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Restructuring the SOE Sector in Vietnam

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This paper assesses Vietnam's recent experience with reforming its state-owned enterprise (SOE) sector and discusses potential ways forward. It does so by: reviewing the economic principles that account for the motivations and shortcomings of state ownership; taking stock of stylized facts about the SOE sector; and assessing the legal and institutional reforms and equitizations that have taken place over the last years. The current focus on microeconomic approaches to firm productivity is highly misleading and a broader reform perspective of Vietnam's development model is needed. While there is little compelling evidence that the state of the SOE sector is as dismal as some analysts suggest, the paper highlights an increasing implementation lag of the legal reform progress — reflecting fault lines in Vietnam's political economy. SOEs can and should play a vital role in Vietnam's development strategy going forward. However, a more precise vision for the sector, based on a more elaborate assessment of market failures and externalities in different parts of the economy, is needed.

Keywords: Vietnam, state-owned enterprises, transition economics, development macroeconomics

1. Introduction

Vietnam experienced an impressive development performance over the last two decades. It transitioned from low- to middle-income status within one generation, with average growth rates around 6 per cent since 1990 — one of the highest in the world. However, the current level of development poses new socio-economic and political challenges. Notably, while growth has thus far been driven by factor accumulation and structural change (McCaig and Pavcnik 2013), with surplus labour depleting and the highest returns from structural change soon to be exhausted, the focus has increasingly shifted towards reforms that improve sectoral and firm efficiency so as to use the country's resources most effectively. This is consistent with Dani Rodrik's (2013) argument that growth driven by structural transformation risks running out of steam if the fundamental capabilities involving human capital accumulation and institutions are not eventually developed. Indeed, growth in Vietnam has recently lost some

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momentum (cf. Pincus 2015). Even though this is partly cyclical and driven by external factors, there are rising concerns over a structural moderation of the growth rate. If the country does not manage to sustain the momentum in its reform and economic transformation, it might risk ending up in a so-called "middle-income trap".[1]

Reforming the state-owned enterprise (SOE) sector is a key challenge in this context and involves multiple inter-sector linkages and external effects. So far, a sizeable public sector has been part of Vietnam's impressive development performance. This is evident from Figures 1 and 2, which highlight that, as of 2000, about 60 per cent of Vietnamese labourers worked in some sort of SOE.[2] Since then, Vietnam's economy experienced considerable structural change (including a decline in the relative importance of SOEs, though they still remain numerous) and new challenges emerged. Constrained public resources, evident from a public debt-GDP ratio around 60 per cent,[3] require their use being more focused, effective, and tailored towards sectors with most externalities and market failures.

The aim of this paper is to discuss potential pathways of SOE reform in Vietnam against the background of those challenges and to evaluate recent reform measures. This paper argues that the existing microeconomic approaches to evaluating firm productivity of SOEs are highly misleading. SOEs perform different functions in the Vietnamese economy than private firms and hence cannot be evaluated against the same measures. Rather than attempting to get SOEs to perform like private firms and trusting the market to correct itself, this paper advocates for getting SOEs to fulfil appropriately designed objectives within Vietnam's larger macroeconomy.

To do this, section 2 first provides a critical review of the literature that assesses the performance of SOEs. Section 3 provides a brief historical overview of key developments in Vietnam's SOE sector over the last 30 years since Đổi Mới. Section 4 takes stock of the SOE sector today. Through six key stylized facts of the SOE sector, this section also exemplifies the problems in efficiency measurement discussed in section 2. Section 5 assesses the most recent reform efforts, looking at legal developments, their implementation in practice and especially the equitization process.[4] Against this background, section 6 concludes and provides policy recommendations.

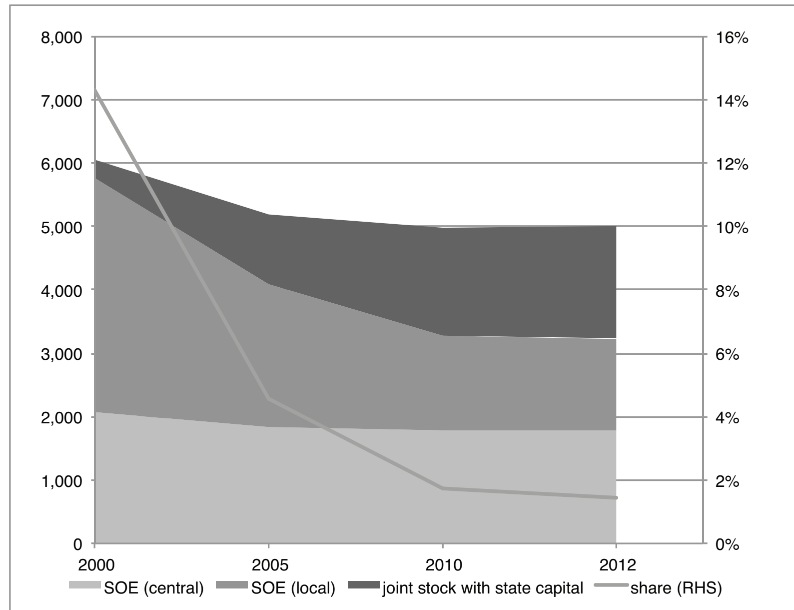
2. A Critical Review of Assessments of SOEs

The conventional wisdom in post-Cold War economics has favoured privatization reforms and cast a pessimistic light on Vietnamese SOEs. In this section, I make three criticisms of the literature favouring privatization. First, the more recent literature no longer treats privatization as an absolute good; second, when evaluating SOEs, the pro-privatization literature often makes problematic assumptions about their production functions; third, it is problematic to evaluate SOEs against microeconomic objectives that they were not and should not be designed to meet.

First, while earlier studies on (especially European) transition economies were enthusiastic about the improvements in micro-performance from privatization, a more careful look at causality issues in the recent evidence draws a more opaque picture about the effect of *de jure* private ownership on firm performance. For example, the seminal literature survey of studies from several transition economies by Estrin et al. (2009) concludes that "privatization per se does not guarantee improved performance", with especially few robust results for China (likely the most relevant comparison for Vietnam). Moreover, Fforde (2004) has noted that for the case of Vietnam, the mainstream view of inefficient state ownership is hard to reconcile with the country's rapid growth during the 1990s, a period in which the share of total output produced by the state sector was growing. Similar to Gainsborough (2002) he argues that firms might effectively operate like private firms even though they are *de jure* state-owned, suggesting that not only productivity and efficiency but even de facto ownership might be difficult to measure.

