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**POLITICAL ECONOMY OF REFORM: CASE STUDIES OF ASIAN DEVELOPMENT BANK-  
SUPPORTED POLICY-BASED LENDING OPERATIONS**

**POLICY REFORM IN VIET NAM  
AND THE ASIAN DEVELOPMENT BANK'S  
STATE-OWNED ENTERPRISE REFORM  
AND CORPORATE GOVERNANCE PROGRAM LOAN**

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## **FOREWORD**

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## **ABSTRACT**

This paper presents a case study of the Asian Development Bank's State-Owned Enterprise (SOE) Reform and Corporate Governance Program Loan that was aimed at supporting fundamental and sensitive reforms in Viet Nam's transition. It examines the context of SOE reform involving Viet Nam's unique, domestically driven process that shapes policy decisions; the design of the Program; and key issues related to implementation and sustainability of selected core reform measures. The purpose is to draw lessons that can assist in better understanding the policy reform process in order to lead to the more effective preparation and implementation of programs supporting such reforms. In order to help structure the case study, a framework is introduced for the analysis of the political economy dimension of policy reform. This framework is proposed as a useful general tool both for the ex post understanding the political economy dimension of policy reform, as well as an analytic tool for assisting in the ex ante design of specific policy reform programs and related policy-based lending.

*“In order to learn how men will act in a given situation, or how a change in the situation will modify their behavior, it is surely more practical to observe their behavior than to attempt to discover by introspection or otherwise what they might be supposed to do if actuated by a certain motive operating alone.... Of much greater importance to the economist than any “pure” theory are the knowledge and understanding of the concrete facts of production, distribution, consumption, of the whole economic situation with all its causal processes. To most of this material the processes of specific observation, systematization, and inductive inference are applicable. To much of it, particularly in its dynamic processes, or processes of change, no other method is of any service.”*

Jacob Viner (1917)

## FOREWORD TO THE CASE STUDIES

### Research Strategy

This research focuses on exploring the political economy dimension of policy reform. The *research strategy* involves developing a set of comprehensive case studies of policy-based lending programs supported by the Asian Development Bank (ADB) in three countries: Indonesia, Thailand, and Viet Nam. This paper focuses on Viet Nam.

The *case studies* were designed to present detailed stories about the policy reform process, focusing on the political economy dimension of reforms. The aim of each case study is to provide not only an account of a particular ADB program, but more important, to place it in the specific—and evolving—reform context in which the program was formulated and implemented, describing the policy process involved. Since the context is so crucial with respect to policy reform initiatives, the case studies provide narratives on local conditions and historical circumstances. The focus of the cases is on the *interplay* between ADB’s program and the surrounding environment, with particular emphasis on the policy reform process, and its political economy dimension. The basic purpose of the case studies is to find out why and how things happened, so that this knowledge can be used to better understand the policy reform process, in particular the role of political economy factors; and more specifically, to assist in the future planning and implementation of programs supporting policy reforms.

The *general preparation for the case studies* has involved an extensive *literature review* focusing on policy reform and on the policy/reform process, with particular emphasis on the political and institutional dimensions. Examples of the literature reviewed include Grindle (2001), Grindle and Thomas (1991), Drazen (2000), Brinkerhoff and Crosby (2002), Haggard and Kaufman (1992), and Bates and Krueger (1993), as well as a variety of related case studies. A second part of the preparation for the conduct of case studies involved the *development of a framework* for

understanding/representing the political economy dimension of policy reform. A preliminary framework, drawing on both literature review and in-depth examination of a variety of cases/examples in diverse settings, is presented in Abonyi (2002). The preliminary framework discussed in that paper was further refined prior to the case studies, including through training workshops; and is then tested through application to this set of case studies.

## The Case Study

Case studies have been an accepted part of research and teaching in a wide range of disciplines, including law, medicine, management, as well as public administration and public policy. There is an extensive and growing literature focusing on the case study method (e.g., Yin 1994, Flyvbjerg 2004, Helper 2000, Odell 2001); as well as many cases and related research manuals prepared in top management and public administration/public policy schools. However, the use of the case study is relatively rare in economics as a research strategy. The issues raised in the earlier quote from Viner (1917) are equally relevant today, and as Helper (2000) notes:

“Modern economics began with Adam Smith’s visit to a pin factory, which helped him explain how the division of labour worked.... However, not many economists today do much fieldwork, which involves interviews with economic actors and visits to places they live and work.”

What counts as a case can be as flexible as the researcher’s definition of the subject. In general, a *case* from a research perspective refers to a single instance of an event or phenomenon, such as a decision to devalue a currency, a trade negotiation, or in the particular instance here, a specific policy-based lending program of ADB involving a set of reform measures.

A comprehensive case study can make an important contribution to the understanding of a complex issue such as policy reform. It allows for concrete, context-dependent learning and presentation of a detailed and nuanced view of the world that approximates the complexities and contradictions of the reality of the reform process. Case studies complement other types of economic research such as theoretical, mathematical, statistical, and econometric inquiry. In general, the benefits of case studies include the following:

- (i) A case study conveys a much fuller understanding of the particular concrete event and behavior studied—including richer evidence and reasoning about process and context than is possible through more abstract methods.
- (ii) Complex processes may be most effectively documented through case studies. The world of economics is marked by significant processes such as market evolution, competition, bargaining, institutional change, regional integration, and policy reform.
- (iii) Institutional and structural change can perhaps best be understood through case studies. For example, reforms involving introduction of market-based mechanisms into once centrally managed economies involve changes in institutions over time. Documenting such changes is the first step toward deeper analysis and generalization.

Preparing comprehensive case studies takes a great deal of time and effort. It requires going into extensive details on the event and its context in order to construct the “narrative” that captures the complexity and nuances of the real life situation. In particular, preparation of the case studies presented here has involved the following steps:

- (i) review of key documents related to the “event”, i.e., the ADB program, including relevant ADB documents, accessible documents of other international financial institutions (IFIs) namely International Monetary Fund and World Bank, and to the extent available, documents of the Government of Viet Nam
- (ii) review of literature, analysis, and data on the specific policy reform context, in this case, related to Viet Nam’s economy, economic transformation, political and administrative system, and policy reform process
- (iii) extensive interviews with key participants, including government officials involved with the policy reform process in general, and in particular those involved with the design, negotiation, and implementation of the specific ADB program; ADB staff and management; and staff of other relevant international financial institutions
- (iv) application of the analytic framework to structure the information, in the process testing/refining the framework through the cases.

In summary, the case studies here are intended to generate (i) *individual detailed stories* or analyses that provide information about the policy reform process in a particular setting; (ii) a *set of stories/analyses* that can provide the basis for generalizations about policy reform; and (iii) a *framework* that has been tested and refined through application, and that may be used to guide future analysis, including for a better understanding of experience (*ex post* assessment) and in the design of more effective programs to support policy reform (*ex ante* analysis).

## I. INTRODUCTION

### A. Prologue

On 31 December 2002, the Asian Development Bank’s \$100 million State-Owned Enterprise Reform and Corporate Governance Program Loan (SCPL) to support the Government of Viet Nam’s reforms in the state-owned enterprise (SOE) sector was closed.<sup>1</sup> This was 3 years after ADB Board approval in December 1999, just over 2 years after the start of the Program<sup>2</sup> in October 2000, and 1 year ahead of the planned closing date of 31 December 2003. The speedy completion of the SCPL was in marked contrast to the significant delays in ADB’s Financial Governance Reforms Sector Development Programs Loan to the Government of Indonesia (see Abonyi 2005a), and to the premature cancellation of the Agricultural Sector Program Loan to Thailand (see Abonyi 2005b).

The SCPL, unlike the ADB program loans in Thailand and Indonesia, was not part of an external financial package to an economy in crisis. It was initiated, designed, and implemented within the context of a domestically driven, on-going reform process that provided the overall framework for the SCPL. Viet Nam launched its reforms in 1986 as *doi moi*, or “economic renewal”, to guide the economy’s transition from centralized bureaucratic planning to the introduction of new market-based institutions. The focus of the SCPL on reshaping the fundamental structure and role of SOEs

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<sup>1</sup> The Program Loan itself was for \$97 million, supported by two technical assistance (TA) loans, TA 3353-VIE: Corporatization and Corporate Governance, \$1.6 million; and TA 3354-VIE: SOE Diagnostic Audits, \$1.4 million, bringing the total package to \$100 million.

<sup>2</sup> Called within ADB as the “date of loan effectiveness”, which was 2 October 2000 for the SCPL.

in the economy and the related development of a viable private sector touched on a complex and sensitive issue at the core of Viet Nam's reform process. This was the challenge of striking an appropriate balance between the role of government and of the private sector in the economy—and the corresponding political debates and institutional change. Therefore the “story” of the SCPL is less in the details of the program or even in the implementation of its specific measures. It is more the evolution and role of the SCPL within the broader context of Viet Nam's reforms and continuing transformation.

This paper presents a case study of the SCPL that was aimed at supporting key reforms in Viet Nam's transition. The purpose is to draw lessons that can assist in better understanding the policy reform process in order to lead to the more effective preparation and implementation of programs supporting such reforms. In order to help structure the case study, a framework is introduced for the analysis of the political economy dimension of policy reform. This framework is proposed as a useful tool both for the ex post understanding the political economy dimension of policy reform (e.g., as in the case of the SCPL), as well as an analytic tool for assisting in the ex ante design of specific policy reform programs and related policy-based lending.

