

# Reform in Economic Institution to Promote Restructuring and Changing the Economic Growth Model

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## ABSTRACT

*Despite its continuous improvements in the past 25 years, Vietnam's economic institutions failed to act as a dynamic of economic restructuring and changes in economic growth model in the coming period. When the state fails to identify its functions and duties at all levels in economic management, it cannot control effectively all operations in the market. The state will be slow to change its habits of intervening in the market with its administrative decisions instead of indirect regulatory instruments used for dealing with market defects. In this paper, the author analyzes, interprets and make suggestions about two major issues: (1) Changes in concepts of economic functions of the state in the market economy; and (2) Effective use of macroeconomic regulatory instruments.*

**Keywords:** economic institutions, restructuring, economic growth model, economic growth, economic function, state, market economy, macroeconomic manipulation.

After 25 years of economic reform, the Vietnamese economy has gained impressive achievements: a pretty high and long-lasting growth rate, a more competitive economic structure; an HDI nearing the world average, and a position as a promising emerging market in international investors' eyes. The model of horizontal growth based on cheap labor, exploitation of natural resources, and subcontract jobs has helped Vietnam develop from a backward and underdeveloped economy to a country with medium income (above the lower threshold); deal successfully with hunger and poverty; and improve its socio-technical infrastructure and living standard.

Due to effects of the global financial crisis and economic recession, along with its effort to integrate fully into the world economy, the Vietnamese economy also reveals various shortcomings that hinder its sustainable development, which can be seen by its ICOR and VA/GO rates, structure of exports, trade gap, labor productivity and other factors of economic growth, etc.

Although Vietnam's economic institution has been continuously reformed in the past 25 years, it should play well the role of a dynamic in the process of restructuring the economy and changing the economic growth model. Reform in the economic institution involves a wide range of issues, this article only discusses the following two groups of issues.

## **1. AWARENESS OF THE FUNCTION OF THE STATE IN MARKET ECONOMY**

### **a. On the Role of the State:**

First of all, we need to identify function of the state in the market economy because it is the foundation for reform in economic institution. Operation of market economy is based on participation of three entities: producers (suppliers of goods and services); households or consumers, and government. In managing economic operation at present, however, there is some confusion about positions and roles of the three entities.

In principle, the state should perform its own function but in fact, it sometimes fails to do so, or does it poorly and interferes too much in operations of other entities. For example, in macroeconomic management, the most important functions of the state are to set forth development targets, forecast possible fluctuations in the market, control monopolies, and create a healthy competition, etc. but the state has not concentrated its

efforts properly on these tasks while spending too much energy on prices and wages which are fields for companies.

When the state cannot identify its tasks and functions at different levels and in different fields of the market economy, it cannot manage effectively operations of the economy and change habits of intervening in the market using administrative decisions instead of regulatory instruments. Such indirect instruments are what can make the state control more effective and appropriate to mechanisms of the market economy. *The state control in market economy means creating a legal infrastructure that reflects targets and subjective will adopted by the state in development process, and other entities can modify their operations accordingly.*

#### **b. The State as an Entity to Mend and Handle Market Failures:**

Both theories and practices show that resources are not always allocated reasonably by the invisible hand. Market failures may cause disasters for the economy and lead to crises.

In Vietnam in recent years, runs on real estates, securities, or rice and foodstuff are proofs of market failure in allocation of investments and waste of national resources. Many economists describe market and the state as two wheels that direct the economy. Lack of coordination between the two wheels is what is usually called *inadequacy of the state control over market economy*.

In the process of globalization and economic integration, the role of the state is increasingly important. Competition at product, corporate and national levels become inseparable. National competition has become decisive factor in effort to enhance product and corporate competitiveness in regional and international markets. Product and corporate competitiveness is based on competitiveness of the economy, and in interactions between the three entities, competitiveness of the economy acts as the leading factors. *It could be concluded that the function of the state in economic management is to create factors that drive the market to develop.*

In reality, it is necessary to recognize fully the role of the state in macroeconomic management and control and avoid exaggerating the role of market in economic development. The market works under rules of “invisible hand” while these rules always operate according to natural laws. Intervention by the state in the market, however, aims at directing the flow toward its targets. *In other words, relationship between objectivity of market laws and subjectivity of government desire for economic*

*growth do not cancel out. This is the most difficult point in both theory and practice of the process of changing the centrally-planned economy into market economy, and also the inadequacy in current mechanism for economic management.*

Regarding the market economy, it still reveals three major defects: (1) a danger of imbalance between supply and demand that may lead to crises; (2) lack of attention paid by enterprises to the good of community because of their profit motive and competition that lead to pollution, violations of laws or frauds, etc.); and (3) market economy, in nature, always works to advantage of a minority and cannot make everybody rich.