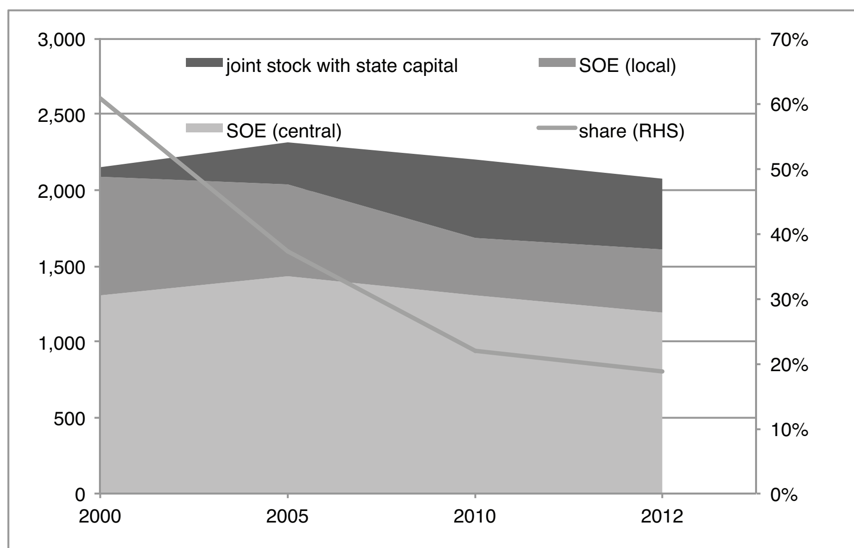
Second, much of the literature that favours privatization has problematically assumed that firms follow the traditional Cobb-Douglas production function with constant returns to scale

FIGURE 1
Number/Share of SOEs



SOURCE: Own calculations based on GSO (2013).

FIGURE 2
Number/Share of Employees in SOEs



SOURCE: Own calculations based on GSO (2013). Number in thousands.

(CRTS). However, Paganini (2016) shows that the estimated misallocation of capital across sub-Saharan African firms highly depends on the assumed elasticity of substitution and that the traditional Cobb-Douglas assumption can be rejected by the data. Dong (2011) demonstrates similar problems of mismeasurement using Korean data (also see recent findings, e.g., Herrendorf, Herrington and Valentinyi 2015; León-Ledesma, McAdam and Willman 2010). Therefore, at best, the evidence for improved firm performance under private ownership stands on shaky grounds. Section 4 provides further evidence that the production function cannot be assumed to be CRTS in the case of Vietnamese SOEs.

Third, and most importantly, it is problematic to evaluate SOEs against the objective function of private firms. Key studies in the literature on SOE performance in mainstream economics focus on firm indicators that are intrinsic to private firms that do not necessarily extend to SOEs, such as profit maximization, business efficiency, or — to a lesser extent — employment effects. The assumption is that improved firm efficiency at the micro level will lead to improvements at the macro level. However, even if we accept that private firms may be more efficient and profitable at the micro level, this does not at all imply that privatization would lead to the aggregate welfare optimum, especially in an economy as heavily distorted as Vietnam's. Several economic studies highlight the potential merits of direct government intervention in environments with market failures, large frictions and externalities (see, especially, Murphy, Shleifer and Vishny 1989 and Poyago-Theotoky 1998). SOEs are potential candidates to implement such government interventions. In this case, SOEs must be evaluated against their macroeconomic objectives. This is because even though implementing government policies might be detrimental to SOEs' profitability or efficiency, the produced externalities may compensate for such micro-inefficiencies.[5] The nature, magnitude and significance of such externalities not only ought to shape whether optimal government intervention should take the form of regulation or state-ownership (for example, see Lawson 1994; Djankov et al. 2003; Putniņš 2015), but also what SOEs' objective function should be. For example, if there is a coordination failure of private firms to produce a good which serves as an important input for other firms, providing this good at a certain (below-market-value) price could enter the SOE's objective function. Other examples include financial intermediation in the context of constraints or poorly aligned market incentives for financial lending, or the provisioning of social safety nets and redistribution if employment turnover is high and/or a public welfare system is largely absent. While the literature has unfairly evaluated Vietnamese SOEs using metrics designed for private firms, this paper advocates for evaluating them according to their promise to meet social and public objectives.

3. Historical Background: Key developments in the SOE sector since *Đổi Mới*

To understand current SOE reforms, a quick review of developments since the beginning of *Đổi Mới policies* after the Sixth National Congress of the Communist Party of Vietnam (CPV) in 1986 is instructive. This is because the economic renovation that took place in this context provided the economic and legal framework for reforming the SOE sector. Contrary to most Central and Eastern European transition economies, this process took a rather gradual and pragmatic "trial and error" approach, where lessons were drawn from incremental reforms and reflected in revised policy strategies going forward (Rama 2008; Mishra 2011). As in the case of China, these reforms were not intended to constitute a full transition to a Western-style market economy with a largely dismantled SOE sector. For our purposes,[6] it is reasonable to distinguish three broad periods concerning reforms of the SOE sector since the beginning of *Đổi Mới*:

A. First Tentative Steps Towards Reform (until 1998)

While the first legal provisions[7] for private sector development were established in the early 1990s

and different reforms (such as Decree 217 in 1987) aimed at improving SOEs' governance and steering them more towards market activities, practical steps towards equitization were rather cautious at the beginning of *Đổi Mới*. A pilot programme during the 1992–96 period aimed at equitizing several small and medium sized SOEs in non-strategic business areas. As only five SOEs were equitized, the need for bolder reform efforts became apparent.[8] However, while Decree 28 from 1996 expanded the scope of the process to all non-strategic small- and medium-sized SOEs, only twenty-five additional SOEs were equitized during the subsequent 1996–98 period and authorities were confronted with limited scope for equitization in view of little domestic capital mobilization and foreign investors learning that they did not get proper returns on their investments. The reorganization of the larger-scale SOE sector into Economic Groups (SOEGs) and State Corporations (vertical SG90 and horizontal SG91) with Decrees 90 and 91 in 1994 was another important reform during this period, helping to scale up state capital and to get rid of phantom enterprises. However, this also established a new fault line in Vietnam's political economy — the newly formed economical entities created "a potential basis for political power independent from the state apparatus" (Fforde 2004). This was exacerbated by the fact that these conglomerates had hundreds of subsidiaries, which created severe principal–agent problems and made effective state control difficult.