## **B. Policy Reform: Political Economy Perspective and Framework**

Policy reforms and programs supporting such reforms often involve intense and continuing debate, negotiations, and at times conflict among stakeholders with differing perspectives and preferences with respect to the nature of policy issues and proposed responses. The design and implementation of reform programs are also a function of the institutional environment within which reform takes place. In this context, reforms may be modified, blocked, or even reversed at any time during the policy reform process. Recurring problems associated with reforms and supporting policy-based lending—for example problems attributed to “government commitment”—therefore arise because such reforms are fundamentally not a technical exercise in “optimal policy design”, but a complicated, long-term, and uncertain process of societal change in incentives, behaviors, institutions, relationships, and power alignments.<sup>3</sup>

Political economy factors play a critical role in shaping policy reforms and in conditioning the effectiveness of related policy-based lending.<sup>4</sup> At the most general level, the term “political economy” refers to the interrelationship between political and economic processes and institutions, and of particular interest here, the relationship of the latter to policy decisions. A “political economy” perspective signals the central role of *politics and institutions* in the policy reform process. Reform involves politics, because it requires collective choices in an environment characterized by conflicting perceptions and interests, with no simple unifying incentive scheme for resolving such differences.<sup>5</sup> Policy reform also takes place in a world of institutions that conditions the initiation, design, implementation, and sustainability of such reforms.<sup>6</sup>

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<sup>3</sup> For a more detailed discussion of policy reform as a process of change see Abonyi (2002).

<sup>4</sup> For detailed discussion of this issue see Abonyi (2002).

<sup>5</sup> This is consistent with Drazen (2000); see also Abonyi (1986).

<sup>6</sup> For a discussion of the role of institutions in policy reform see Rodrik (2003). At the micro level, reform is implemented by institutions, and involves organizational change. The management literature is suggestive here; see for example Smith (2002).

The role that politics and institutions play in policy reform and associated programs as the SCPL is related to how such policies and programs are shaped as they move through the various stages of the policy reform process. These stages, which in practice tend generally to be more iterative than sequential and not particularly well defined, include the following.<sup>7</sup>

- (i) *Initiating reform*: How did the basic issues addressed by the SCPL get on the policy agenda as political priorities? For example, were they placed there by domestic stakeholders or external interests (IFIs)?
- (ii) *Managing the complexity of policy issues*: Policy issues are complex, and therefore *design* of a reform program such as the SCPL is a way of reducing this complexity so that policymakers and implementing agencies can act on such issues. But what are the implications of particular program designs for the political process, and for institutional capacity and change?
- (iii) *Endorsing reform*: Reforms need to be legitimized—endorsed or approved—through a process of policy-related decision making. Where and when in the policy process are such decisions made, and do they signal in a credible way the government’s commitment to reforms?
- (iv) *Implementation*: Implementing reforms involves institutions or organizations (in the case of the SCPL comprising provincial and municipal authorities and individual SOEs) that transform proposed reform measures into organizational actions. However, can the issuance of a decree, e.g., to “corporatize” a certain number of SOEs, be assumed to be the same as implementing lasting change at the enterprise level, including changes in incentives, resource flows, organizational relationships and linkages, outputs, and performance?
- (v) *Sustaining reform*: Policy reform requires implanting enduring change over the long term. In the case of the SCPL the challenges of sustainability relate to both specific reform measures in the policy matrix, such as changes in ownership structure and/or behavior of specific SOEs; and to more general enabling factors that condition the sustainability of such reforms, such as the government’s basic position on the role of state in the economy.

The stages of the policy reform process, their relationship to the role of politics and institutions in policy reform, and the manner by which these core political economy factors constitute key sources of uncertainty and risk in reform or government commitment together comprise a conceptual framework for assessing the political economy dimension of reform.<sup>8</sup> The framework is summarized in Figure 1, and serves as the organizing framework for analysis of the SCPL case. It is proposed as generally applicable to a wide variety of reforms in diverse settings: providing a useful framework for the analysis of particular cases of policy reform such as the SCPL. However, the application of the framework—both as an *ex post* tool for understanding the political economy dimension of policy reform, and as an *ex ante* analytic tool to assist in the design of specific policy reform

<sup>7</sup> This is based, in part, on Grindle and Thomas (1991). See Abonyi (2005a) for a more detailed discussion of these stages in the context of ADB’s Agricultural Sector Program Loan (ASPL) to Thailand. See also Abonyi (2005b) for a discussion in the context of ADB’s Financial Sector Governance Reforms Program Loan to Indonesia.

<sup>8</sup> The framework draws on a range of developments in the literature, particularly Grindle and Thomas (1991), as well as Haggard and Kaufman (1992), Brinkerhoff and Crosby (2002), Drazen (2000), and Abonyi (1986).

programs and related policy-based lending—must proceed from a detailed and comprehensive understanding of the *specific context* of policy reform programs. For example, analysis of the SCPL case must begin with an understanding—and therefore an extended discussion—of the broader setting of Viet Nam’s reform process and continuing transformation; this defines the context that shapes the evolution of the SCPL.

The rest of this paper is structured as follows. The next section (II) develops the Vietnamese context. It begins with a brief overview of Viet Nam’s transition process—including the uniquely Vietnamese approach to reform, *doi moi* or “economic renewal”; Viet Nam’s political institutions and economic management system; and the role of external donors in a domestically driven reform process. It then reviews briefly SOE reform up to the time of the SCPL. Section III discusses the SCPL in terms of the key stages of the policy reform process including: initiating reforms or getting issues on the policy agenda; making complex policy issues manageable through program design; endorsing reforms via the policy decision process; implementation, including both “nominal implementation” of reform measures and implanting reforms; and key issues in sustaining reforms. Building on this, Section IV presents a brief discussion of the nature and role of politics and institutions in the policy reform process as reflected in the SCPL case, including their implications for “government commitment” with respect to policy-based lending. The final section (V) summarizes key lessons learned from the case, and makes some general observations about the implications for policy-based lending and associated conditionalities.

In sum, the basic message of the case is that the design and implementation of the SCPL is deeply and inextricably intertwined with political economy factors shaping the reform process in Viet Nam: the role of politics and institutions. Therefore a better awareness of the role of these political economy factors within the context of the policy reform process may help reduce the gap between the planned and actual outcomes of reforms. Hopefully this will lead to a better awareness of the likely risks and uncertainties of reform programs and associated policy-based lending, which in turn will strengthen their design and implementation.<sup>9</sup>

## II. SETTING THE STAGE

### A. Viet Nam in Transition

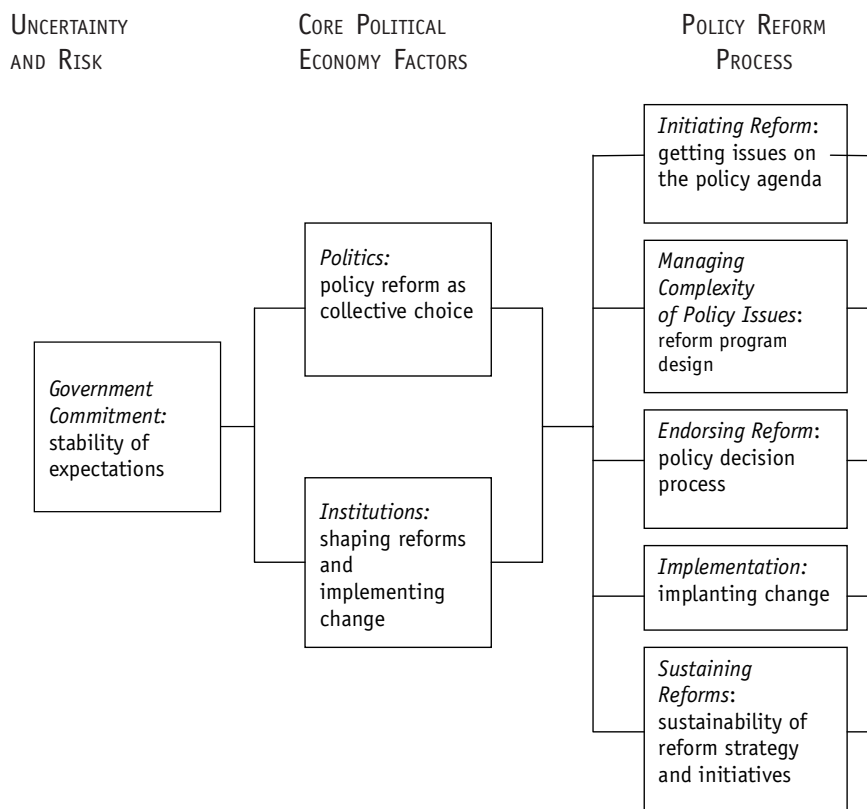
This section provides a brief and general background on Viet Nam’s development and transformation, with particular emphasis on policy reform primarily up to the time of the design and launching of the SCPL in 2000. Therefore this section is not intended as a detailed discussion of Viet Nam’s development experience or development strategy.<sup>10</sup> Rather its aim is to provide the context for looking briefly at the role of SOEs and SOE reform, in preparation for the discussion of the SCPL to follow. Excellent discussions of Viet Nam’s approach to reform and development

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<sup>9</sup> “Effective” refers here to reforms that are both relevant and feasible; see Abonyi (2002).