Each country, according to its historical conditions and characteristics, and its chosen targets, may adopt different instruments for dealing with these defects. Sustainable development, a common worry today, means requiring the state to employ its instruments to overcome these defects.

The state neither pays enterprises for risk they face nor causes risks for enterprises through its administrative decisions. At present, system of Vietnam's commercial laws, although imperfect, covers most economic fields. Poor performance and efficiency of enforcement of commercial laws come from the fact that governmental interventions, at different levels, are not appropriate to market laws. Moreover, the state lacks tools and supervising mechanism to force all players in the market to comply with playing rules.

The recent financial crisis and economic recession of the world economy start again dispute about the role of government between two opposite viewpoints: *government is smaller than market, or vice versa*. Realities of Vietnamese and international economies show that all crises came from governmental failure to overcome market defects. It does not matter whether the state or market is larger, the problems are that how the state intervenes in the market and whether instruments it uses are appropriate to its role and distort market relations or not.

### **c. Three Aspects of Economic Institutions in Need of New Approaches:**

At present, all models of market economy take sustainable development as their targets by solving at the same time three problems: economic growth, social welfare and better environment. In Vietnam, three problems of vital importance should be solved properly.

(1) Governments of all level should reform their thinking way and action plans when performing the function of economic management. This is a difficult and complicated task in the process of changing from the centrally-planned economy to the market economy. Economic management by the state should aim at not only developing a transparent and level playing field for all entities, but also dealing with inherent market defects to create a combined strength from the state and the market.

(2) As an emerging economy, Vietnam can select operating instruments that are proved to be appropriate to Vietnam's socioeconomic characteristics and WTO rules. The market is a tool, or a medium for achieving development targets of a country, not a target in itself. Making use of market instruments, therefore, is not contrary to the act of presetting targets in Vietnam's economic model.

(3) To ensure consistency of laws for operation of the market, laws on different markets should be reviewed and reformed. We suggest working out plans for improvement in each markets. Each plan involves review of relevant laws and rules. for example, realty market is related to various laws and rules. All of them should be reviewed and amended to create a consistent framework for operations in this market.

## 2. EFFECTIVE USE OF MAROECONOMIC INSTRUMENTS

### **a. Use of Zoning and Planning Appropriate to Operations in Market Economy:**

Reform in planning task aims at identifying socioeconomic contents government of all levels should make plans for, and calculating of balanced allocation of resources to planned targets in order to orient the market toward such targets. Planning and zoning, in fact, is an effort to re-identify the role of the state in orienting the market toward the planned target. One of important tasks in planning and zoning is to indicate and predict factors affecting development targets.

It is necessary to change contents and methods of determining socioeconomic targets *from giving commands to giving instructions*. For example, changing the economic structure, mobilizing idle capital, or setting limits for CPI rise should be considered as prediction to give investors some orientation, not as commands for the government to carry out. The central part in planning for the state is to give guiding signals to the market; and identify policies, solutions, or measures to achieve the planned targets.

Regarding socioeconomic development targets, full attention should be paid to indicators of sustainable development, such as social welfare and protection for environment, to require local governments to perform well their functions. Economic targets, thinking through, are only the means while social and welfare targets are the end of development.

**b. Delegation of Economic Management Authority:**

Decentralization of economic management authority to ensure flexibility for the market is a common trend in the world economy. This trend in Vietnam is the extensive delegation of economic management authority to local government. The delegation should be based on the following principles:

- Fuller decentralization also requires a better mechanism for supervising, monitoring and investigating local governments. Specifically, the government should concentrate on three tasks: Making policies, issuing rules and regulations, and investigating and punishing violations. Specific decisions on local socioeconomic life should be left to local governments.

- Delegation of authority should be based on consistency and full attention should be paid to local autonomy in making decision according to their comparative advantages. The common trend in the world is to expand financial autonomy and rights to supply urban services for local governments.

- Implementation of decentralization should aim at ensuring rights and benefits of local governments and residents when they acquire full ability to take responsibility and fulfil their tasks.

- Local authorities should take full responsibility for implementing their assigned tasks when provided with full right and authority. There should be no overlap between what the central government and local governments do in the same district or province, or between tasks performed by authorities of different levels of the same district or province.