B. Taking a Comprehensive Reform Perspective and Acceleration of Equitization (1998–2008).

Broadly, the 1990s marked a shift from a declining state sector to a resurgent one: against the background of a relatively successful reorganization of the SOE sector and based on early reform experiences, the government increased ("virtual") control over SOEs and made them "pay for the regime" (Fforde 2007). While this process already started in the early/mid-1990s, Decree 44 from 1998 further laid out a more comprehensive legal approach towards reforming the SOE sector. All SOEs were classified into three groups according to their level of importance, and equitization gained momentum:[9] 845 SOEs were equitized between 1998 and 2002. The "Strategy for Socio-Economic Development 2001–2010" at that time still emphasized a "leading role" of the State economic sector. However, it also envisioned the development of a multi-sector economy and mentioned: the need to address corporate governance issues in SOEs; that the State does not need to hold 100 per cent capital in them; as well as the option of liquidating some of them. In 2002, Decree 64 was issued to improve the legal framework of equitization. On the one hand, the decree furthered operational decentralization of the process by requiring owning entities to formulate arrangement schemes for SOEs under their management (Art. 31). On the other hand, non-strategic SOEs below a certain size were threatened with liquidation if they opposed equitization (Art. 2), highlighting the aim of the government to maintain central control over the process, even if only virtually. As a result, 1,292 SOEs were equitized between 2002 and 2004. The SOE reform programme also required dealing with issues such as many enterprises' bad debts and applying market-based methods in valuing them subject to equitization, which was reflected in Decree 187 from 2004. It also put equitization into the context of transparency and capital market development (Art. 1). The five–year Socio-economic Development Plan 2006–10 mentions the restructuring, renewal and equitization of SOEs as one of fifteen major tasks and solutions for the Five-Year-Plan. In this context, the State Capital Investment Corporation (SCIC) was established in June 2005 and started operating in August 2006 as the government's shareholder in small- and medium-sized SOEs (similar to Temasek in Singapore, Khazanah in Malaysia, and QIA in Qatar). Various line ministries and provincial governments had to transfer their scattered ownerships to SCIC with the aim of restructuring and divestment. Kim, Nam and Cuong (2010) mention that, by February 2008, around 4,000 SOEs were equitized since *Đổi Mới* — 3,400 of which had been equitized since 2000. While this estimate seems to be on the high side,

it highlights that most real progress in SOE reform was achieved during this period. This can also be inferred from the fact that of the 965 SOEs handed over to SCIC until end-2013, 845 were transferred in 2006 and 2007 (SCIC 2011). At the same time, most equitized SOEs were small and basically no equitization of large SOEs took place (Sjöholm 2006).

C. Growing Disparities between Legislation and Implementation (since 2007).

As SCIC (2011) points out, the restructuring of ownership in SOEs seems to have slowed down after 2007, especially with regard to equitization: the number of SOEs equitized between 2007 and 2010 was only two-thirds of the equitizations in 2006 alone, with the raised equity values also severely falling short of planned targets (see section 5). Over the period 2006–11, investment of SOEGs and SOGs in non-core businesses increased from 1.9 per cent of equity (0.8 per cent of assets) to 3.3 per cent of equity (1.1 per cent of assets).[10] While enterprise restructuring — in particular of SOEGs and State-Owned General Corporation (SOGCs) — was still considered as one of three priorities of economic restructuring under the "Socio-economic Development Plan 2011–2015" (together with public investment and financial market development), these developments point to a growing disparity between legislation and implementation. This is documented in more detail in section 5.

4. Taking Stock of Vietnam's SOE Sector

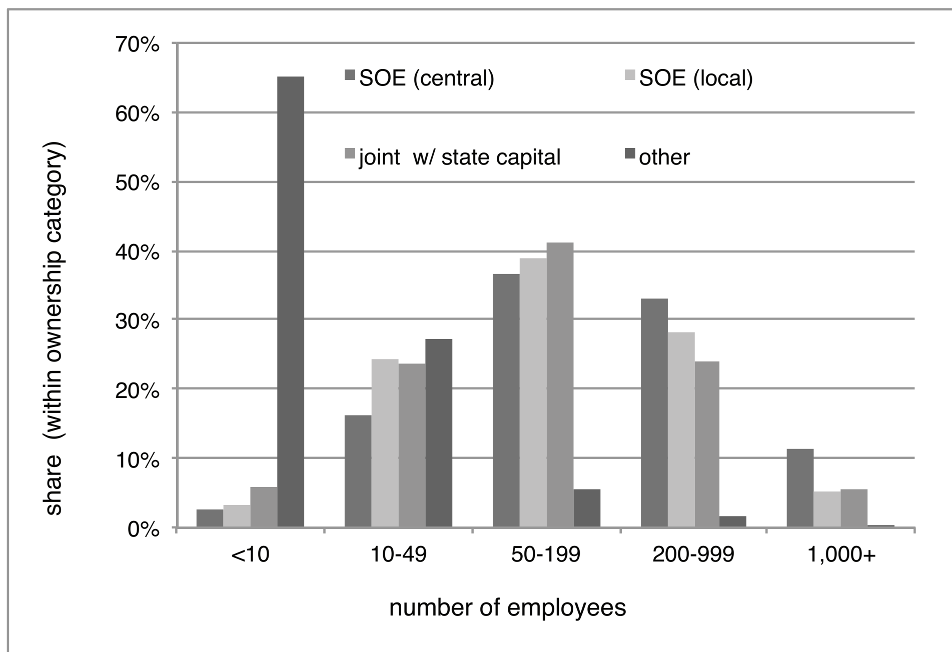
Following these reforms, where does the SOE sector in Vietnam currently stand? How important is it? While the existing literature tends to paint a dire picture of SOEs in Vietnam, this section provides a nuanced challenge to that picture through six stylized facts. This sets the stage for the evaluation in section 5:

A. *Though few in number, SOEs still play a considerable role in the economy.* By the end of 2012, there were 3,239 SOEs in the narrow sense, 55 per cent of which were controlled by the central government (see Figure 1). On top of this number, 1,761 enterprises were joint stock corporations with some minority share of the state. While this only constitutes a mere 1.4 per cent of the Vietnamese enterprise population, these enterprises employed about 18.8 per cent of (formal) employees (see Figure 2) and a much higher share of capital (see below).

B. *Hence, SOEs differ considerably from other firms in terms of size and input use.* Taken together, this — unsurprisingly — implies that SOEs are particularly large enterprises. As Figure 3 depicts, two-thirds of private enterprises have less than 10 employees, whereas the majority of SOEs has considerably more than 50 employees. Furthermore, salaries in enterprises owned by the central government are more than 50 per cent higher than in an average firm. (However, this is untrue for locally owned SOEs or joint stock corporations with state capital.) In terms of asset use, SOEs are more capital-intensive than other firms. While unsurprising, the magnitude of this difference is striking nevertheless: SOEs, on average, command more than three times as many fixed assets per employee than non-SOEs. The comparison with foreign investment enterprises is striking as well: one would expect foreign investment enterprises to focus on capital-intensive goods, yet, their average fixed asset/employee ratio is only half that of SOEs.[11]

C. *There is still a relevant share of relatively small and local government-owned SOEs.* Despite SOEs being relatively large, Figure 3 highlights that there is still a considerable fraction of relatively small SOEs, especially — but not exclusively — under the control of local government. A look at Figure 1 also highlights that the number of local government-owned SOEs is still considerable. This sometimes leads to situations where several SOEs under different owners are not only economic competitors, but political

FIGURE 3
Distribution of Firm Size by Ownership



SOURCE: Author's own calculations based on GSO (2013).

ones as well (e.g. Nguyen Xuan Thanh and Pincus 2011). Because many SOEs that fulfil support functions for local officials are of questionable macroeconomic utility, it may be in the provincial government's interests to not comply with SOE reforms set by the national government. This explains why provincial governments fall short in terms of SOE restructuring, as section 5 highlights later.

