

RESTRUCTURING THE PUBLIC ECONOMIC SECTOR: APPROACHES TO ENHANCING ITS MACROECONOMIC REGULATION AND SUPPORTIVE IMPACTS

by Assoc. Prof., Dr. NGUYỄN TRỌNG HOÀI & MEcon. HUỲNH THANH ĐIỀN*

The role of state-owned enterprises (SOEs) is to help the government make macroeconomic regulation, correct market flaws, support economic reforms as well as develop infrastructure, and beef up national defense and security. This research aims to evaluate their role in the aforementioned groups of objectives based on four aspects, namely institution, development strategies, management and industry structure of SOEs, thereby determining the aspects to be restructured. The research result shows that SOEs have been playing well their role of making macroeconomic regulation and repairing market flaws, due to their big share in investments and involvement in numerous industries. However, they have not performed well in economic reforms in terms of mobilizing external capital, facilitating input conditions for other industries, maintaining economic growth, and improving the balance of trade. Even worse, they have produced crowding-out effects on other sectors. The success and drawbacks of SOEs stem from the following aspects, namely institution, development strategies, management and structure of industry.

Based on their achievements and shortcomings, the research proposes restructuring SOEs in such a way that maintains their capacity to make macroeconomic regulation, correct market flaws, and improves their role in economic reforms, national defense and security. The restructuring should be conducted on four aspects: institution, development strategies, management and structure of industry.

Keywords: Restructuring, state-owned enterprises (SOEs), institutional environment, macroeconomic regulation, market flaws, economic reforms.

1. Research background and issues

Although it has been 10 years since their equitization, SOEs still hold a big share in the gross investment and GDP. According to the GSO, in 2009 SOEs accounted for as much as

35.13% of GDP and 40.6% of gross investment, but created only 10.5% of total employments in the economy. Additionally, their investment efficiency is low with the ICOR being 1.5 times as high as the national average (Bùi Trinh 2010;

* University of Economics - HCMC

quoted in Porter et al., 2010). Moreover, SOEs tend to crowd out other sectors (non-public and foreign-invested ones) when they gain top priority in exploiting natural resources, have credit guaranteed by the government and secure an easy access to land stock (Porter et al., 2010).

These unsolved problems make it very necessary to restructure SOEs with a view to improving their business performance and supportive impacts on the whole economy. The study includes a review of theories of the role and restructuring of SOEs to propose an analysis framework. Next, based on the analysis framework, it assesses the role and trends of SOEs in the Vietnamese economy. The result is used for deciding the aspects to be restructured.

2. Analysis framework for public sector restructuring

According to Keynes (1936), as quoted by Mankiw (2010), SOEs undertake the role of making macroeconomic regulation through which the government carries out its fiscal and monetary policies and fixes market flaws (Mankiw, 2010). According to Hassard et al. (2010), SOEs help with economic reforms by developing products, enhancing competitiveness and the number of local enterprises in the international market, providing access to external sources of capital and maintaining economic growth. Moreover, SOEs provide support for other sectors (Todaro, 2009; Nguyễn Trọng Hoài & Huỳnh Thành Diên, 2011) and play a pioneering role in developing infrastructure; supporting national defense and security; and supplying services that fail to attract other sectors (Patel, 2004; Kahla, 2007; Mankiw, 2010).

Restructuring of SOEs occurs when the existing structure becomes outdated, fails to accomplish its role, worsens or hinders other sectors (Hassard et al., 2010; Hiley, 1999; Balassa, 1979). Gauld (2003) thinks that the restructuring deals with the renovation of public management, economic strategies and institution in various fields controlled by the government.

Therefore, in carrying out the restructuring, the role and the current structure of SOEs should be analyzed.