To ensure the aforementioned principles, all laws and rules about organization of administrative machinery, such as Government Organization Law, Law of Organization of People's Committee and People's Council, and National Budget Law, etc. should be improved and amended. A law of local governments that covers all characteristics of rural, island, urban or mountainous districts as suggested by Resolution of the VCP National Congress X is also necessary.

**c. Reform in Policies and Laws on Different Markets Based on Restructuring Targets:**

Development of all kinds of markets reflects change in economic structure and advantages of the economic in international competition. Improvement in markets in Vietnam, therefore is based on the two principles: (1) ensuring consistency in economic relations between markets because no market can develop on its own and each market is always a cause of consequence of others; and (2) Development of markets should be under control of government protected by relevant laws and oriented toward targets set for each stage of development.

Examining consistency and development of markets, including commodities, finance, realty, labor and technology markets, based on the two principles and relevant laws allows us to identify aspects in need of improvement.

**d. Flexible Use of Four Groups of Macroeconomic Instruments:**

Operations of aggregate supply and demand in the market economy and governmental role in macroeconomic control aim at four economic targets: GDP growth, job creation and decrease in unemployment rate, price stabilization, and increase in net export. To achieve those four targets, the state usually employs four groups of policies or macroeconomic instruments.

- Fiscal policy includes policies on taxes and public expenditure. They are the most important because they not only affect aggregate supply and demand but also give signals to the market. The fiscal policy should be very flexible to adjust itself to macroeconomic targets. For example, increases in public expenditure can stimulate the market demand while higher tax rates can reduce spending.

- Monetary policies are used by the central bank to regulate the finance market, and more importantly, to control inflation and stabilize market prices. Monetary policies usually have their greatest effects on aggregate demand through such instruments as interest rate, credit supply, and open market operations, etc.

- Policy on public expenditure aims at modifying relationship between accumulation and spending and regulating the market demand. This policy is manipulated frequently when inflation or deflation occurs.

- Foreign trade policy modifies export and import, ensures increases in net export (export value minus import one), regulates aggregate supply and demand, and helps implement policy on exchange rate.

The four groups of policies could be adjusted according to existing characteristics and conditions in order to serve effectively the effort to achieve macroeconomic targets in general and changes in economic structure in particular.

**e. State-owned Economic Organizations as Instruments for Overcoming and Mending Market Defects:**

As was stated above, the market economy contains three inherent defects in its nature. Effective governance of a government shows itself in its ability to employ instruments to limit negative effects caused by these defects. Using state-owned economic concerns is a way of intervention in the market with materials forces of the government. Reform in state-owned concerns, therefore, is to restructure these forces to help them play well the task of mending these defects, and supply better public goods and services needed for a sustainable development.

Analyzing the army of existing state-owned concerns from this viewpoint, we could identify three problems: (1) There is a confusion between state-owned companies operating for profit and non-profit public institutions; (2) Most state-owned companies have no ability to direct the market if their monopoly is removed; and (3) The government seems to leave to the market two fields badly in need of governmental intervention - supply of public goods and serves, and key industries requiring a huge investment but promising a low profitability. Public investment should reflect political determination of the government and should be determined by profit motive of state-owned companies.

Restructuring of state-owned companies aims at turning this army into material forces and plays well their role as effective instruments for regulating the market. This is a very important issue because it not only aims at enhancing the government's economic management, but also links economic development with social progress and equality.

**f. Institutionalization of PPP Model in Investment:**

Public-private partnership (PPP) is a model in which the government pays the private business for economic benefit generated by the investment project while the private business does not gain benefit directly from the project. At present, many



projects on infrastructure (building of roads and bridges, water supply, import of high technologies, etc.) are following this model. In this model, public investment is used as a bait to attract private investment. However, there is no legal framework for this form of partnership in investment and it is carried out based on separate agreement and needs to be institutionalized at national level.

If this model is applied broadly, supply of various public goods and services can attract private investment, which helps reduce the number of state-owned companies. This is also a form of investment where the state mends the market defects and implements its role of economic management.

Conclusion: The relationship between the state and market could be solved by reforming economic institutions in which the state plays the most active role in overcoming and limiting three inherent defects of the market employing regulating instruments and acting as a leader for restructuring and changing the growth model. Moreover, in the context of globalization and economic integration, the role of government becomes more important to improvement in both national and corporate competitiveness. Improving the economic institutions means continuing the reform in economic institutions to serve the restructuring of economic structure in order to enhance the competitiveness where *the most important process is to change concept of the role of government in management of the market economy*■

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