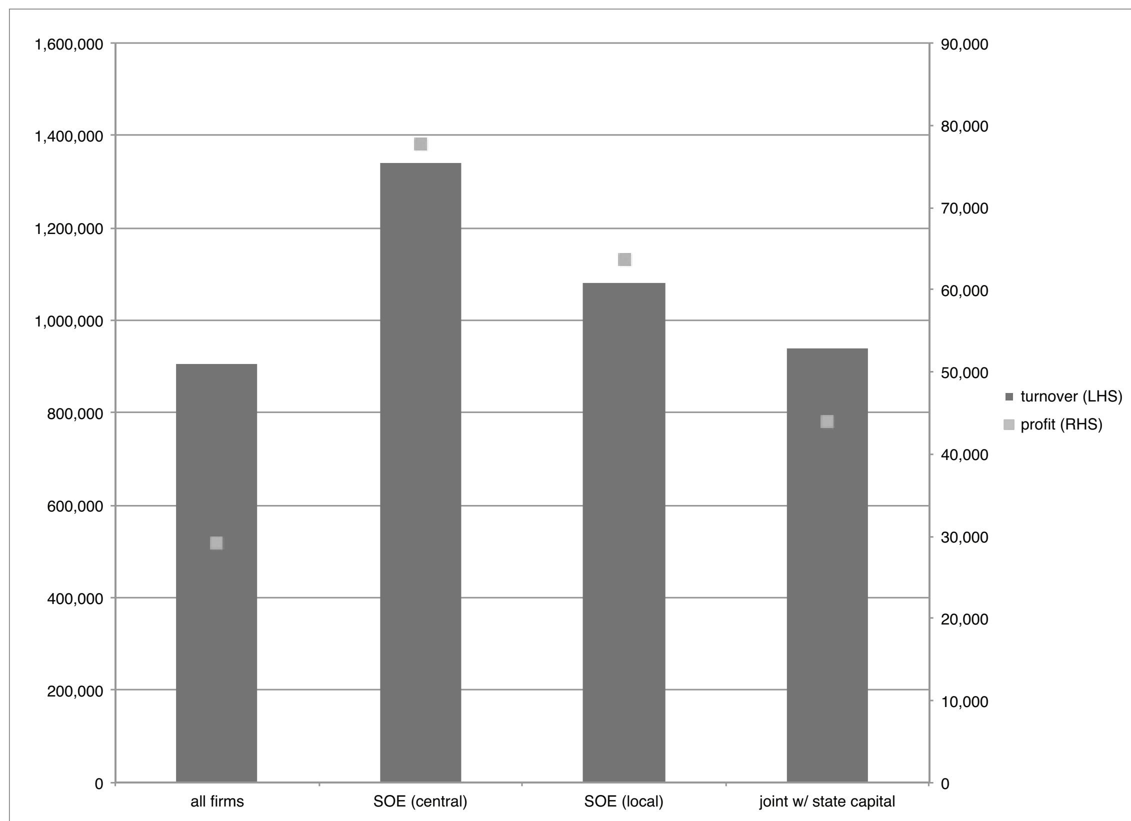
D. *SOEs pay a major share of corporate taxes.* According to a 2014 report, SOEs account for 65.5 per cent of corporate income tax payments among the 1,000 largest corporations surveyed, although they only made up 29 per cent of the total number of businesses among this sample. This not only reflects their disproportionally large size but also their role in the state budget.

E. *Conditional on their factor inputs, SOEs seem to generate higher turnover and profit.* Figure 4 shows an estimate how "productive" firms are in employing their inputs. For this calculation, a standard production function of the following form is used:

$$\ln(A_j) = \ln(Y_j) - \frac{1}{3}\ln(K_i) - \frac{2}{3}\ln(L_j) \qquad (1)$$

where Y is either net turnover or profits, K is the value of fixed assets and long-term investment, L is the number of employees, and j indexes the different types of firms. The results depicted in Figure 4 indicate that, for a given level of capital and labour input, SOEs seem to generate a higher turnover and profit. This result might be surprising as one would expect SOEs to be less productive than private firms in general. Furthermore, one would

FIGURE 4
Aggregate "Efficiency" Calculations of Firm Types



SOURCE: Author's own calculations based on GSO (2013).

not assume an SOE to be more profitable as its objective function is not oriented towards maximizing profits but internalizing market externalities. Rather, this result either suggests that: SOEs often operate in protected sectors or environments, where they can generate benefits from being shielded (legally or *de facto*) from private competition; or that they use another production function altogether, so that the approximation of equation (1) is not appropriate. Notably, while the results are remarkably robust to the assumed capital/labour share and to a human capital correction of labour (accounting for the possibility that SOEs employ more educated labourers), equation (1) assumes constant returns to scale (CRTS). Once one drops this assumption and allows the capital share to increase even slightly (to around 0.35 instead of 1/3, with the labour share constant at 2/3), the "efficiency edge" of SOEs vanishes. This raises the question whether the assumption of CRTS holds in practice, across different firms in different sectors, and highlights the methodological problems of estimating the efficiency of SOEs as though they are private firms, as reviewed in section 2. Analysing firm-level data leads us

to our last stylized fact that CRTS is indeed a problematic assumption:

F. *Higher "profitability" reflects the sectoral specialization and different resource use of SOEs.* We use the World Bank's Enterprise Survey to get a somewhat more detailed picture of productivity patterns across Vietnamese firms.[12] We begin by estimating the following production function at the firm level (indexed by *i*):

$$\ln(Y_i) = A + b_1 \ln(K_i) + b_2 \ln(L_i) + X_i\theta + u_i \quad (2)$$

where we control for firms characteristics X_i such as location in either a metropolitan area or in the country's South[13] and firms' ownership status. The results are presented in Table 1. Overall, we find that when all firms are analysed together, they indeed seem to produce under constant returns to scale (columns 1–3). We find that government ownership has a positive effect on output productivity only if one does not control for differences across sectors (column 2 vs. 3).[14] The more important insight, however, arises once we allow SOEs to apply a different production function (that is, the parameters *b1* and *b2* in equation (2) are allowed to be different for SOEs than for other firms). As columns 4–6 demonstrate, there is compelling evidence that SOEs produce under increasing returns to scale (particularly, a higher partial output elasticity of capital) while other firms do not experience such scale economies. Again, this suggests that most conventional techniques of productivity estimation are meaningless for comparing SOEs to private firms because SOEs face a completely different production function (not to mention that SOEs have a different objective function than private firms in the first place).[15]

The picture that emerges from these six stylized facts is that SOEs still play a considerable role in Vietnam's economy, especially concerning factor use (notably capital) and their contributions to Vietnam's tax base. While there are still several small SOEs of questionable economic legitimacy, the overall state of the sector does not seem as dismal as several analysts and commentators have suggested.[16] Moreover, the results from the firm level analysis suggest that the fetish to compare SOE performance to private firms adds little value to solving Vietnam's development challenges. Not only does such an exercise treat private and state-owned enterprises on unequal grounds (that is, with respect to private firms' objective function of profit maximization and single business efficiency) and conventionally neglects the much more interesting spillover effects of SOEs to the private sector (which can be both negative and positive), but they are also conceptually problematic as SOEs and private firms seem to produce with substantially different production functions. While this might reflect shortcomings in Vietnam's overall business environment (that might be institutional as well as due to other market imperfections), it also reflects the different functions state-owned and private firms fulfil.