<sup>10</sup> Excellent and detailed discussions of Viet Nam’s development experience, particularly the reform and development process can be found in Arkadie and Mallon (2003) and ADB et al. (1998)—both key sources for this section of the paper.

**FIGURE 1**  
**POLITICAL ECONOMY OF POLICY REFORM AND POLICY-BASED LENDING:**  
**A FRAMEWORK**



may be found in a variety of sources, including as related to this case, Arkadie and Mallon (2003), ADB et al. (1998), Dollar (1993), and Forbes et al. (1991).

## 1. *Doi moi*, Reform, and Development

Since the late 1980s Viet Nam has been successful in achieving and sustaining impressive economic growth, combined with significant gains in poverty reduction. The economy was transformed from an inward-looking, stagnant economy to a rapidly growing and diversifying “economy in transition”, while maintaining macroeconomic, social, and political stability. In this, Viet Nam has outperformed all other transition economies except People’s Republic of China.<sup>11</sup> For example, during the period 1991–1995 the economy grew at an average of 8.2% per annum, led by a 12.6% per annum growth in the industrial sector, and 9.5% growth in services. Being in a “good neighborhood” helped, given the economic performance of the other Southeast and East Asian economies. However, in the period 1996–2001, which coincided with the sharp regional

<sup>11</sup> See for example Figure 1.2 in Arkadie and Mallon (2003).

downturn during the 1997 Asian financial crisis, Viet Nam's economy continued to expand at around 7.0% per annum, with the industrial sector maintaining an average annual growth rate of 12.2 percent.<sup>12</sup>

The performance of the Vietnamese economy took by surprise an international community particularly IFIs, which regarded Vietnam's development targets as overambitious, and its pace of reforms too slow and scope overly limited. Viet Nam did indeed take a comparatively "slow boat to reform", implementing a selective, "step-by-step" approach, which included acting decisively in some areas, while moving cautiously in others. In this, Viet Nam implemented its own version of economic reform called *doi moi*, or "economic renewal" that transformed a centrally planned economy into an increasingly market economy.

With the declaration of *doi moi* in 1986 Viet Nam embarked on a process of gradual, yet comprehensive reforms. Market mechanisms have replaced, step-by-step, the command style of production and resource allocation, while significant structural reforms were implemented in the management of the economy. From an institutional perspective, reforms were aimed at making existing institutions work better, while gradually introducing new market institutions. From a political perspective, reforms were the outcome of on-going domestic debates regarding economic strategy and institutions, within the framework of the existing one-party (Communist) political system.

In general, reform came as a pragmatic response to deep-seated economic problems. The reunification of Viet Nam in 1976 was followed by a decade punctuated by periods of economic stagnation and macroeconomic instability. The central planning system proved to be inadequate in responding to problems plaguing the economy, leading to tentative experimentations with reform. For example, in 1981 reform measures introduced included a partial contract system for agricultural production, along with some autonomy for state-owned enterprises to sell on the open market and set salaries; and between 1979-1985 administrative decentralization was initiated.

When *doi moi* was launched at the Sixth National Congress of the Communist Party (Sixth Party Congress) at the end of 1986, Viet Nam was facing an emerging economic crisis. The annual inflation rate was over 700%; exports were less than half of imports; budget resources were strained by high military expenditures and support for loss-making SOEs; there was virtually no foreign direct investment (FDI); and official development assistance was very limited. This led to a debate during the preparation of the Sixth Party Congress about problems with the central planning system as the institutional framework for economic management. As a consequence, the Sixth Party Congress agreed to abolish the system of bureaucratic centralized management based on state subsidies; and to move to a multi-sector, market-oriented economy with a role for the private sector to compete with the state in "non-strategic sectors."

The scale of reforms that followed was very wide, with no clear pattern of "sequencing" or coordination, and driven to a large extent by pragmatic experimentation and "learning by doing." In general, the key strategic building blocks of *doi moi* that emerged since 1986 have included the following:

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<sup>12</sup> It should be noted that there are differences in estimates of Viet Nam's growth rate. The figures in the text are from Tables 3.1-3.3 in Arkadie and Mallon (2003). However, they are consistent, for example for the key period 1996-2001 with ADB estimates (see economic statistics sections of various *Asian Development Outlook* issues). However, IMF estimates are lower for selected years during this period and therefore for the average over this interval (see for example Table 1 in IMF 2004).

- (i) *rural reforms*, involving dismantling a system of collective farming and shifting toward family farms as the basic productive unit
- (ii) *price reform*, which in effect ended the centrally planned “command economy” through a shift to market-determined prices for most goods and elimination of most subsidies
- (iii) *macroeconomic stabilization* program, which included fiscal and monetary policy reforms to control money supply and prevent inflationary pressure, for example including an extensive IMF-style domestic adjustment package in 1988–1989 focusing on positive real interest rates, drastic exchange rate adjustment, and efforts to balance the state budget; this was accompanied over time by an increasing sophistication of the government in managing macroeconomic policy
- (iv) *trade reform*, involving liberalization of the trading environment through quota and tariff reductions, eventually covering almost all aspects of the trading regime—but with state trading agencies retaining significant power; involving also the continuing maintenance of licensing and quota systems in selected areas
- (v) *exchange rate reform*, which included adoption of a more market-oriented exchange rate policy, accompanying steps toward restructuring of the financial system
- (vi) *opening up to foreign investment*, beginning with enactment of the Foreign Investment Law in 1988, amended over subsequent years, as in 1992 to accommodate business cooperation contracts, and in 1997 to allow for build-operate-transfer (BOT) projects

Two key areas of reform that proceeded more cautiously and where significant differences emerged with key donors (IFIs) involved the expansion of the private sector, and the (related) reduction of the role of the state in the economy, particularly in terms of SOE reform. *Private sector development* began with the introduction of measures such as the 1990 the Law on Private Enterprise and Law on Companies that provided important legal basis for the establishment and operations of private firms, and the key revision of the Constitution in 1992 allowing individuals to exercise property rights over income-producing assets and personal property. Over time, private sector growth made notable contributions to Viet Nam’s economic performance, particularly to employment growth. However, the movement has been gradual toward the acceptance of a significant active role for the private sector and private property in the economy (e.g., through privatization, deregulation of the role of the state, facilitating the establishment and operations of private firms); as distinct from a more rapid and less ambiguous acceptance of the role of markets in economic governance and in mediating the flows of goods and capital (e.g., through the elimination of price supports, freer trade, market-determined exchange rates).

With respect to SOEs, as will be discussed in later sections, issues of enterprise management, control, and particularly ownership have been approached cautiously. As a consequence, SOEs have continued to retain a relatively important role in production and trade, and as recipients of financing. Underlying the more measured approach to both private sector development and SOE reform is in part the intent on the part of key political stakeholders to retain a significant role for the state in the economy, and the domestic debate over what that role should be.

The Vietnamese approach to reform turned out to a large extent to be effective. Following the launching of *doi moi*, in 1986-2001 Viet Nam underwent a remarkable transformation. There was rapid and sustained economic growth; inflation was brought under control; poverty was substantially reduced; the traded sector (exports and imports) expanded significantly; FDI inflows

increased substantially; and the economy underwent considerable structural transformation with significant contraction of the relative share of agriculture, and a corresponding expansion of the share of industry.<sup>13</sup> Policy and institutional reform through *doi moi* is generally seen as having played a central role in Viet Nam's rapid and sustained transformation and development, including through improved incentives, increased competition, reduction in barriers to trade, import/adoption of new ideas and technology, and creation of new market institutions.

However, despite key institutional changes in two decades of reform, substantial challenges remained at the time of the SCPL, including among others:

- (i) weak law enforcement, particularly as related to property rights and business-related dispute resolution, leading to continuing constraints on the development of markets and the expansion and performance of firms
- (ii) lack of transparency and cumbersome administrative procedures resulting in a proliferation of new and changing legislation, decrees, and regulations issued by numerous agencies and local authorities; these have created a confusing and at times contradictory tangle of requirements for private business that left considerable discretion for authorities at various levels, contributing to a rising incidence of corruption—recognized and increasingly addressed by the government<sup>14</sup>
- (iii) financial sector problems, including a still heavily regulated financial system with a segmented credit market dominated by four large state-owned commercial banks, with considerable barriers to entry through licensing control by the State Bank of Viet Nam (SBV), and a significant share of credits still channeled to SOEs by the four main banks

One important, persistent, and widespread problem in the reform process has been the gap between policy decisions—directives, regulations, legislation—and the implementation of such decisions. The capacity of central agencies to ensure and monitor the implementation of reforms by various levels of government and implementing agencies has been limited within the framework of Viet Nam's political and economic management system.

## 2. Political Institutions and Economic Management<sup>15</sup>

A key characteristic of the Vietnamese reform process has been the continuity of political institutions and an orderly, if bureaucratic, administrative system. This has provided a relatively

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<sup>13</sup> See for example data related to Viet Nam in ADB's economic indicators (see various issues of the *Asian Development Outlook*). See also table 3.2 in Arkadie and Mallon (2003).