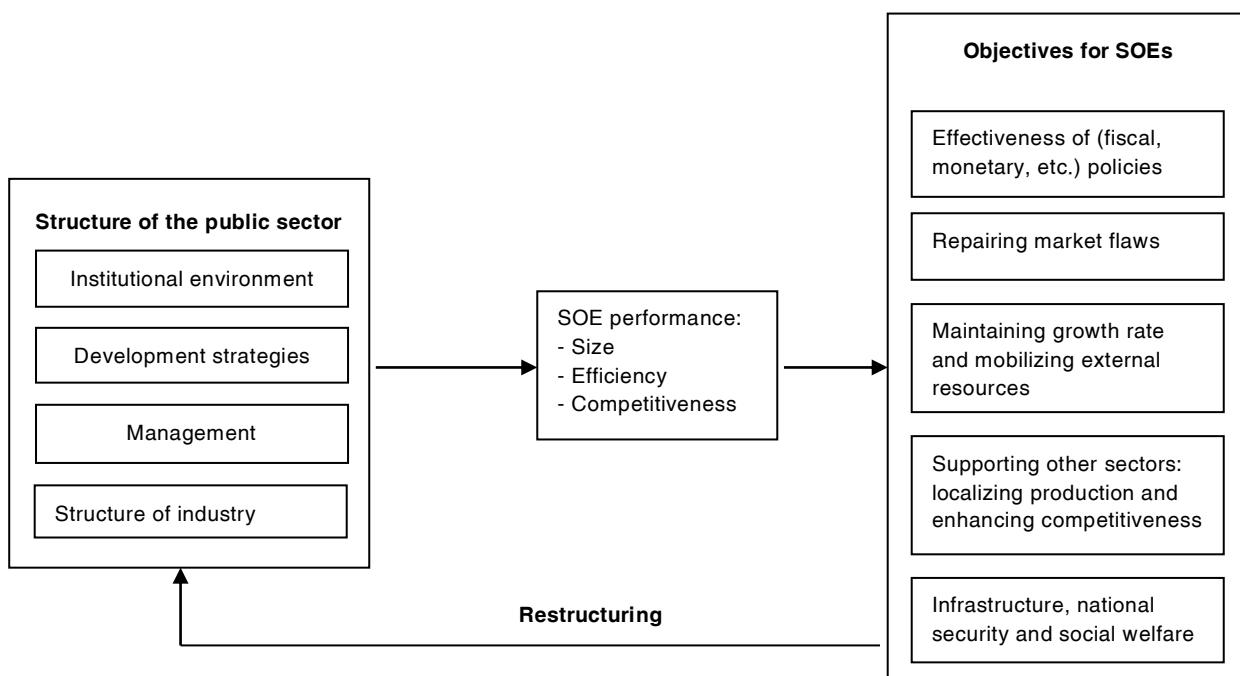
Approaches in this research are conducted in the same way as in Hiley (1999) and Hassard et al. (2010): first, analyzing SOEs' role in national targets (such as making macroeconomic regulation, fixing market flaws, facilitating economic reforms, constructing infrastructure and developing national defense and security); next, analyzing influential aspects to the success and failure of SOEs' role (such as institution, strategies, management and structure of industry). The result is used to suggest the fields that need restructuring. The analysis framework is summarized in Figure 1.

3. Research data and methodology

Data for the variables in the analysis framework are gathered from the GSO and related researches. The methods mainly used in this research are: (1) cause-effect and comparative methods to analyze the role of SOEs towards the groups of objectives in the economy (represented by dependent variables in the model) and (2) descriptive and comparative methods to analyze the structural aspects of SOEs, thereby indicating the ones to be restructured.

4. Analysis of SOEs' role towards national targets

Calculation of GSO data (2001-2009) shows that SOEs' contribution to the economy is decreasing despite their biggest share compared to other sectors in terms of GDP, investments and industrial output value. In 2000, their contributions to the three aforementioned categories were 38.52%, 59.1% and 42% respectively. These figures dropped to 35.13%, 40.6% and 23% respectively in 2009. As can be seen from Table 1, SOEs hold the largest share in investment and asset values despite a slight decrease. Meanwhile, labor force and revenues of SOEs undergo a dramatic fall. This reveals that SOEs are switching to capital-intensive



Source: Suggestions by the research group

Figure 1: Analysis Framework of SOE Restructuring

industries. Hence, their labor productivity is seven times as high as that of non-public enterprises, but only equals 90% of that of foreign-invested enterprises (GSO, 2010).

