BETTER FINANCIAL MEASURES FOR THE REFORM IN THE PUBLIC SECTOR

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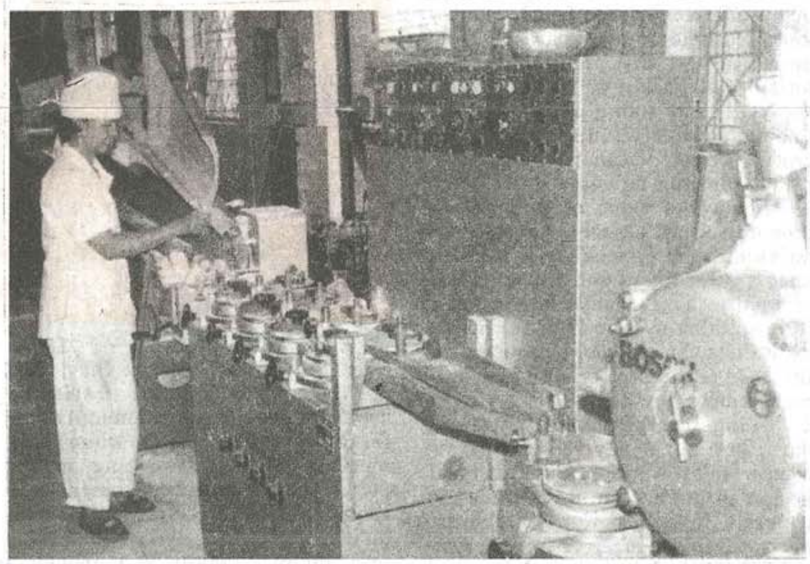
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I. PROCESS OF PERFECTING THE FINANCIAL MECHANISM OF STATE-OWNED COMPANIES

Considering perfecting the financial mechanism of state-owned companies as an important measure to improve their performance, the Government and Ministry of Finance (MF) issued various degrees and circulars to accelerate the process, including:

- Degree 59/CP dated Oct. 3, 1996 on the financial and accounting management for state-owned companies,
- Degree 27/1999/NĐ-CP issued on April 20, 1999 by the Government on adjustments to the mechanism for financial and accounting management in state-owned companies,
- Degree 63/2001/NĐ-CP issued on Sep. 14, 2001 by the Government on tranformation of companies run by civic and political organizations to one-member limited companies,
- MF Circular 62/1999/TT-BTC dated June 7, 1999 providing guidelines on management and use of assets and capital in state-owned companies,
- MF Circular 63/1999/TT-BTC providing guidelines on management of sales, expenditure, production cost and services in state-owned companies,
- MF Circular 58/2002/TT-BTC dated June 28, 2002 about financial management in one-member limited companies run by civic and political organizations,

Degree 59/CP in particular is considered as a milestone in the task of perfecting the financial mechanism of state-owned companies thereby helping them improve their performance and play well the leading role in the market economy.

The financial mechanism, however, reveals certain problems that should be solved as soon as possible.

II. MORE ADJUSTMENTS TO FINANCIAL MEASURES ARE NEEDED

1. Distribution of after-tax profit in one-member limited companies must be reformed with a view to giving incentives to laborers and managers.

Point C of the MF Cirrcular 59/2002/ TT-BTC dated June 28, 2002 on the financial mechanism of one-member limited companies run by civic and political organizations requires that the profit after paying company income tax and covering losses suffered in previous yearsshould be spent on the following items:

(a) 10% of the profit is put in the financial reserve until the reserve equals 25% of the legal capital.

(b) 5% is put in the redundancy fund until it equals total pay for six months.

(c) After (a) and (b), the remainder is spent on:

- 10% at most is put in the fund for bonus.
- 10% at most in the fund for benefits.
- 5% at most in the fund for reward for the management: this 5% isn't allowed to exceed VND100 million on condition that the before- tax profitability ratio is equal to or higher than the planned ratio. If the before-tax ratio is lower than the planned one, the 5% level will be reduced accordingly.
- a minimum of 30% is turned into an add-on to the legal capital.
- the company owner is allowed to decide how to use the rest: adding it ti the legal capital, turning it into investments or paying to the Treasury.