<sup>14</sup> The Vietnamese government has taken important steps to fight corruption—in the time horizon of the SCPL—including addressing it as a major item in the Sixth Party Plenum in 1998, launching of an anticorruption campaign in 2000, and establishing in 1998 a hotline to receive business complaints. However, corruption at various levels continues to be an issue and constraint on business and economic performance.

<sup>15</sup> This section is based to a large extent on Arkadie and Mallon (2003) and Doan Hong Quang (2004).

stable environment for policy decisions, enabling the government to make decisive macroeconomic decisions and implement significant reforms, despite limited development of a formal legal system.

Politically, Viet Nam remains a one-party state, governed by the Communist Party of Viet Nam, whose role in state management is somewhat “opaque.” Most senior government officials are members of the Party; most ministers and provincial leaders are members of the Central Committee of the Party; and the prime minister, president, and chairman of the National Assembly are members of the Politburo, the inner core of Party leadership. The National Assembly is defined by the 1992 Constitution as the highest organ of the state, highest representative body of the people, and the only organization with legislative powers, including power to amend the Constitution. It is elected every five years, meets usually two to three times a year, and has the mandate to oversee all government activities.

A significant institutional change at the time of the SCPL involved the growing importance of the National Assembly in the policy decision process. The Assembly was becoming increasingly active in reviewing government plans, budgets, and implementation performance; and in drafting and scrutinizing legislation that have historically tended to be written in fairly broad terms with interpretation and implementation depending on administrative directives from the prime minister, ministers, and provincial administration. For example, in the case of the 1999/2000 Enterprise Law (related to key reform measures in the SCPL), the National Assembly played a strong role in amending and influencing the details of the legislation.

The National Congress of the Communist Party convenes every five years to set the country’s overall policy direction, with resolutions of the Party Congress providing the country’s broad economic strategy. This is translated into the Socio-Economic Development Strategy and Plan (SEDP), in particular the 10-year Socio-Economic Development Strategy and the 5-year Socio-Economic Development Plan. These, in turn, are supported by a number of annual and sectoral plans. For example, in April 2001, the Ninth Party Congress endorsed the 10-year SEDP for 2001-2010; and the 5-year SEDP for 2001-2005 was subsequently approved by the National Assembly.

The government operates at four levels: the central government and three local governments that include provinces, districts, and communes. There is a significant degree of autonomy extended to local administration with regard to implementation of economic decisions and expenditure of allocated budgets.

The formal system notwithstanding, unambiguous statements of policy direction, to the time of the SCPL, have been relatively rare. This reflects both the transitional nature of Viet Nam’s economic system, and the challenges and on-going debates of reconciling a continuing fundamental commitment to a Marxist-Leninist one-party state, with market-oriented reforms and an expanding role for the private sector. In this context, the policy reform process in Viet Nam may be generally described as “behavior-led” rather than “rule-led”.<sup>16</sup> That is, in practice, many formal reforms and regulatory changes often formalize what in effect, is already happening in practice in some part of the country, or have initially been implemented as “experiments” on a pilot basis.<sup>17</sup>

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<sup>16</sup> For a further general discussion of behavior vs. rule-led change see Abonyi (2002), and in the Vietnamese context, Arkadie and Mallon (2003).

<sup>17</sup> However, with the benefit of hindsight, some of the Central Committee meetings in late 1997–1999 did set out some of the broad directions for reforms affecting business. See for example World Bank (2005) (from R. Mallon, private communication).

The corresponding policy decision system places emphasis on collective leadership and consensus. Decision making at all levels is characterized by consensus-seeking, engaging a wide range of stakeholders before decisions are finalized. This leads to a sharing of responsibility, as well as of political risk. It also means that the policy decision process is often “opaque”, in that it is difficult to identify clear decisionmakers or decision points. In this context, central agencies, however seemingly powerful (e.g., State Bank of Viet Nam, Ministry of Planning and Investment) are generally not in a position to impose policy decisions for which a broad consensus does not yet exist. That is, the initiation of major policy and institutional reform requires sustained, time-consuming, and nationally led efforts at consensus building.

Within this framework, implementing policy decisions requires a “buying in” by relevant state bodies before action is taken by a designated agency. Yet, individual agencies can be quite decisive in matters they see as lying within their mandate. As a consequence, cooperation/coordination between line agencies and/or different levels of government can be challenging. The implementation of reforms even after high-level (prime ministerial) policy pronouncements and directives therefore often requires to be “negotiated” with and among implementing agencies and associated vested interests.

In sum, at the time of the SCPL, the Vietnamese approach to policy reform involved a pragmatic, gradual, “step-by-step” process of behavior-led change, guided by a consensus-seeking decision system. This sometimes resulted in a slow and “opaque” process of policy decisions, but one which also ensured minimal open conflict, relatively stable outcomes, and domestic/national ownership of reforms. It was also a system where implementing agencies and authorities at various levels could exercise significant *de facto* power over the implementation of policy decisions. In this domestic-driven process of policy reform, external input, for example the role of IFIs, was generally limited either to the presentation of international experience, or to assistance in analyzing the potential impacts of new types of policy options.

### **3. External Donors and the Reform Process**

The policy decision process in Viet Nam was domestically driven and therefore the resulting decisions reflected national priorities and ownership. External financial assistance played a negligible role in the critical initial stages of reform in the late 1980s and early 1990s. Therefore external policy advice was not seen as the necessary means to external financing, but instead was assessed on the basis of perceived relevance to domestic priorities, and likely feasibility given domestic conditions and constraints. This general attitude to external policy advice did not change substantially as interaction with key IFIs increased in the mid-1990s (see for example, IMF 2004, World Bank 2001, and Arkadie and Mallon 2003). The case of SOE reforms provides a useful illustration of the more general issue.

#### **(i) IMF and Policy Reform in Viet Nam**

Following normalization of relations, the IMF approved Viet Nam’s first three-year Enhanced Structural Adjustment Facility (ESAF) financing in 1994 (see IMF 2004). This was the IMF’s key mechanism for policy-based lending focusing on structural reforms. However, the ESAF was not implemented as planned. In its progress review the IMF criticized Viet Nam’s pace of reform,

particularly with respect to SOEs and trade liberalization. As a consequence, although the second annual arrangement under the ESAF was completed, agreement could not be reached on the third annual arrangement, and the program closed in November 1997 without disbursing all the allocated funds. There were to be no further such programs until 2001.

Negotiations between the IMF and the government with respect to policy reform were restarted in 1998. However, negotiations stalled because of fundamental differences over the scope and pace of policy reforms as advocated by the IMF and the government's domestic reform agenda. The IMF was pushing hard for a more ambitious reform program, particularly as related to areas such as SOE privatization (nominally from the perspective of the fiscal burden imposed by SOEs), trade liberalization, and financial sector reform. However, the necessary domestic consensus was not in place on fundamental issues related to the basic role of the state in an increasingly market economy—hence SOE reform—and the pace at which reforms should be implemented. Without such a consensus, the government was not likely to agree to any externally suggested reform program. More fundamentally, as discussed earlier, the government was taking a more gradual and measured approach to reform in an effort to maintain social and political stability, and in order to ensure the relevance and feasibility of policy reforms.

Reform of SOEs was perhaps the most controversial of the structural reforms under discussion with the IMF. Although traditionally the World Bank had taken the lead in this general area, SOE reform was a key part of the IMF agenda in Viet Nam because of the perceived macroeconomic significance (i.e., fiscal implications) of the financing of SOEs.<sup>18</sup> The very strong advocacy position taken by the IMF, for example in the May 1999 Article IV consultations (see IMF 2004), emphasized the need to reduce the role of the state in the economy; requirement for a comprehensive reform framework; and a wider and faster SOE privatization program, with particular emphasis on the larger SOEs.

By contrast, the government's position was one that advocated a continued sustained role for the state in the economy; and a "gradualist" approach to SOE reform. As will be discussed in greater detail, the government's general approach to SOE reform focused on improving enterprise performance, creating greater autonomy and accountability particularly of the larger SOEs; divestiture of smaller SOEs; and leveling the playing field between private firms and SOEs. A key concern of the government was ensuring that jobs existed in the private sector to accommodate workers released by downsizing of the public sector (through SOE reforms), in order to maintain social and political stability. Furthermore, the lack of consensus and expected political resistance by vested interests, (SOE workers and management, controlling institutions), were seen as additional key factors in a need for a slower pace of SOE reform.

It was only in March 2001 that a request for a new 3-year IMF program was brought to the IMF's executive board, after agreement was finally reached with the government. The program was by then under the Poverty Reduction and Growth Facility (PRGF), which was intended to place more emphasis on national ownership of the reform agenda, and integrate more closely macroeconomic policy and poverty reduction. The SOE component of the program was based on a 5-year SOE reform plan adopted by the government in March 2001 that included SOE reform targets for 2001–2003.

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<sup>18</sup> See for example Annex I in IMF (2004): SOE reform is listed first on the major issues under discussion between the IMF and the government throughout the period 1996–2002.

In general, the agreement was seen as reflecting more a shift in the IMF position to align its program more closely with the domestic reform agenda, than an accommodation by the government to IMF pressure (IMF 2004).