However, Table 2 indicates a decrease in revenues and human resource produced by SOEs'

investments and asset values. This implies that SOEs' investments have lost their effectiveness in the past few years. The ICOR is one and a half times as high as the national average and much higher than those of Taiwan and South Korea recorded in the 1960s (Porter et al., 2010).

Table 1: Indicators of enterprises' size in 2000 and 2008

| Indicator | Labor force | | Revenue | | Investment | | Asset value | |
|----------------------------------|-------------|------|---------|------|------------|------|-------------|------|
| Year | 2000 | 2008 | 2000 | 2008 | 2000 | 2008 | 2000 | 2008 |
| Total (%) | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| SOEs (%) | 59 | 24 | 55 | 31 | 67 | 47 | 56 | 48 |
| Non-public enterprises (%) | 29 | 53 | 25 | 47 | 10 | 35 | 8 | 31 |
| Foreign-invested enterprises (%) | 12 | 23 | 20 | 21 | 23 | 18 | 36 | 21 |

Source: Calculation of GSO data (2010)

Table 2: Indicators of enterprises' business performance in 2000 and 2008

| Indicator | Labor force/ investment | | Labor force/ investment value | | Revenue/ investment | | Revenue/ asset value | |
|------------------------------|----------------------------|------|----------------------------------|------|------------------------|------|-------------------------|------|
| Enterprise category/Year | 2000 | 2008 | 2000 | 2008 | 2000 | 2008 | 2000 | 2008 |
| SOEs | 3.12 | 0.90 | 9.09 | 1.96 | 0.66 | 0.56 | 1.93 | 1.21 |
| Non-public enterprises | 10.58 | 2.73 | 30.69 | 6.65 | 2.07 | 1.13 | 5.99 | 2.77 |
| Foreign-invested enterprises | 1.77 | 2.22 | 2.75 | 4.32 | 0.70 | 0.97 | 1.09 | 1.88 |

Source: Calculation of GSO data (2010)

SOEs' big share in investments is a good condition for the government to make macroeconomic regulation and repair market flaws. An example of this is the successful inflation curb by means of a tight monetary policy and investment cuts in 2007. Moreover, SOEs take part in industries that fail to attract other sectors to remedy imbalances in the economy. According to the GSO, SOEs accounted for 5% of investments in community services in 2009.

As shown in Figure 2a, SOEs' investment growth rate has a negative and significant (at a significance level of 5%) effect on FDI growth rate (with the regression coefficient of -1.33). This means that a rise in investment in SOEs will entail a fall in mobilizing capital from outside. In other words, SOEs do not accomplish the role of raising investments that are used to upgrade infrastructure and create favorable conditions for other sectors.

According to Figure 2b, SOEs' investment growth rate also produces a negative and

significant (at a level of 5%) impact on the growth rate of annual volume of goods flow (with the regression coefficient of -0.168). This implies that investment in SOEs failed to build a good infrastructure to reduce transport costs. In other words, SOEs have not played well their role to reduce transaction costs by expanding and enhancing infrastructure.

Figures 2c and 2d show that SOEs' investment growth has an insignificant effect on annual growth rates of export value and GDP respectively. This suggests that their role is inconspicuous in improving the balance of trade and promoting general economic growth.

In brief, SOEs have fulfilled the role of making macroeconomic regulation and repairing market flaws, but have failed to perform well in economic reforms by not creating supportive impacts on other sectors and the whole economy, raising external capital, reducing input costs, maintaining economic growth, and improving the balance of trade.

