – economic demands. The financial market, in general, and the monetary market and capital market in particular remained at low development level. The securities market was newly-established and weak. At present, many secondary markets in Vietnam has not been developed. The cooperation and interaction among markets in the system remained loose. The banking system has had many potential risks. The information transparency has not always been guaranteed. Moreover the current legal system has not created conditions for the necessary independence of the State Bank and loosened conditions for financial market penetration of investors, especially foreign investors. The legal system on credit also showed quite clear discriminations among credit suppliers as well as among customers of credit organizations¹².

6.4. Science and technology market

In the last decade, thanks to the direction of “*considering science and technology as a growth momentum*”, a number of mechanism and policies on the operation of the science and technology market have been legalized to regulate behaviours, participation and interaction among the players in the science and technology market. However, the current science and technology market has remained weaker than other production factor markets. Observation of the science and technology market in Vietnam in recent years disclosed that the technology level of Vietnamese enterprises remained low; transactions in the science and technology market were limited (enterprises mainly involved in machinery transactions rather than high technology value ones like patents or R&D contracts); there was a large supply from foreign science and technology enterprises and organizations but the price was too high for enterprises to afford. Hence it was widely believed that the present science and technology market in Vietnam is only in infant stage¹³. Meanwhile this kind of factor market is the indispensable part to ensure the fast and sustainable economic growth.

7. Economic opening and integration

¹² This was demonstrated via the discrimination between state commercial banks and joint stock commercial banks, between domestic banks and joint venture banks and branches of foreign banks. The discrimination was also clearly showed between SOE customers and private sector customers.

¹³ See “Vietnam Economy in 2003” by the Central Institute for Economic Management, “Science and technology” part, pp. 89-92.

In addition to legal framework improvements to create and/or to harmonize the legal system (see Part 2.1 above), the Government of Vietnam has taken a number of measures to boost the international economic integration. Some important measures are as follows.

- Conduct dissemination and explanation for government agencies, mass organizations and people on international economic integration to raise the awareness on its importance and opportunities and challenges;
- Actively develop *the Overall Strategy on international economic integration* with a detailed agenda to be used by agencies, local authorities and enterprises to rearrange their structure and/or business strategies and to improve their competitiveness for more efficient integration;
- Conduct economic restructuring to make full use of competitive advantages of industries or nation, improving quality, reducing production cost, creating spearhead products capable of penetrating the international market.
- Continue rearranging and reforming SOEs to improve their performance efficiency;
- Focus on training to generate a human resource with high skills, professionalism, industrial working style and high discipline. Pay more attention to creating managerial people and entrepreneurs. Develop and implement some policies on attracting and using talented people;
- Enhance international economic activities by diversifying markets and partners and participating in international organizations to improve the position and power of Vietnam.¹⁴
- Make all possible efforts to quickly complete negotiations on WTO accession based on options and agendas suitable with Vietnam's situation and requirements of international partners.
- Establish and strengthen the National Committee on international economic cooperation to support the Prime Minister for organizing and directing integration activities.

As a result the international economic integration in recent years has made significant progress. International relations were expanded and international commitments were well implemented; at the same time, a number of bilateral and multilateral agreements were signed, generating new developments in international economic relations. According to a 2005 report by Ministry of Planning and Investment, the export market was maintained and expanded; the total export value quickly increased by 16.2% per year, accounted for more than 50% GDP and reached USD 370/person. The official development aid (ODA)

¹⁴ For example, to achieve this objective, the Government set the first task for foreign affair agencies in foreign countries as to serve the national economic development.

continuously increased through years, even when the world economy faced with difficulties. The total value of agreements signed between 2001 and 2005 was around USD 14.7 billion, in which the non-refundable aid accounted for 15-20%. The foreign direct investment (FDI) also increased thanks to the continuously improved investment environment via policy amendment and supplementation. During the five year 2001-2005 period the total registered capital was USD 17.9 billion, 19.3% higher than the planned figure. The total implemented capital was USD 13.6 billion, or 12.5% higher than the planned figure of USD 11 billion.

Despite problems which need to be solved quickly (For example: key export products remained raw materials or processing products with low added value; slow ODA disbursement reduced its efficiency), such achievements should be considered as encouraging since Vietnam has just been at the preparation and trial phase for new institutions to ensure a real and comprehensive economic integration.

It is obvious that thanks to reform efforts in the last 20 years, especially in the last five years (notably the years 2004 and 2005), Vietnam has established initial market economic institutions. However it is also clear that despite initial encouraging results, Vietnam still has to face with a number of difficulties due to the lack of theoretical base and historical practices. Hence the development and improvement of the institutional framework for the socialist oriented market economy are and will be considered as one of the *leading tasks* of the Government of Vietnam.

The objective of this task is not to create a different market economy, but to make use of advantages of the current market economy as an “instrument” for national economic development, while the socialist orientation is considered as a “guideline” to direct market economic actors to fully achieve socio-economic development targets. Initial experiments on institutional reform showed that the market economic institution was not an unchanged category, but a usually changing one. Which roles the State and the market in Vietnam should take during the economic operation seriously depend on the development level of the economy at individual periods. Vietnam is under the economic transformation process. Hence it is crucial to identify the role of the State. The role of the State should be continuously maintained; however, direct intervention should be reduced and state management function should be increased with initial focus on developing and improving the market institution framework.