### **(ii) World Bank and Policy Reform in Viet Nam**

The World Bank's focus in its policy-based lending to Viet Nam was intended to be on structural reforms and transition to a market economy. Although a number of such programs were proposed, between 1994 and 2000 only one was approved, the Structural Adjustment Credit (SAC), implemented 1995–1997, and including a focus on SOE reform. However, according to the World Bank's own assessment, its impact on the reform process was modest at best: "...in hindsight, the relevance was not high" (see World Bank 2001). As with the IMF, it was not until 2001 that a World Bank policy-based lending program, the Poverty Reduction Support Credit I (PRSC I, formerly SAC II) was put in place.

The technical advisory role of the World Bank was seen as generally more effective than its attempts at policy-based lending. However, this experience also reflected the domestically driven nature of Viet Nam's reform process. The experience with the State-Owned Enterprise Reform in Vietnam Project (supported by the Poverty Reduction Strategy Credit I, or PRSCI) demonstrated the reluctance of the Vietnamese to follow advice they felt was "out of synch" with domestic requirements and constraints (World Bank 2003, 6).<sup>19</sup>

As the IMF's, so the World Bank's approach to policy reform in general, and SOE reform in particular, evolved in Viet Nam, increasingly accommodating the domestic reform process. Emphasis shifted away from an emphasis on the scope and pace of SOE privatization, toward a focus on private sector development. In this context, there was increasing emphasis on the "demonstration effects" of privatization of the more "medium size" SOEs (see IMF 2004). The World Bank's first Poverty Reduction Support Credit (PRSC I), which accompanied the approval by the IMF of the PRSC in 2001 noted above, focused on enhancing transparency of SOE operations and the effectiveness of the SOE "equitization" process (a concept discussed in detail in the next section). The World Bank's approach continued to evolve under PRSC II, approved in May 2003, in part reflecting a tacit acknowledgment of the on-going resistance to externally pushed privatization by the government, and the practical difficulties of implementing enterprise reforms. In the words of the IMF's review, "by mid-2003 IMF and World Bank came to accept the government's desire to retain a relatively large share of the economy in the public sector, and restructure (rather than equitize) large SOEs" (IMF 2004, 38).

### **(iii) ADB's Prior Experience with Policy Reform in Viet Nam**

Although ADB had limited involvement with the SOE sector in Viet Nam prior to the SCPL, its experience with policy-based lending echoed to some extent that of the IMF and the World

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<sup>19</sup> "The Vietnamese recipients/ beneficiaries tended not to share consultants' recommendations based on experiences in transition and market economy countries. The recipients often felt that the project recommendations were 'too radical' or 'too demanding' against the existing evolutionary SOE reform policies in Vietnam, and some of the proposed measures were 'out of synch' with the legal and regulatory framework of Vietnam."

Bank (see for example ADB 1999b). ADB resumed lending to Viet Nam in October 1993, providing two loans to support policy reform prior to the SCPL. The first was the Agriculture Sector Program Loan, the second the Financial Sector Program Loan.

The experience with the Agriculture Sector Program Loan reflected the complexities of undertaking policy-based lending in Viet Nam. Declared effective on 17 April 1995 for an implementation period of three years (1995–1998), the loan was closed on 30 June 1998. There were a number of delays and difficulties during implementation, particularly as related to trade liberalization in the rice export and fertilizer import trades, and settlement of nonperforming loans (NPLs) and outstanding loans with the Viet Nam Bank for Agriculture and Rural Development. This resulted in a delay of more than 1 year in the release of the 2<sup>nd</sup> tranche. Viet Nam marched at its own pace in reform. It should be noted that this Program did touch on SOE-related issues in the agriculture sector.

The experience with the Financial Sector Program Loan was similar. Declared effective on 3 February 1997, the loan was closed on 31 Dec 1999 with release of the second tranche delayed as in the case of the Agriculture Sector Program Loan. In general, the government did not implement on schedule a number of policy conditions, particularly as related to the drafting and enactment of legislation; and there were also differences in interpretation of key policy conditions between ADB and the government (ADB 1999b).

In general, ADB's experience with the loans supporting policy reforms, prior to the SCPL, seemed to indicate that Viet Nam was likely to implement measures that it saw appropriate, and often already "in the pipeline" prior to the loan (as in the case of the Agriculture Sector Program Loan), where domestic consensus was already in place. The timing of the implementation of reforms also could be uncertain, given Viet Nam's consensus-based approach to policy decisions. Reforms where domestic consensus was not yet in place were unlikely to be "rushed" because of loan funds, particularly with measures involving legislation (as in the case of the Financial Sector Program Loan).

In summary, the experience of all three IFIs prior to the SCPL indicates that the policy reform process in Viet Nam was under strong domestic control, with national ownership. Reforms that were part of policy-based lending by IFIs were likely to be agreed to and implemented only to the extent they were seen as relevant and feasible by the government, and subject to a domestic consensus being in place.

## **B. Context: SOE Reform**

### **1. SOEs in the Vietnamese Economy: Overview**

Viet Nam's economic transition had mixed results by the time of the SCPL. In certain areas such as price liberalization, exchange rate unification, tax reform, and liberalization of the trade regime—in the development of the role of market mechanisms and related institutions—progress had been substantial. However, the government made much less progress in transforming the ownership structure of the nonagricultural economy in general, and SOEs in particular. Since the

start of economic reforms in the late 1980s, the share of the state sector in gross industrial product had declined only slowly.<sup>20</sup>

Historically, SOEs played an important role in the economy of Viet Nam. However, this role had been more modest than in other transition economies such as the People's Republic of China, former Soviet Union, or the countries of Eastern and Central Europe. Therefore the consequences of a slower pace of SOE reform in Viet Nam have been less significant as a constraint on economic growth and development than some external commentators, in particular the IFIs, have initially predicted.

Around the time of the SCPL, SOEs accounted for a still significant share in national income, averaging around 30% of GDP between 1986 and 2000, with non-oil SOEs contributing around 23% to the state budget (40% if oil SOEs are included). The share of SOEs in industrial output was around 50% in 1991, falling to around a still considerable 36% by 2000. The relative share of employment by SOEs was historically modest, employing around 7.5% of the total labor force in 1990, falling to around 5% by 2000. There were relatively few large-scale, capital-intensive SOEs, and the vast majority of enterprises employed under 500 people, with many employing under 100. Generally sound macroeconomic management, particularly since the initiation of *doi moi* limited government budget resources used to subsidize SOEs, thus hardening the budget constraint (Mekong 2002). However, a significant share of state-linked bank credits continued to be channeled to the SOE sector, making up approximately 45% of total credit to the economy in 2000, down from close to 53% in 1996 (IMF 2002).

## 2. SOE Reform Process: Key Elements up to the SCPL<sup>21</sup>

The need to strengthen the performance of SOEs was a recurring subject of debate well before the *doi moi* reforms. However, fundamental to this debate was a continuing commitment to a key role for the state in the economy, and therefore for SOEs in economic development. Over time, there was increasing focus on the role of the private sector in long-term economic development, and on the relationship between SOEs and private enterprises. Therefore SOE reform and the development of the private sector have been interrelated in Viet Nam's reform and transition process. In this context, SOE reform had a dual purpose: (i) strengthen the performance of SOEs so that they can perform more efficiently and effectively in an increasingly market environment, and at the same time reduce the burden on government finances; and (ii) help develop the private sector by shrinking—within limits—the scope of SOEs in the economy.

Before summarizing key elements of SOE reform up to the time of the SCPL, it may be useful to briefly touch on the SOE-private sector development interface as providing in part the rationale for SOE reform. In general, SOEs were seen as a key constraint on private sector development, a central feature of *doi moi*. Government gave preferential treatment to SOEs and in effect, restricted private enterprise from moving much beyond smaller businesses that could compete with SOEs. Constraints on the development of private enterprise included (i) lengthy, cumbersome, and

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<sup>20</sup> See for example Arkadie and Mallon (2003), Mekong Economics (2002), and ADB et al. (1998).

<sup>21</sup> This section is based to a large extent on Arkadie and Mallon (2003), Mekong Economics (2002), and ADB (1999a).

expensive business registration procedures; (ii) licensing requirements from the Ministry of Trade, including needed support from local “people’s committees”, who often may have had a stake in maintaining the dominant position of local SOEs as a source of revenues and were therefore threatened by potential new private entrants; (iii) preferential access of SOEs to land and foreign investment; and (iv) preferential lending by state-linked banks to SOEs. Therefore an important dimension of SOE reform should be related to “leveling the playing field” between state enterprises and private business through effective reform of the SOE sector, and formulating and implementing measures that facilitate the establishment and operations of private business.<sup>22</sup>

In general terms, Viet Nam has taken a cautious approach to SOE reform, involving “two tracks” (see Arkadie and Mallon 2003). On one track the focus was on exposing SOEs to the pressures of markets—termed in the reform process as “commercialization”—by forcing them to compete, on a gradually more level playing field with each other, with imports, and with a growing private sector. On a second track, the focus was on developing a new policy and regulatory framework for the SOE sector to force individual enterprises to restructure, and to alter the landscape of the SOE sector as a whole through ownership reform measures such as “equitization” and liquidation. This second track stood in marked contrast to the rapid privatization in the former Soviet Union and in Eastern and Central Europe.