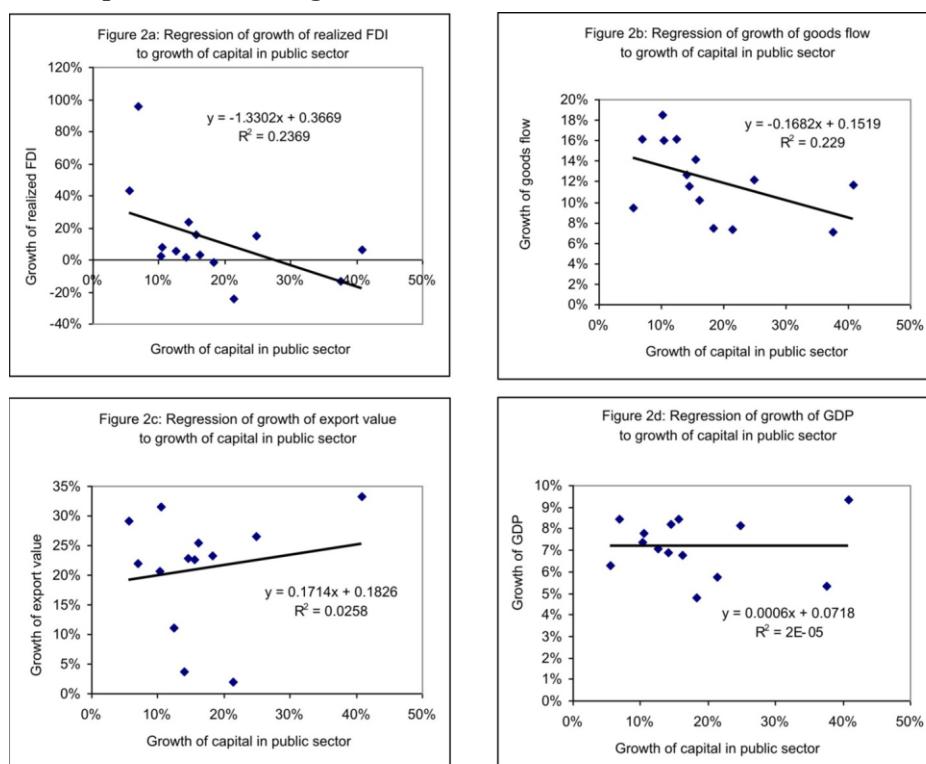


Figure 2: Impacts of increases in investment in SOEs on indicators of economic strength

5. Facts of major aspects related to SOE restructuring

The previous section deals with the role of SOEs in groups of economic targets. This section analyzes four aspects of SOEs, namely institutional environment, development strategies, management, and economic structure, to determine what aspects to be restructured.

a. Institutional environment:

Vietnam's economic development follows the leadership of the Communist Party through Political Platform 1991. Based on the Platform, Hà Đăng (2010) deduces that the general economic development model consists of two objectives, namely to build a socialism-oriented market economy and combine industrialization and modernization with knowledge-based economy. SOEs are expected by the government to take the decisive role in realizing these goals. This implies that SOEs are controlled by public institutions such as the government, ministries, and local authorities. In other words, the government (including local authorities) functions as a controller and a manager of SOEs.

This facilitates macroeconomic regulation and market flaw correction. In the case of petroleum industry, for example, Vietnam has only 12 enterprises importing petroleum, all of which are SOEs. The government, thereby, controls selling prices to regulate the economy. Another example is the distribution of customer goods. Despite operating as a cooperative, Saigon Co-op is actually an SOE through which the government implements policies for stabilizing prices to restrain inflation.

Management of this type, however, can produce inequality to other sectors in terms of exploiting national advantages, accessing land stock and guaranteeing credit. Consequently, this leads to mentality of passive reliance among

SOEs, entailing high debt-to-equity ratios in several state-owned corporations.

According to a report from the Finance Ministry, corporations and general SOEs have very high debt-to-equity ratios. In 2008, for example, this ratio was 42 times for Cienco 5; 22.5 times for Cienco 1; and 21.5 times for Lilama (Porter et al., 2010). Moreover, since 2005 when operations of SOEs were regulated by Companies Law 2005, inequality have gone from bad to worse because economic sectors may be equal before law but they are treated unequally by public authorities. An example of this is the advantages enjoyed by SOEs in accessing land, especially public land lots, and acquiring credit guarantee from state-owned banks (Porter et al., 2010).

b. Development strategies:

Since 1975, the VCP has been insisting that SOEs take the leading role in strategies for national economic development. This view has slightly changed over time to adjust SOEs' role to a particular context of development. According to proceedings of the 6th VCP Congress (1986), it is necessary to attach SOEs' leading role with their big share in both production and distribution. The Conference of Central Committee, Term 6 (1989) confirmed their leading role, but stated that it was unnecessary for them to hold a big share in all industries. Political Platform 1991 only specifies that the public sector plays a leading role in the economy. Strategy for socioeconomic stabilization and development in the 1991-2000 period approved at the 7th VCP Congress (or 1991 Strategy for short) determined development strategies for SOEs as follows:

- Developing key industries and fields, controlling major enterprises and undertaking activities that other sectors cannot afford or do not want to engage in.