With this in mind, we can now assess the more recent SOE reforms in section 5.

5. An Assessment of Recent Reform Progress

What recent actions have been taken by the government concerning the SOE sector? And how can they be assessed in view of the concepts reviewed and derived in section 2?

Over the period of the last "Socio-economic Development Plan", several legal reforms have been implemented. Between 2011 and 2013, the World Bank (2014) registered a total of twenty-six related Decrees and eleven Decisions and Directives. Two are especially worth highlighting: Decision 929 from July 2012 on the restructuring of SOEs; and Decree 61 from mid-2013. The former specifically targeted the roughly 1,200 remaining SOEs with 100 per cent state ownership (including SOEGs and SOGCs) with the aim of focusing their activities on core sectors to deliver essential public-purpose products and services. In view of strong speculative investments of state conglomerates in the real estate and finance sector

TABLE 1
Firm Productivity Regression Results

Variables	*(1)* *ln(sales)*	*(2)* *ln(sales)*	*(3)* *ln(sales)*	*(4)* *ln(sales)*	*(5)* *ln(sales)*	*(6)* *ln(sales)*
ln(labor)	0.725***	0.700***	0.730***	0.694***	0.718***	0.726***
	(0.0762)	(0.0822)	(0.0779)	(0.0870)	(0.0798)	(0.0765)
ln(labor) x government dummy				–0.0128	0.186	–
				(0.184)	(0.256)	–
ln(capital)	0.323***	0.325***	0.318***	0.311***	0.312***	0.309***
	(0.0533)	(0.0535)	(0.0536)	(0.0553)	(0.0540)	(0.0533)
ln(capital) x government dummy				0.197*	0.0975	0.171**
				(0.103)	(0.137)	(0.0731)
Government Share		0.00886**	–0.00259			
		(0.00416)	(0.00607)			
Government dummy				–4.356**	–3.458*	–4.099**
				(1.702)	(1.982)	(1.706)
Private Foreign Share		0.00665*	–0.00185	0.000269	–0.00207	–0.00174
		(0.00368)	(0.00569)	(0.00650)	(0.00873)	(0.00888)
Private Domestic Share		0.00463***	–0.00394	–0.00211	–0.00447	–0.00417
		(0.00167)	(0.00432)	(0.00492)	(0.00735)	(0.00756)
Sector dummies	No	No	Yes	No	Yes	Yes
Metropolitan	0.267**	0.251**	0.203	0.252**	0.210*	0.211*
	(0.124)	(0.126)	(0.124)	(0.128)	(0.123)	(0.123)
South	0.165	0.147	0.114	0.131	0.112	0.108
	(0.120)	(0.121)	(0.121)	(0.124)	(0.121)	(0.121)
Constant	13.05***	12.66***	13.71***	13.66***	13.96***	13.97***
	(0.989)	(1.039)	(1.182)	(1.137)	(1.202)	(1.233)
t-statistic CRTS (overall)	0.92	0.19	0.93			
t-statistic CRTS non-SOE				0.09	0.60	0.73
t-statistic CRTS SOEs				1.77**	2.17**	2.42**
Observations	328	326	326	326	326	326
R-squared	0.722	0.721	0.763	0.725	0.765	0.765

NOTES: Standard errors in parentheses. ***, **, and * denote statistical significance at the 1, 5, and 10 per cent level, respectively. OLS estimation based on the World Bank's Enterprise survey. *t*-statistic CRTS is for the test that the sum of parameters for labour and capital equals 1 (against a two-sided alternative).

(as evident in the collapse of Vinashin 2009/2010), this measure was long overdue. Decree 61/2013 regulates the assessment, supervision and public financial disclosure of SOEs.

These and multiple other legal reforms highlight considerable efforts by the government of Vietnam (especially the central government) to reform the SOE sector (see Wacker 2016 for a more detailed discussion). However, these efforts suffer from at least three serious shortcomings: a focus on micro-efficiency through regulation at the expense of SOE's social and public functions; laggard implementation due to misalignments of political incentives; and the shaky equitization process.

5.1 Focus on Micro-efficiency by Regulation

First, the most recent reforms are barely concerned with social or public functions of SOEs and instead are focused on getting SOEs to perform a limited set of business functions. For example, lightheaded expansion strategies into non-core business areas leveraged with state capital, as portrayed in Pincus (2015), are limited with contained contingent liabilities (Decree 206/2013). Moreover, recent legal reforms on investment (Law 67/2014) and enterprises (Law 68/2014) that do not directly relate to SOEs have been interpreted as important steps towards "levelling the playing field between different types of firms", as widely advocated by international donors and organizations (e.g., World Bank 2016, p. 75; IMF 2016, p. 20). This highlights the same confusion that the existing literature has (as reviewed in section 2). As compelling as the slogan of a "level playing field" may sound, it neglects the prior and more important concern of putting the right players on the right field: it is unlikely that the first complaint of twenty-two soccer players on a ping-pong table is that it is not completely even. Conversely, having two ping-pong players on a football field, and focusing on levelling the playing field, is an obvious misuse of resources. In other words, the first-order problem is to identify sectors with the largest market frictions and externalities that provide a strong rationale for direct government involvement, and those where appropriate regulation of private firms will maximize welfare. In any case, there is rarely an economic argument for a "level playing field" between private firms and SOEs as it is hard to imagine a situation where competition between the two will maximize welfare.

Like the existing academic literature, the reforms' focus on microeconomic efficiency does not resolve the more pertinent question: what specific role should SOEs play in Vietnam's changing socio-economic environment? While it is reasonable to focus on key business areas (Decision 929/2012, Decrees 71/2013 and 91/2015) this reflects an entrenched micro- and business-centric view that neglects the macroeconomic rationale for having SOEs. Similarly, while sound and public financial reporting by SOEs is important (Decree 61/2013), such reforms side-step the possibility of establishing other possible objective functions of SOEs that can be assessed and monitored by the public. On the surface, the idea that SOEs should play a different role from private firms seems to already be reflected in Vietnam's current "Strategy for Socio-Economic Development 2011–2020". It emphasizes a differentiated policy mix of private sector regulation and supervision (especially in financial markets) and a SOE sector that retains a key role in producing those essential products, goods and services that private firms are not (yet) able to provide or have no incentive to provide (e.g., due to market failures).[17] On the other hand, the more recent Public Investment Law (49/2014) suggests that investment projects of social character be conducted by the government itself, possibly even in public-private partnership. What is absent in any case is a well-founded motivation for why private firms do not provide those essential goods and services at the socially optimal quantity and an appropriate mapping into SOEs' objective function.