- (i) *Commercialization of SOEs:* In late 1987 the Soviet Union and Eastern and Central Europe drastically reduced trade and financial flows to Viet Nam, causing SOE performance to deteriorate. This triggered a focus on shifting SOEs to a more commercial (market) basis, with greater autonomy and increased responsibility for their own financial viability. The issuance of Decision 217/HDBT in November 1987 marked the first *doi moi* step toward a broad-based SOE reform program. It involved giving SOEs the autonomy to formulate their own operating plans within the framework of broad government guidelines on development priorities. The key operational change involved a shift to market-based relationships with suppliers and customers through the introduction of economic contracts as the basis for transactions among enterprises and businesses. Within this framework SOEs now had to purchase inputs directly from suppliers, and could sell their products on the open market.
- (ii) *Re-registration, reorganization, liquidation:* Decree 217-HDBT also allowed, however, for the decentralization of authority to establish SOEs. This, in turn, led to a proliferation of new SOE registrations, particularly at the local level. By 1990–1991 Viet Nam had around 12,300 SOEs with a total capitalization of Dong 34,000 billion (or approximately \$2.4 billion at the current exchange rate). This helped trigger a second round of reforms focusing on reorganizing and consolidating the SOE sector. The government issued a decree in November 1991 requiring all SOEs to re-register or close, and made commercial viability as the main criterion for establishing SOEs. As a consequence, by

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<sup>22</sup> An additional link between SOE–private sector development was that much of the initial FDI into Viet Nam involved joint ventures with SOEs. Assets (mostly land) were often moved from SOEs into “greenfield” projects with foreign investment, involving in effect partial privatization measures. Strong growth in these ventures provided opportunities for the emerging private sector, and “demonstration effects” from private sector-led development (from R. Mallon, private communication).

April 1994 the number of SOEs shrank to around 6,300 enterprises through liquidations (about 2,000) and mergers (about 3,000). However, the total capitalization of the new SOEs increased to around Dong 53,000 billion (about \$3.8 billion). In practice, most liquidated and merged SOEs were small, locally managed enterprises with less than 100 employees and Dong 500 million in capital (about \$45,000). Moreover, the total assets of liquidated SOEs accounted for less than 4% of total SOE assets. Following government instructions in March 1994 for a second phase of re-registration, a new wave of mergers and liquidations reduced the number of SOEs to around 5,500 by the end of 1997. This led to the retrenchment of over 1 million SOE workers, many of whom were absorbed by private businesses.

- (iii) *Equitization and divestiture:* Following the Seventh Party Congress' call for the dissolution or change of ownership of SOEs not seen as essential for state ownership, the National Assembly approved a pilot "equitization" program in December 1991, implemented by the government. Equitization was a politically sensitive concept; in effect, a form of partial privatization though not explicitly stated that way, with the state in most cases retaining a share in the enterprise and in principle, a commitment to worker control through share ownership. Operationally, SOEs were to be transformed into joint stock companies, with a proportion of state shares in the enterprise required to be sold, and employees given preferential access to such shares. The objectives of SOE equitization were to create a new type of enterprise with diversified owners; lead to a more efficient use of state assets; and mobilize investment in the new types of SOEs. However, progress was very slow, despite follow-up policy directives. For example, although the Prime Minister issued another decree in March 1993 to accelerate the pilot equitization program, nearly three years later at the end of 1995 only five SOEs were equitized. To accelerate the process, in May 1996 the government issued a further directive to extend the scope and scale of equitization, requiring SOE-controlling agencies to select enterprises for equitization. This was further strengthened by subsequent decrees and decisions in 1997 and 1998, including listing steps that had to be followed in the equitization process. The pace of equitization during 1998–2000, although proceeding much faster, remained slow at the time of the SCPL. The number of equitizations did increase significantly to around 550 enterprises during 1998–2000, as compared with just 17 during 1992–1998.<sup>23</sup> However, in practice, equitization generally targeted only smaller SOEs with capital stock of less than VND 10 billion, or \$700,000.
- (iv) *Legal framework for SOE activities and corporate governance:* Legal framework governing business enterprises evolved slowly, but gradually reduced differences in treatment between enterprises—SOEs and private businesses. Steps in this direction included the approval by the National Assembly of the Laws on Foreign Investment in 1987, and on Private Enterprise and on Companies in 1990. A key measure was the inclusion in the Constitution in 1990 of the rights of the nonstate sector to operate alongside the state sector. To facilitate improved corporate governance and closure of nonviable SOEs, the 1993 Law on Bankruptcy and the 1995 Law on State Enterprises were

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<sup>23</sup> The exact figures vary among different sources, see for example ADB (1999a), Mekong Economics (2002), and Doan Hoang Quang (2004).

introduced. The latter provides the first legal basis for the operation of SOEs, including rights and responsibilities of enterprises with respect to equitization, divestiture, and selling assets; further, it legitimized the autonomy of SOEs in making business-related decisions. However, in practice, the implementation of these laws was limited. For example, up to the time of the SCPL few bankruptcy cases were brought to the economic courts, and the law was seen as providing little protection for creditors. Similarly, few SOEs published financial reports as required under the Law on State Enterprises. One perspective on the poor implementation was limited understanding of the purposes of these laws—approved as conditions of a World Bank loan, with little real domestic consultation or “ownership” (see for example Arkadie and Mallon 2003).

- (v) *State corporations:* In March 1994 government instructions for reregistration also issued instructions for consolidating SOEs into two categories: state enterprises and state corporations. This was a categorization of enterprises, and did not involve changes in enterprise behavior or incentive framework (as distinct from “corporatization”, a concept introduced under the SCPL and discussed in later sections). It was intended, in part, to streamline SOE administration, separating state ownership from state regulation—a key issue in the domestic SOE reform debate. The administrative grouping of enterprises under umbrella organizations was intended to help facilitate this separation. The further grouping of SOEs with similar orientation was intended not only to rationalize SOE supervision, but was also aimed at creating competitive advantages, especially on international markets, through increased scale. However, there was considerable debate about both the desirability and the utility of state corporation model, within the context of SOE reform.

### 3. Key Issues at the Time of the SCPL

By the time of the SCPL there were considerable changes in the structure and operations of the SOE sector compared with the *pre-doi moi* days. However, in spite of significant progress, a number of key problems and constraints on SOE reform remained.

- (i) *Financial constraints:* Given the slow pace of reform, the burden of financing SOEs, especially ones with deteriorating performance, although off the books of the state budget, were now borne by the weak, state-linked banking system—an issue of particular concern to the IMF. For example, in 2000, SOEs still absorbed approximately 45% of the total credit to the economy. Furthermore, by the end of 2000, approximately 20% of bank loans to SOEs were estimated as nonperforming.
- (ii) *Slow pace of liquidation:* There was limited progress made in the liquidation of nonviable SOEs. This was due in part to a cumbersome legal framework and procedures for liquidation that made it difficult to enforce creditor rights and for the authorities to declare bankruptcies. More fundamentally, there was concern about the impact on social stability of higher unemployment, likely to result in the short term from the liquidation of the worst performing enterprises, especially larger SOEs. The resistance of powerful vested interests both within and outside particular SOEs was also an important factor.

- (iii) *Slow pace of equitization:* The pace of equitization continued to be slow, constrained by factors including: a cumbersome administrative process; nonsuitability of some SOEs were to equitization given that they were not commercially viable enterprises; too small sizes of some SOEs to operate under a joint stock management structure; difficulties in the valuation process and resolution of enterprise debts; and resistance by vested interests, including controlling agencies, SOE managers, and SOE workers who feared loss of control, revenues, and jobs. In addition, poor accounting and auditing standards made the scrutiny of many enterprises' financial performance difficult, further discouraging potential investors.
- (iv) *Constraints on restructuring larger SOEs:* A key part of SOE reforms were measures to encourage large enterprises to restructure and downsize in order to reduce losses and unserviceable debts and to improve competitiveness. However, restructuring large SOEs that were under state control remained a challenge, addressed only in a limited way by reforms of the 1990s.
- (v) *Role of the state in the economy:* Perhaps the most fundamental factor in the limited scope and slow pace of SOE reforms related to a continued commitment by the Communist Party to the role of the state in the economy, and consistent with this, maintaining a significant role for SOEs. Official commitments to accelerating SOE reform notwithstanding, resolutions of both the Eighth (1996) and Ninth (2001) Party Congresses maintained that the state was to continue to play a leading role in economic development. At the same time, there was a lack of national consensus—basic disagreements within the Party—on the relative roles of the state, markets, and private enterprise in the economy. This debate was reflected for example in the resolution of the Third Plenum of the Ninth Party Congress.<sup>24</sup> It was also reflected in the gap between policy pronouncements and change in the actual operations and/or status of particular SOEs.