- Linking and supporting other sectors and performing the leading role and the function of employing macroeconomic regulation.

- Transforming unnecessary SOEs into other forms of companies and ownership, or dissolving them after preparing employment policies for their workers.

The strategy for 2011-2020 approved by the 11th VCP Congress 2011 (or Strategy 2011 for short) adopts combination of economic development with development of advanced production relations but also confirms the influential role of SOEs to other sectors. In general, SOE development strategy included in Strategy 2011 are appropriate to the theoretical framework on SOEs' role that is oriented towards macroeconomic regulation, support for other sectors, maintenance of high economic growth, and guaranteeing of national defense and security.

Views on development SOEs into large corporations are proposed at the 3rd Conference of Central Committee, Term 9: "... certain economic groups could be established by combining state-owned corporations with partners from other sectors to engage in various industries, but play an influential role in their principal fields based on high specialization, big investment and working capital, national and international operations, high technology and managerial skills, intensive R&D activities and production. At the pilot stage, such corporations can be established in certain industries where SOEs enjoy favorable conditions and advantages that allow them to integrate into and compete successfully in the international market, such as petroleum, telecommunications, electricity and construction."

Strategies 2011 also affirms "building some powerful groups of mixed ownership with state ownership being dominant" is suitable for Vietnam's scenario and the government's

expectation to found SOEs that are powerful enough for international competition in the context of integration. However, this establishment should be considered thoroughly based on demand, input, related industries, and structure and competition within the industry (Porter et al., 1990) instead of relying only on subjective ideas.

c. Management of SOEs:

Since 1991, there have been two major plans to re-organize SOEs, namely equitization (since 1991) and establishment of economic groups (since 2005). The former aims to enhance economic efficiency of SOEs (Trần Ngọc Hiên, 2007). In reality, it helps solve several problems: (1) eliminating mentality of passive reliance among SOEs on the government's financial support; (2) reforming administration and promoting participation of shareholders; (3) motivating development of new classes of enterprises of mixed ownership in which the stake held by the state is in the form of dominant or non-dominant shares (Trần Hữu Nghĩa, 2009). The equitization helps establish links between economic sectors and makes equitized enterprises a necessary condition for development of non-public sectors. However, the process of equitization is progressing slowly and lacks thoroughness, as the government still holds dominant shares in most of the equitized enterprises.

According to Dinh La Thăng (2010), Vietnam has had 12 state-owned groups until 2010, and 10 of them are the result of the rearrangement of corporations established according to PM Decisions 90 and 91; two others are founded by combining independent enterprises operating in the same field. The goals of establishing such groups are to promote economies of scale, and connect companies in the same corporations for major R&D projects and macroeconomic regulation. The government's recent guaranteeing

of credit to corporations has made the public debt increase and caused controversy about SOEs' economic efficiency, which has brought doubts about their role in making macroeconomic regulation and supporting other sectors.

It is now too premature to draw any conclusion about the role of SOEs from their high debt-equity ratios. However, the past five years saw threats to and opportunities for the success of these groups. Regarding the threats, the groups will be a barrier to entry by non-public sectors into industries that the state need not control, which creates pressure on public debt and causes macroeconomic imbalance. Concerning opportunities, they enjoy economies of scale and technological replacement, thereby supporting the government in macroeconomic regulation and market flaw fix.

d. Structure of industry:

Industries controlled by SOEs up to 2009 includes transport, warehousing, telecommunications, electricity, combustible gases and water supply, mining, national defense and security, agriculture and forestry, and construction (Nguyễn Trọng Hoài & Huỳnh Thanh Diên, 2011). In this way, SOEs can control most key industries in the economy, thereby facilitating macroeconomic regulation. This was proven effective by the inflation control based on tight monetary and fiscal policies in 2008.