While a clearly identifiable subset of cases where SOEs ought to be preferable to either (regulated) private firms or to direct government intervention is missing more generally (also see Putniņš 2015), the continued importance of SOEs can probably be best explained by political factors.[18] Recent reforms can be interpreted as a move by the state towards better regulating a sector it officially owns

but has lost control of. The goal is to make SOEs act more like private firms and to hence avoid that governance failures and associated waste of state capital turn into full-fledged government failure (as Pincus 2015, pp. 40–42, suggests in the context of Economic Groups and General Corporations). As described below, even this proves difficult in practice.

5.2 Laggard Implementation Due to Misalignments of Political Incentive Structures

The second serious shortcoming in recent reform efforts is its sluggish implementation. Concerning Decision 929 on SOE restructuring and divestment, the Steering Committee for Business Renovation and Development notes that between 2011 and 2013 only 19 per cent of the originally planned state capital was divested from non-core businesses. Overall, only 180 SOEs were restructured during this period, of which 99 were equitized, with US$12.7 million in assets publicly offered and the rest being sold internally. These numbers clearly fall short of the initial targets and highlight that the restructuring of SOEs proved more difficult in practice than anticipated.

Progress has been faltering for Decree 61 on SOEs' financial reporting as well. For example, as of August 2014, 18 out of the 78 enterprises (SOEGs and SOGCs) requested to submit their financial monitoring reports under Circular 158 did not submit their reports, and another 22 had yet to be checked. Only 3 SOEGs had submitted their financial statements. Furthermore, 8 out of 18 line ministries and 32 out of 63 provinces did not submit their requested reports. Accordingly, the Ministry of Finance has not been able to provide a consolidated report in time by the end of 2014. A survey on financial disclosure of SOEGs found that, as of October 15, 2014, some SOEGs disclosed their 2013 audited financial statement appropriately, but a number of them have not.

While it is possible that the laggard implementation is due to technical and human resources difficulties in adjusting to the new rules, it is at least equally likely to be caused by institutional fragmentation (Pincus 2015), potential turf-wars between different government entities, and political currents within the wider government — including SOE managers (see the third stylized fact in section 4).[19] So far, the central government has attempted to overcome these constraints by tightening control, putting other entities on a tight leash, and "doing more of the same" (see, e.g., PM Decision 36, Circular 171, Circular 158/2013). For example, the central government tried to respond to lagging SOE restructuring with assigning tasks for the implementation of the master plan on economic restructuring and of Decision 929 (PM Directive 11/2013) and speed up divestment by lifting restrictions on selling equities below par or book value (Resolution 15/2014). In 2014, PM Dũng has pressured line ministries and provinces to complete their financial reports by announcing that those SOEs which do not submit financial statement risk being classified down (which affects payment schemes). Furthermore, the government indicated that leaders of local governments and provinces that do not meet targets run the risk of being replaced. In October 2015, the government issued Decree 87/2015 with the aim of tightening the supervision of SOE to improve their performance.

These efforts suggest that while the central government hopes to accelerate and take control of the SOE reform process, other parts of the State — especially at the local, provincial, or some line ministry level — are resistant to these efforts. This implies a misalignment of political incentive structures. This fragmentation of the state is also visible from the fact that until September 2013, PM Dũng approved restructuring plans for 18 out of 20 groups/corporations under his authority (8 groups and 10 special corporations), while ministries and Provincial People's Committees have just approved about 40 per cent of the total plans required, with local authorities only approving 20 of the required 101 plans (Nguyen Dinh Cung 2013, pp. 27–29, 93).[20]

5.3 The Shaky Equitization Process

The final shortcoming of the SOE reform process concerns the shaky and labile equitization process. For example, through 2011–13, only about 100

SOEs were equitized — which was the aspired target for 2012 alone — most of which came from the 74 equitizations in 2013 (including 12 SOGCs).[21] Furthermore, the equitization process has mostly focused on small SOEs, and only a small share of equitized assets of SOGCs has actually been transferred to non-state shareholders. In 2014, about 140 SOEs were equitized, which compared well with the progress over previous years but was still lower than expected. In 2015, stakes in roughly half of the targeted 289 SOEs were sold, also only raising half of the targeted 8.7 trillion dong. Furthermore, the Infrastructure Working Group of the VBF (2015) notes that equitizations are often "economically unimportant because few shares of the former SOE are sold, and those that are sold are sometimes sold to passive investors, including banks, that will not have the interest to improve management efficiencies".

Public offerings and stock market listing have been the focus of the SOE equitization strategy: for the initial plan of a total 582 SOE restructurings over the period 2011–15, 531 SOEs were required to be equitized through initial public offerings (IPOs; see Stoxplus 2014). Whether this strategy, public offerings combined with quick stock market listing (Decision 51/2014), was successful in boosting financial liquidity is highly questionable — the combination of shallow domestic financial markets, relatively tight foreign ownership limits (which have been lifted however with Decree 60/2015) and receding global liquidity since the 2013 "Taper Tantrum" probably calls for a more innovative and gradual policy mix.

Moreover, from a macroeconomic perspective, the equitization process has been plagued by a vicious cycle where the government tries to deepen financial markets *through* IPOs. However, the foreign investors that are needed to boost liquidity remain absent inter alia *because* of shallow capital markets — i.e. the concern over stocks being illiquid (besides other concerns about non-government shareholders being too small to influence corporate governance). The shaky start of the equitization process led to disappointing equitization outcomes which, in turn, kept capital markets shallow and created a public perception among foreign investors that the market is not attractive. Given severe information frictions, investors used these perceptions for pricing expectations of firm values in upcoming IPOs, leading to suboptimal outcomes. Examples for recent disappointing offerings include Vinamotor, which only sold 3.1 per cent of auctioned shares in March 2014. Another example is Vietnam Airlines, which managed to sell its whole 3.48 per cent stake in November 2014, but mostly to two corporate investors (presumably domestic banks), while the IPO failed to attract enough foreign investment. The capital raise of US$60 million would not even suffice to buy a new plane. The most recent sale of a 8.8 per cent stake to ANA raised another US$108 million but fell short of the initial target of finding a strategic partner willing to take up a 20 per cent stake. The IPOs of the Hai Phong, Nha Trang and Quang Ninh ports in May 2014 were also disappointing, with only 47, 6.3, and 7.5 of initially offered shares sold. Similarly, offerings of Cam Ranh Port, a subsidiary of Vinalines, in March and April 2015 sold only 9.6 and 5.4 per cent of shares initially put for sale, respectively. Six different auctions of Vinacomin (coal mineral industries group) subsidiaries between April and December 2015 also could not sell more than 4.5 per cent of shares in the best case (average: 2.0 per cent). One auction even had to be cancelled due to lack of investor interest. The same was true for the offering of Vietnam Posts and Telecommunications Group planned for November 2015 at the Hanoi Stock Exchange. This does not mean that there have been no successful equitizations. Positive examples include Vinatex, which attracted twelve corporate foreign investors in September 2014; Ben Thanh Tourist, which sold all shares offered with the lowest winning bid double the starting price in December 2014; the March 2015 IPOs of Hanoi Transport Service Corporation (Transerco) and Thong Nhat Eletromechanicals (VinaWind); Tran Phu Electric and the Infrastructure Development and Construction Corporation (Licogi) in April 2015; and the equitizations of Thang Long GTC (touristic, services, entertainment), Vegetexo, Vinatea, and Central Transport Hospital in fall 2015.