### **III. EXPLAINING THE ODDS: POLICY REFORM PROCESS, SOE REFORM, AND CORPORATE GOVERNANCE PROGRAM LOAN**

#### **A. Initiating Policy Reform: Getting on the Policy Agenda**

The need to strengthen the performance of SOEs and to reform the SOE sector was on the government's policy agenda as a priority issue well before the *doi moi* reforms, and remained on the agenda throughout the (still on-going) reform process, as discussed. However, while there was a basic consensus on the need to reform SOEs, the scope and focus of such reforms, the details or "configuration" of the policy issue and appropriate policy responses continued to be debated

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<sup>24</sup> "A high degree of unanimity of perception is yet to be obtained regarding the role and position of the state economic sector and state enterprises... many issues remain unclear, entailing conflicting opinions, yet practical experiences have not been reviewed for proper conclusions. There are many weaknesses and bottlenecks in the state administration of state enterprises...." Mekong Economics (2002, 34)

as the reforms evolved. As noted, there was a continuing deep commitment within the political system for a key role of the state in the economy, and therefore to maintaining a significant, if evolving, role for SOEs. Although consensus was maintained on the need to reform SOEs—in terms of strengthening individual enterprise performance and their role in the economy, and restructuring the SOE sector as a whole—there was no domestic consensus on what this entailed. In practice, although a stated and demonstrated priority of the government, SOE reform has proven to be a difficult, complex, and sensitive issue that touches on the core of Viet Nam’s economic, social, and potentially political transformation.

Reform and restructuring of the SOE sector also emerged as an area where, as discussed, there have been continuing strong attempts by IFIs to shape the definition and scope of the issue, as well as associated reforms. However, the policy agenda as related to SOE reform continued to be firmly domestically driven. Within this context, although the SCPL seems to have been initiated in the context of ADB’s interest in providing financial and technical support for Viet Nam’s reforms,<sup>25</sup> it was seen by the government as generally responding to a key issue on the domestic policy agenda where external support was useful—as long as it conformed to domestic definitions of “relevance” and “feasibility”.<sup>26</sup>

## **B. Managing Complexity: Design of the SCPL**

### **1. Complexity of Policy Issues and Program Design<sup>27</sup>**

Policy issues are complex in part because of the political nature of such issues and because of the diversity of institutions that play a role in the policy reform process. A different dimension of complexity relates to the very structure of policy issues. Such issues generally involve many elements and interconnections (“feedbacks”) among these elements through which change or reforms may be transmitted or cancelled out. For example, improving the efficiency of SOEs is a function of factors such as the structure of the industry within which enterprises operate (e.g., competitive structure/entry-exit barriers/relative concentration); systems and procedures that relate to enterprise operations (e.g., accounting and financial management systems); quality of personnel (e.g., management, labor); operations management (e.g., production, marketing); as well as the broader environment that constrains or facilitates SOEs performance (e.g., political constraints on sourcing, sales, financing, tax code). These also represent different leverage points where reform initiatives may focus in order to help bring about desired outcomes, namely improving SOE efficiency and performance. Similarly, improving the efficiency of the SOE sector as a whole could involve focusing primarily on larger SOEs through measures such as “equitization”, or more on smaller SOEs through measures such as divestiture and leasing—with potentially different outcomes.

Generally there are interconnections among different dimensions of a policy issue and/or between what may be framed as different policy issues, such as “SOE reform” and “promoting development of the private sector”; or “SOE reform” and “regulatory and competition policy at

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<sup>25</sup> Based on interviews with ADB staff and management, key ADB consultants, and senior government officials.

<sup>26</sup> See Abonyi (2002) for a discussion of “relevance” and “feasibility” in the context of policy reform.

<sup>27</sup> For further discussion of complexity of policy issues see Abonyi (2002); and as related to program design in the context of Thailand, Abonyi (2005a); and of Indonesia, Abonyi (2005b).

the industry level.” This can make it difficult and somewhat arbitrary to define boundaries for what should be part of a particular reform program, and what may be excluded.

In general, how a policy issue is posed or structured therefore plays a significant role in shaping reform measures that are intended to address it. The design of a reform program is the process through which the complexity of policy issues is addressed—where boundaries are drawn, and where decisions are made about the focus of measures intended to bring about improvements. The “design teams” are often given considerable latitude early in the policy reform process in defining the scope, focus, and structure of the program, including associated gains and losses from reform initiatives—and therefore “reform winners” and “reform losers”—as well as the institutional requirements of implementing reforms. Program design decisions then shape the subsequent policy reform debate and the implementation process.

## 2. Design Process: Selected Issues

The design of the SCPL took place against a backdrop of complicated on-going discussions between the government, IMF, and World Bank, on Viet Nam’s reforms in general, and SOE reform in particular. As noted, there were fundamental differences between the government and the IFIs with respect to the scope and pace of reform in Viet Nam, particularly as related to SOEs. These differences were not resolved during the time of the preparation of the SCPL, and were also reflected to some extent in design-related discussions and negotiations between the government and ADB.<sup>28</sup>

At first ADB pushed for expanding the scope and accelerating the pace of equitization-as-privatization, much along the lines of the other IFIs. This was not acceptable to the government, for reasons discussed earlier. Therefore significant time was spent on clarifying and trying to reach common understanding and agreement on key policy issues and reform measures. All in all, the design of the SCPL took almost four years from the inception of the project preparatory technical assistance (PPTA) in 1996/7 (ADB 1996) to the finalization and approval of the design of the SCPL.<sup>29</sup> The actual design-related discussions between the government, led by the State Bank of Viet Nam (SBV) and ADB took almost two years, with ADB Board approval of the SCPL on December 1999 and the loan declared “effective” on October 2000. Over time, ADB shifted its position away from treating the transfer of ownership as the core issue in SOE reform.

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<sup>28</sup> In general, ADB wanted to participate more deeply, but wished to do so with an independent program, rather than as part of an IFI package, particularly not under the IMF umbrella. For this a “no objection” letter was required and secured from the IMF. However, based on interviews, there are indications that both the IMF and the World Bank were not completely pleased with the ADB initiative, seeing it as potentially weakening or “undermining” the joint IFI “negotiating leverage” by providing “easy money” to the government, i.e., financing that did not include the kind of conditions that the IMF and the World Bank were requiring in order to make policy-based lending available to Viet Nam.

<sup>29</sup> The PPTA resulted in a comprehensive report on the economic/industrial and reform context in Viet Nam, and proposed a detailed action program for policy-based lending for SOE reform and private sector development. This work was an important basis for program design discussions between the government (led by the State Bank of Viet Nam) and ADB—discussions that took almost two years—with ADB Board approval of the SCPL on December 1999 and the loan declared “effective” on October 2000.

In particular, the concept of “corporatization” emerged as an important focus of discussions and negotiations in the design of the SCPL, also reflected at the PPTA stage (see ADB et al. 1998). Corporatization had been introduced earlier in the context of SOE reform in Viet Nam, including support by other donors, but with slow progress in its implementation.<sup>30</sup> Therefore corporatization was proposed by ADB as a core focus of the SCPL kind of intermediate stage toward possible equitization, divestiture, or liquidation of selected enterprises. It was aimed at changing the status of SOEs classified as state corporations that were not subject to the earlier provisions of the Company Law. The concept implied the incorporation of these enterprises as a state-owned joint stock company or state-owned limited liability company, requiring an amendment to the existing Company Law. Operationally, transforming state corporations into joint-stock companies meant subjecting them to hard budget constraints, corporate governance requirements, and market-related incentive structures. It was also aimed at a separation of ownership (by the state) and management functions, intended to provide for greater management autonomy and flexibility.

The concept of corporatization was an important breakthrough in the government–ADB joint design of the SCPL, and more generally, in the approach to SOE reform in Viet Nam. Philosophically, it was consistent with the government’s “step-by-step” approach to SOE reform. Operationally, it provided a preparatory or transition stage between commercialization (implemented under the State Enterprise Law), and equitization/divestiture/liquidation (implemented under the existing Company Law and Law on Private Enterprise).

The concept of corporatization, however, was seen as very complex. It took considerable time for ADB and the government to reach agreement on its relevance, role, and operational meaning. In these discussions, at first there were basic differences between the government’s and ADB’s approach to the issue, and more generally to the SCPL design. ADB was seen by the government as generally taking a very “bureaucratic and legalistic” approach to key issues inappropriate to the reality of the Vietnamese context.<sup>31</sup> In particular, initially the government viewed ADB’s approach to corporatization as very similar to equitization; as a kind of “backdoor privatization” that was problematic. By contrast, the government wanted to take an approach that was “less legalistic” and focused more on the kind of behavioral changes it wanted to induce in relevant SOEs. Therefore the government wanted a more flexible definition of the concept, and focused more on consistency with local conditions and constraints, with particular attention to existing institutional capabilities, rather than focusing on conformance with “international best practice.”

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<sup>30</sup> For example, in the early 1990s the Central Institute for Economic Management pushed for single-owner limited liability companies in the Company Law with the aim of facilitating corporatization. The need for corporatization was also discussed in 1995 at a UNDP/WB workshop on “Alternative Approaches to Improving State Enterprise Efficiency”. One of the presentations at this workshop was on corporatization experiences in People’s Republic of China, made by State Planning Commission Vice-Chairman Tran Xuan Gia (later Minister of Planning and Investment). Technical assistance to support corporatization had been provided by a number of donors prior to the SCPL including UNDP, WB, and AusAID (from R. Mallon, private communication).

<sup>31</sup> From interviews with senior government officials, ADB staff and management, and key consultants.