However, SOEs still engage themselves in many industries where the private sector can take responsibility. This just does not create favorable conditions for development of other industries and even produces crowding-out effects on the private sector regarding access to sources of capital, credits, land and natural resources (Nguyễn Trọng Hoài & Huỳnh Thanh Diên, 2011). This fact implies that SOEs failed to undertake their supportive role towards economic industries.

Decreases in labor force of the public sector are considered as a right tendency, showing that SOEs are abandoning unnecessary industries. This fall, however, comes along with a rise in their share in the gross investment. Table 1 signifies that in 2000 SOEs make up 59% of labor force and 67% of gross investment. In 2008, these figures drop to 24% and 48% respectively, meaning decreases by more than half in labor force and by less than half in investment. Despite this, labor productivity of the public sector only equals 90% of that of the FDI sector (although the latter is mainly involved in labor-intensive industries).

6. Conclusion and policy implications

a. Conclusions:

SOEs have fulfilled the role of making macroeconomic regulation and repairing market flaws thanks to their big share in gross investment and involvement in many industries. However, they have not performed well in economic reforms such as raising external capital, supporting input conditions, maintaining economic growth, and improving the balance of trade. Moreover, they even produced crowding-out effects on other sectors.

What contributes to their success in regulating the economy at macro level and repairing market flaws are their big share in gross investment and involvement in many industries as well as in proper strategies for developing SOEs for national targets. The government can easily intervene in the economy because SOEs are well under control of local and central governments.

The drawbacks in SOEs' role are attributed to the institutional environment and vertical management in the government. This leads to heavy reliance on support and favor in exploiting natural resources and accessing bank credits. Moreover, efforts to establish powerful groups to regulate the economy and the market at a macro

level, and upgrading technology, etc., were not based on analyses of competitiveness of SOEs in terms of demand, output, related industries, structure and competition within the industry. Additionally, huge but discrete investment in many industries causes a crowding-out effect on other sectors.

b. Policy recommendations:

The results show that the restructuring of SOEs should be conducted by maintaining macroeconomic regulation and repairing market flaws. At the same time, it is of necessity to strengthen their role in economic reforms to make supportive impacts on other economic sectors: mobilizing capital from outside, improving foreign trade, and encouraging the growth of other sectors by developing and transferring technology, improving infrastructure and education, etc. The restructuring should deal with the following four aspects: institution, strategy, management, and economic structure.

First, on institution, there should be particular rules and laws for operations of SOEs. Companies Law (2005) should not be applied to their operations as it is now so that their economic role can be specified: targeting state-owned capital at regulating focuses and enhancing their supportive impacts. If SOEs operate in the same legal framework as companies from other sectors, unequal treatment by governmental agencies in terms of access to natural resources, land stock, and formal credit, etc. will persist and become more widespread.

Second, regarding development strategies, they should specify four groups of targets: (1) determining SOEs as a main force through which the government carries out macroeconomic regulation (by adjusting fiscal, monetary and foreign trade policies) and policies for technological development; (2) SOEs undertake the role of repairing market flaws, especially with appropriate involvement to insure industry

balance in the economy; (3) SOEs are responsible for supporting economic reforms by maintaining economic growth, facilitating flows of foreign investment, orienting and transferring technology for other economic sectors, investing in industries that create great supportive impacts, promoting export and localization, etc.; (4) SOEs take the lead in building infrastructure and exploiting key resources to encourage development of other sectors.

Development strategies should determine which kind of resources and infrastructure should be exploited and controlled SOEs and which should not. Otherwise, SOEs will produce crowding-out effects.

Third, concerning management, the four aforementioned groups of targets show that SOEs do not develop for profit, but for the sake of the country's socioeconomic interests. Thus, rules relating SOE operations, functions and duties should be made into laws to help them realize these strategic targets. It is especially important to avoid scattered investment in industries whose development strategies are not prioritized. SOE governing bodies can remain under the central or local governments for ease of economic regulation. However, they must be inspected by the National Assembly instead of the government to guarantee objectiveness in the inspection mechanism.