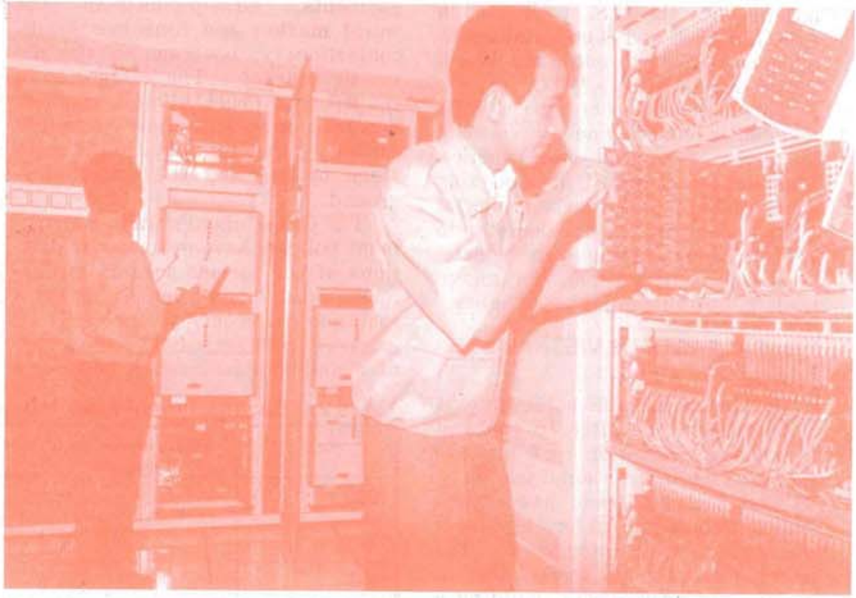
In this regulation, there are irrational points that should be amended:

- The financial reserve should be equal 75% of the legal capital because the business performance could be seriously damaged by force majeur. It's force majeur that made the oil price exceed its ceiling in the past few months and coffee price fall in 2001 and 2002 with the result that companies in these businesses suffered great losses. The Government had better allow one-member companies to form the financial reserve that is equal to 75%, instead of 25%, of their legal capital to increase their ability to deal with risks.
- The 10% level for funds for bonus and benefit could be increased to 15% each while the minimum of 30% adding to the legal capital could be 50% instead.

- The 10% level for funds for benefits and reward is too low to encourage laborers and managers to improve their performance. To encourage them to work harder, pay more attention to the business performance, apply technical renovations, work out initiatives, reduce production cost, improve company's competitiveness and expand its market share, the percentage put in these funds could be increased from 10% to 15% (after a 10% part is put in the financial reserve and a 5% part in the redundancy fund.)

- A 30% add-on to the legal capital is small because most one-member companies developed from state-owned companies run by civic and political organizations are important companies in which the State had better hold all of their shares. These companies must be consolidated continuously, and increasing their legal capital is an important measure to take. In my opinion, the Government had better raise the add-on from 30% to 50% and reduce to the minimum the percentage that could be turned into investments or payments to the Treasury.

2. Companies could be exempted from fee on the land using right when liquidating their factory buildings. At present, many companies that want to sell old factory buildings before building new ones in other locations have to pay the fee on land using right set by land authority based on the market prices as allowed by the Degree 04/2000/NĐ-CP dated Feb. 11,2000. As a result, they run short of capital needed for buying



the land using right for the piece of land on which they want to build new factory buildings (because the State doesn't refund the fee when the old factory building is sold). This regulation fails to encourage companies to move to more convenient locations, so it must be amended.

3. VAT on farm products bought from individual peasants (who issue no invoice) could be exempted: According to Point d, Article 10 of the VAT Law, exemption of the VAT of farm products without invoice supplied by individual peasants doesn't apply to farm products to be exported. This regulation discourages companies from buying farm products directly from peasants to export them because they can't collect the input tax they paid when buying farm products without invoice, while other companies do the same thing but they sell processed farm products to export companies instead of exporting them directly, they could enjoy exemption from the input tax. In other words, the regulation encourages trading between export and processing companies in place of trading between peasants (producers) and export companies.

Moreover, the Ministry of Finance has had plan to petition the Government to revoke the practice of deducting the input tax on farm products bought from peasants without invoice. This plan is against the basic principle of the VAT Law that allows "companies to set off against the otput tax the input tax they have paid," because prices of all farm products include many input tax to be deducted (on fuel, fertilizer, insecticide, farm machine, etc.). Therefore, it's reasonable to deduct the input tax on farm products bought by export companies without invoice from individual peasants.

We hope that what we discuss above will help deal with obstacles to the financial mechanism in state-owned companies with a view to helping them improve their performance and competitiveness and play better the leading role in the economy as required by the Resolution of the VCP Central Committee of 9th term.■