This suggests that continuing doing "more of the same" in the current situation is unlikely to be successful. So far, it seems the government's strategy has been to require other state entities (SOEs, line ministries and subnational authorities) to stick to initial plans, or even trying to step them up. However, it is questionable if the problem can simply be addressed by stepping up the same plan for the future. Rather, it would be more appropriate to step back and conduct a more careful evaluation of why some offerings were successful, while others were not. At an initial glance, success does not seem to correlate with external conditions or periods of market illiquidity, as evident by the heterogeneous equitization successes in the spring 2015. While sectoral preferences might explain some of the successes in equitization (since several relatively successful IPOs were conducted in sectors where Vietnam is expected to have a competitive edge, such as in textiles or tourist services), sectoral patterns cannot account for the large variation in outcomes. For example, notwithstanding the disappointing port equitizations mentioned above (Hai Phong, Nha Trang, Quang Ninh, Cam Ranh), the offering of Saigon Port, a Vinalines subsidiary, did pretty well in June 2015. This point is probably most striking when comparing three offerings of Vietnam Railway subsidiaries that all took place in December 2015. While Saigon Railways did pretty well (the bidding volume exceeded the offered share volume by 8.7 per cent), the IPO of Hanoi Railways only sold 2.2 per cent of the initially offered shares three days later. Finally, the IPO of Di An Train thereafter sold less than 50 per cent of shares offered. This suggests that specific factors at the firm level — likely related to governance issues, financial planning and reporting, ownership shares and dispersion, or the preparation of the IPO itself — are important factors for the success or failure of individual IPOs. In any case, it is imperative to understand these factors in more detail before stepping up the equitization process. Similarly, little is known about the effect of new shareholder participation on SOE's corporate governance in Vietnam yet.

6. Conclusion and Policy Recommendations

The preceding analysis draws a rather dire picture of de facto SOE reform progress in Vietnam. Implementation fell considerably short of the government's own targets in terms of equitization, non-core business divestment, reorganization, and compliance with reformed rules concerning financial reporting and transparency. Even though Gainsborough (2007) and Fforde (2007) have argued that a divorce of politics from policy is all but exceptional in Vietnam's political economy and possibly an inevitable by-product of a fast-growing economy with even faster growing development aspirations, it is fair to say that with respect to SOE reform, a new level of politicization was reached after 2007. It is therefore prudent to keep in mind the ongoing crisis of the CPV (Fforde 2013) as well as the political fault lines between: the centre and local government; between SOEs and their planners; and within the oblique triangle of party/government officials, private sector, and SOE conglomerates/groups (SOEGs, SG90/91, SCIC etc.). SOEs are especially pivotal due to its independent basis of power. Despite all the serious policy constraints and challenges that vested interests pose, one should not neglect the mobilizing role that ideas can play to overcome them, especially if the CPV can offer a vision of development that includes the SOE sector. In this concluding section, we provide some ideas on how to move forward. We discuss two potential pathways: privatization reforms; and restructuring reforms.

With respect to privatization reforms, even with a passive agenda to regulate and dismantle SOEs, there is considerable room for improvement. First, there is a multitude of formal privatization methods that do not only differ with respect to their effects on firm performance but also how vested interests of insiders are treated. So far, there seems to be little flexibility in this regard, with a focus on IPOs that is especially problematic in the context of Vietnam's shallow capital market (cf. Sjöholm 2006; VBF 2015). Second, the focus on speed in recent equitization has to be questioned. It rather seems appropriate to take a step back and

evaluate why some of the equitizations mentioned in section 5 were more successful than others. Of course, this has to be done under rather tight fiscal constraints that call for quick equitization revenues.[22] But little is gained from futile public offerings without investor interest, as in the case of Vinacomin in June 2015, the Posts and Telecommunications Group in November 2015, or Vin Hao Mineral Water in December 2015, which only add to the vicious cycle of disappointing equitizations as described above.

With respect to restructuring reforms, what would a more ambitious, comprehensive agenda for the SOE sector look like? Such reform should start with the considerations presented in this paper: ask which market imperfections in Vietnam provide a rationale for SOEs; and, on this ground, define the objective function for each SOE in a precise and measurable manner. By evaluating SOEs against their respective objective function, they can be grouped into sectors that are: (a) subject to full and formal privatization given the absent economic rationale for state ownership (as is true for the many SOEs in consumer industries); (b) of strategic economic interest due to complementarities and spillovers between SOEs and private firms (see Poyago-Theotoky 1998); (c) of strategic national interest and retain full state ownership (such as defence); and (d) where the status is unclear.[23] Public support for such an agenda requires highlighting the social welfare implications of SOEs' objective functions and public monitoring of their achievement. Promotions and human resource management systems should be based on their ability to achieve these goals.[24] Such a strategy could help to redefine the role of SOEs in a changing socialist economy with several capitalist market features and a clear outward-oriented component. Doing so could allow the CPV to overcome its political crisis.

Under either scenario, it is essential to develop formal financial markets that are able to absorb the equity shares of SOEs sold and to make sure regulation of firms keeps up with realities in a constantly changing environment. Special emphasis should also be paid to the regulation and governance structure of SOEs in strategic sectors with the potential of positive spillovers to private firms. A strategic holding and investment corporation with clearly defined non-profit targets (but active ownership in profit-maximizing joint ventures) potentially provides an appropriate structure while simultaneously being compatible with WTO and potential TPP regulations.[25] The importance of such accompanying reforms concerning regulation and financial development is hard to overestimate as it concerns the "central issue of whether or not better economic performance will be attained through changes exogenous to SOEs (…) rather than through formal privatization" of firms that are already largely treated as private in nature by their owners (Fforde 2004; on the latter, see also Gainsborough 2002). Similarly, Pincus (2015) highlights that former state-owned private firms have little incentive to increase efficiency in an environment where easy profit is made from privileged access to land titles, credit, and markets based on old personal ties and market power. Thus, in their survey of empirical studies, Estrin et al. (2009) also highlight that complementary reforms and institutions are critical for obtaining positive privatization effects. This can also be seen from the Chinese experience, where after accelerated privatization of SOEs slowed down in the 2000s, the country continued to combine a large SOE sector with high-growth performance. Instead of broad-based privatization, China set clear priorities in their privatization attempts (e.g., the *zhuada fangxiao* policies) and placed them in a wider context of macroeconomic reform. Maybe what Riedel (1995) wrote two decades ago is more true today: "At the moment, the government is focusing far too much on the reform and privatization of the state-owned corporations … [which is] much less important than to create an environment for firms to grow in the private sector … What Vietnam needs is not only a market economy but a well-functioning one."