Finally, on economic structure, the most important is the structure of industry and labor force. The government should build a list of government monopolies, industries where SOEs engage in supporting activities or play an equal part to companies from other sectors and industries where SOEs are not allowed to operate. This list aims at producing supportive impacts on all sectors, correcting market failure and guaranteeing national defense and security■

References

1. Balassa, B. (1979), "A 'Stages Approach' to Comparative Advantage", in Adelman, I. (Ed.), *Economic Growth and Resources*, Macmillan, London, pp. 121-56.
2. Campbell, I. (1996), "Public Sector Restructuring: The Human Dimensions", *Management Development Review*, Vol. 9 Iss: 4, pp.23 – 25.
3. Đảng Cộng sản Việt Nam (2011), *Văn kiện Đại hội Đại biểu toàn quốc lần XI*, (Proceedings of the 11th National Congress), Chính trị Quốc Gia Publisher, Hà Nội.
4. Đinh La Thăng (2010), "Về tập đoàn SOE ở Việt Nam" (About SOE in Vietnam), Workshop on Socioeconomic Issues in Modifications of Political Platform 1991 submitted to the 11th VCP Congress, pp. 98-103.
5. Gauld, R. (2003), "The Impact on Officials of Public Sector Restructuring: The Case of the New Zealand Health Funding Authority", *International Journal of Public Sector Management*, Vol. 16 Iss: 4, pp..303 – 319.
6. Hà Đăng (2010), "Qua cương lĩnh, thử tìm hiểu mô hình kinh tế tổng quát thời kỳ quá độ ở nước ta" (Overview of Vietnam's Transit Period through the VCP Political Platform" presented at the workshop on "Socio-economic Issues in Modifications of Political Platform 1991" submitted to the 11th Congress, pp. 1-3.
7. Hassard, J. et al. (2010), "China's State-Owned Enterprises: Economic Reform and Organizational Restructuring", *Journal of Organizational Change Management*, Vol. 23 Iss: 5, pp.500 – 516.
8. Hiley, M. (1999), "Industrial Restructuring in ASEAN and the Role of Japanese Foreign Direct Investment", *European Business Review*, Vol. 99 Iss: 2, pp.80 – 90,
http://info.worldbank.org/etools/docs/library/83812/Patel_RolesOBsIndia-FINAL.pdf.
9. Kahla, V. (2007), "The Role of State Owned Enterprises in Infrastructure Development", retrieved from <http://www.cabri-sbo.org/.../Session%201.1%20Vuyo%20Kahle%20Transnet.pdf> on April 10, 2010.
10. Lê Hữu Nghĩa (2009), "Cổ phần hóa doanh nghiệp nhà nước ở Việt Nam: Mấy vấn đề lý luận và thực tiễn" (Equitization of State-owned Enterprises in Vietnam: Theoretical and Practical Issues), available at <http://thongtinphapluatdansu.wordpress.com/2009/06/07/3037/> (April 10, 2011).
11. Mankiw, G.N. (2010), *Macroeconomics* (7th Edition), Worth Publishers.
12. Nguyễn Trọng Hoài & Huỳnh Thanh Diên (2011), "Phát triển khu vực kinh tế tư nhân: Tiếp cận các giải pháp giảm thiểu tác động lấn át và nâng cao tác động hỗ trợ", (Developing Private Sector: Approches to Reducing Their Dominant Influences and Enhancing Supportive Influences), *Economic Development Review*, Iss: 245, March, pp. 2-7.
13. Patel, U.R. (2004), "Role of State-Owned Financial Institutions in India: Should the Government 'Do' Or 'Lead'?", Conference on Role of State-Owned Financial Institutions, Washington, D.C., April 26-27, 2004.
14. Porter & Vietnam's Central Institute for Economic Management (2010), "Báo cáo đánh giá năng lực cạnh tranh của quốc gia của Việt Nam" (A Report on National Competitiveness of Vietnam).
15. Porter, M..E. (1990), *The Competitive Advantage of Nations*, Free Press, New York.
16. Todaro, M.P & Smith, S.C., (2009), *Economics Development*, tenth edition, England, Pearson Education Limited.
17. Trần Ngọc Hiên (2007), "Cổ phần hóa doanh nghiệp nhà nước - thực trạng và giải pháp" (Equitization of State-owned Enterprises – Fact and Solutions), *Công sản*, No. 6 (126).