While garnering the political will to implement these proposed reforms may prove daunting, it may be the CPV's only hope to unite party fractions and overcome political constraints — by providing a vision that meaningfully redefines the role of the SOE sector in Vietnam's macro

development model. As Rodrik (2014) highlights, history is full of cases where the implementation of new ideas by those in power relaxes political constraints from vested interests. Unless the CPV can provide such a vision, the full dismantling of the SOE sector will indeed be the last resort. While this might prevent economic and political collapse, it will also dismantle the economic basis of Vietnam's socialist development model, the party's legitimacy-lender of last resort.

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NOTES

1. The idea of a potential "middle-income trap" was pioneered by Gill and Kharas (2007) and characterizes a situation where growth strategies based on factor accumulation face an uphill struggle to maintain their impressive growth performance through middle-income status if they are unable to exploit economies of scale. While Latin America and the Middle East provide examples of economies unable to escape this trap, it is by no means an unavoidable fate.
2. The difficulty with analysing and restructuring the SOE sector in Vietnam starts with the problem how to count SOEs. For example, OECD (2012) mentions about 1,000 SOEs in 2010, whereas the World Bank (2011) reports 3,364. According to SCIC (2011), the number of 100 per cent state-owned enterprises decreased from 5,655 in 2001 to 1,358 in mid-2010. These discrepancies most likely arise from the different ways that groups and conglomerates are accounted for and whether one only considers 100 per cent state-owned enterprises, majority-owned ones, or also joint stock companies with state capital.
3. According to the World Bank (2015), total outstanding public debt (government, government-guaranteed and local government) was 59.6 per cent of GDP at the end of 2014 and expected to rise towards 65 per cent of GDP by 2017, which is a relatively high level for a developing country.
4. In Vietnam, "equitization" (*Cổ phần hóa*) is a broader term that refers to acquiring private equity shares in SOEs, which is often also referred to as "privatization" in other countries. The term "equitization", however, seems appropriate as the goal is not simply to divest unprofitable SOEs. While this is true for several SOEs (especially the smaller, less profitable ones), the goal for other SOEs (especially the larger ones) is to find strategic investors for enterprises and conglomerates that aim to become competitive players in an increasingly global market.
5. Related arguments have recently been made by Berg et al. (2015) concerning the effect of public investment on growth in the context of implementation inefficiencies and by Moller and Wacker (2017) concerning heterodox macro policies in Ethiopia, a low-income country that experienced exceptional growth rates over the last decade amid high SOE investment and financial repression of private firms. The above arguments assume that SOEs operate as the government's agents, an argument that can be problematic in countries with a complex political economy like Vietnam. See especially Fforde (1993), who instead argued that, for the 1980s, the political process was responsive to SOE business interests.
6. Of course, other classifications are possible and meaningful as well. For example, Fforde (2007) distinguishes three periods of "commercial renaissance" divided by two "traps" (1979–81 and 1989–91) but focuses on a wider perspective, not only the latest reforms.
7. For a more comprehensive account of legal developments during that period, see Le Dang Doanh (1996). Fforde and de Vylder (1996, p. 168) provide an overview of key documents regulating SOE transition in the 1980s.
8. Unless noted otherwise, Kim, Nam and Cuong (2010) is the source for data and information provided in this subsection.
9. See also Gainsborough (2009) for an analysis of the causes and consequences of the accelerated equitization in the late 1990s.

10. Author's own calculations based on GOV (2011).
11. There might of course be valuation problems associated with fixed assets but they should not dramatically change this general pattern.
12. See the working paper version of this article for more detail on the data (Wacker 2016).
13. See Rand, Tarp and Trifkovic (2014) for similar control variables.
14. Using an adjusted Wald test for parameter equality does not allow us to reject the null hypothesis that the true effect of government ownership is the same as for private (domestic/foreign) ownership. We can identify all different ownership shares and they all show a positive effect because the category of "other" is left out.
15. Also note that the negative effect of the government dummy in columns 4–6 cannot be taken at face value because it will be compensated for by its (positive) interaction with capital.
16. Fforde (2007) also views Vietnam's SOE sector as successful in "comparative context" (but as a failure in terms of what was possible).
17. See also *Socio-economic Development Plan 2011–2015* (approved as Resolution 10/2011).
18. While the political economy of SOEs is generally difficult to model (see, e.g., Shleifer and Vishny 1994), several country case studies exist (e.g., Yi-chong 2012 for China and India), including Fforde's (e.g., 2004, 2007) and Lan Nguyen's (2009) comprehensive analysis on Vietnam. How meaningful the government's micro-efficiency focused targets were for Vietnam's wider development strategy in the first place is another, normative, question that could be addressed under a political economy model with constraints highlighting political power structures and alliances that are capable of pushing through reforms aligned with their interests. Unfortunately, reliable political analyses for such an exercise are largely absent.
19. Moving ahead with legal reform faster than practical implementation can keep up with could even be intended in this context because if reforms are not implemented as required, it gives the central government authority to take more drastic steps than the political balance would permit otherwise. The measures described in the following paragraph are consistent with this view. Also note that Fforde (2007) highlights that keeping up with the ebb and flow of legislation has been an important part of SOE managers' work: "Get it wrong and you could be denounced as anti-socialist."
20. However, the heterogeneity could also be due to differences in technical capacity: SOEs under the PM's (and some line ministries') authority are usually larger corporations that often have internal controlling mechanisms in place to meet the reporting standards required by the reforms, while smaller SOEs have yet to develop internal mechanisms to meet them.
21. Plan for 2012: 93; actual equitizations 2011–13: 99 (according to Nguyen Dinh Cung 2013, p. 87).
22. Furthermore, with Vietnam's development level rising, fiscal resources should increasingly switch from SOEs to transferable assets (i.e., the production and maintenance of human and social capital).
23. Where the role of SOEs cannot be easily deduced from analytical economic reasoning, more empirical insights about SOE spillovers would be helpful. Note that Decision 929 follows another strategy by classifying firms according to state ownership shares and based on business considerations, not by the role they could play in Vietnam's macroeconomic development strategy.
24. Further recommendations for SOE governance to limit government failure, such as alternating ownership or rotating management (with promotions based on achievement of firms' function), can be found in Lawson (1994) and Pincus (2015).
25. The idea here is to provide managers a clear objective economic function based not on firm profit but social benefit maximization (e.g., technology transfer). As this is a non-profit operation that fulfils a public service mandate (while still being run on business principles), it could still enjoy government support without violating non-discriminatory treatment clauses (such as in TPP Article 17.4). On general TPP and WTO issues for Vietnam and its SOEs, see Thi Anh Nguyet Le (2015), Le Hong Hiep (2015) and Tu-Anh Vu-Thanh (2017).

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