Key issues in SCPL design, in particular the concept of corporatization, were in fact so complex and politically sensitive, that they required resolution at the Party level—the full implications of which were seen as perhaps not fully appreciated by ADB.<sup>32</sup> That is, the issues went far beyond simply a policy-based lending program, or even individual reform measures, and touched the very core of the domestic debate on Viet Nam's transition and reform strategy. The overall approach taken and core measures in the SCPL had to be consistent with the more gradual, step-by-step approach to SOE reform, and with existing or emerging domestic consensus on issues, given the deep changes such reforms implied in the Vietnamese economic management system. Consistent with this, a critical dimension of reform measures in the policy matrix such as corporatization, required in the eyes of the government, an accommodation of the realities of the political and institutional preparation needed for effective, nondisruptive change.

In this context, differences with respect to the meaning of “satisfactory progress” as related to implementation of measures in the policy matrix also took time to resolve. In this case it was the government that wanted a clear and relatively precise definition of the term, while ADB wanted to leave it more ambiguous, open-ended, and discretionary. This led to concerns on the part of the government of potential future problems relating to differing interpretations of what was effective implementation and compliance.

Again based on interviews, in general, key senior government participants in the SCPL design felt that there were initially fundamental differences between the ADB team and the government on key issues in the design of the program. There was a general sense that the ADB team (including international consultants, important sources of knowledge on “international best practice”), often did not fully understand the Vietnamese context, the constraints it placed on the relevance and/or feasibility of reform measures. Over time, however, what started as an initially considerable gap specifically over the meaning of corporatization narrowed through a continuing process of discussion, debate, and mutual adjustment. In this context, it should also be noted that there were differences within the ADB team as well with respect to the design of the SCPL, specifically how to approach corporatization in the Vietnamese context and even over the very scope and focus of the SCPL, as will be touched on later.

Finally, an important issue in the design of the SCPL, against the background of the decentralized Vietnamese context discussed earlier, was the very limited involvement of implementing agencies. The design process involved primarily central agencies (SBV and the ADB team), and therefore the organizational requirements and potential institutional constraints on implementation were not a key focus of joint discussions in the preparation of the policy matrix. This led to implementation and sustainability issues, as will be touched on in later sections.

### **3. Outcome of Program Design: SCPL**

The SCPL was formulated by ADB as a 2-tranche loan, supported by two TAs, totaling \$100 million to be disbursed in two tranches of \$50 million. The first tranche was to be released on loan effectiveness (actually disbursed on 8 December 2000), and the second tranche was planned

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<sup>32</sup> Based on interviews with ADB consultants and staff, senior government officials.

to be released about one and a half years from the initial disbursement (actually disbursed on 18 December 2002).

The overall objectives of the SCPL were to “promote industrial growth by restructuring the industrial sector to (i) facilitate FDI inflows, (ii) support the development of private enterprises, and (iii) accelerate industrial SOE reform and improve corporate governance of enterprises.” To achieve these objectives, the SCPL was very comprehensive in scope, including a wide range of measures (many with submeasures), and involving a number of implementing agencies. There were 15 first-tranche conditions, and 13 second-tranche conditions that had to be met for the disbursement of the funds. The SCPL timetable required the government to implement this comprehensive and wide-ranging program of reforms within approximately 36 months.<sup>33</sup>

In general, elements of the policy matrix addressed important issues in Viet Nam’s reform process. The core focus of the SCPL was on “industrial SOE restructuring”: on improving the policy and institutional framework for SOE reform. Of particular significance, as discussed earlier, was the introduction of the concept of corporatization and related measures, including enacting the revised Enterprise Law that provided the necessary legal foundation for corporatization. These were potentially significant contributions that addressed important gaps in the SOE reform process, and facilitated the development of the private sector.

At the same time, there was a view that the SCPL design was overly ambitious: too wide in scope, with too many conditions, and included measures whose feasibility was likely to be uncertain. For example, issuing a policy directive for the corporatization of 60% of the medium and large SOEs under the SCPL was one thing, implementing such wide-scale changes at the enterprise level—given the sobering experience with actual SOE reform to date—was likely to prove to be a rather different matter. In this context, the inclusion of measures that required approval by an increasingly active National Assembly (revised bankruptcy procedures, law on accounting) was also a potential source of uncertainty in terms of both timing and final content of reform measures.<sup>34</sup>

#### 4. Road Not Taken: Alternative Perspective on SCPL Design<sup>35</sup>

The SCPL case raises a more fundamental issue with respect to the design of a reform program. Program design involves reducing the complexity of policy issues by drawing boundaries—explicitly or implicitly—with respect to the scope and focus of reforms. This shapes the subsequent institutional and political dimensions of the policy reform process, including implementation requirements. In the case of the SCPL initial discussions about broad issues of private sector development and SOE reform could have led to different program designs.

The particular SCPL design that emerged focused primarily on a relatively small number of the larger state enterprises. Most Vietnamese SOEs are too small for corporatization as joint-stock

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<sup>33</sup> See the policy matrix in Appendix 2 of ADB (1999a).

<sup>34</sup> Based on interviews with senior government officials, ADB consultants, and staff.

<sup>35</sup> Based on interviews with ADB consultants and staff, and senior government officials. See also the PPTA report (ADB et al. 1998).

companies, and were therefore outside the scope of the SCPL—although the program did contain some references to divesting small SOEs. However, initial discussions and explorations about a potential ADB program started along different lines in the context of the PPTA. This was more along the broad lines of an “enterprise development program” that provided potentially wider scope, and could have led to a substantially different type of program design, but one still consistent with the key objectives of private enterprise development and accelerating SOE reform.<sup>36</sup>

It is important to stress that the relevance of the SCPL design that emerged is not in question. The SCPL policy matrix focusing on corporatization was recognized as an important contribution to Viet Nam’s SOE reform process. The intent here is to illustrate using the SCPL case, that the design of a reform program involves identifying and reducing design options with respect to the definition of the policy issue and corresponding reform measures. Different program designs, in turn, could have considerably different political and institutional implications for the policy reform process.

For example, an alternative program design could have focused primarily on removing impediments to domestic private sector development arising from the large number of mostly small SOEs present in a wide range of product markets. By extension, focusing on smaller SOEs could have had at its core, policy and institutional measures aimed at strengthening the capacity of the government to divest such small SOEs, and related measures to facilitate the development of private enterprise. An alternative design of this type would have had different implications for the political and institutional dimension of the Program, and for the implementation and sustainability of associated reform. The history of ambitious reform programs aimed at larger SOEs had not been encouraging to date at the time of the SCPL, as reflected, for example, in the World Bank’s experience in Viet Nam. Generally, larger SOEs were relatively more powerful, often with limited incentive to cooperate with directives from central agencies. Furthermore, the impact of changes in the much smaller number of larger SOEs were likely to be more limited in terms of their employment and income generation, and in facilitating the development of domestic businesses. Therefore a program design that focused on small SOEs perhaps could have been politically and institutionally less complicated, and therefore more quickly implemented in terms of bringing about change at the enterprise and industry level, with potentially wider impact on business development.<sup>37</sup>

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<sup>36</sup> In fact the particular design of the SCPL is one of a large potential set of design options consistent with the much broader range of enterprise development issues addressed in the PPTA, then reflected in the final design of the SCPL. Most of the reforms proposed in the final technical assistance report were subsequently implemented and are seen by some as having had a greater impact on business development and poverty reduction than the particular reforms included in the SCPL. This raises the basic issue as to the reason for the particular design of the SCPL, or why this set of reforms. Was it partly due to preconceived notions by ADB (and generally by the IFIs) about SOEs? The result of rigorous analysis of the specific context in Viet Nam? Or perhaps it suited the purposes of the government to use external “agents” for introducing politically more sensitive reforms? (From R. Mallon, private communication.)

<sup>37</sup> Based on interviews with ADB staff and consultants and senior government officials.

### C. Endorsing Reforms: Approval of SCPL Reform Measures<sup>38</sup>

In principle, policy reforms are endorsed through a process of political decision making within a country's existing institutional framework. This has both formal and informal dimensions. The output of the policy decision process is deemed, at some point, to be decisions endorsing (if approved) a program, that is taken to signal the commitment of the government to undertake the approved reform measures. This is expected to lead to instructions to implementing agencies, directly or mediated through different levels of government, on the priority of the reform measures, and to the allocation of the necessary resources, such as through the budgetary process, for implementing such reform initiatives.

As discussed earlier, endorsement of policy reforms in Viet Nam is a multi-level and multi-player process. It involves the Communist Party (formally through various Party Congresses), the National Assembly (with the mandate to oversee all government activities), the central government (expressed through Prime Ministerial directives introducing reforms), and lower levels of government (provinces, districts, communes). Informally, given the consensus-based decision process, implementing agencies and key enterprises generally also need to "buy into" proposed reforms—indicating their *de facto* endorsement of proposed measures for implementation. All these levels were relevant to the endorsement of the SCPL reform measures.

In general, signing of the SCPL by the government (SBV on behalf of the government) signals its official endorsement of the set of reform measures in the policy matrix. However, on closer scrutiny, as a practical matter, the reform measures in the SCPL fall into three categories from the perspective of effective endorsement or approval. To the extent that policy measures are consistent with the existing domestic reform program and are within the powers of the central government to approve, agreement by the government to the SCPL can be seen as constituting endorsement in the sense of a commitment to implement, e.g., Prime Minister issuing Decision 36/2003 to allow foreign investment in equitized SOEs (first tranche condition). In this context, as noted, the concept of corporatization as reflected in the SCPL required prior approval at the Party level, involving significant time, effort, and discussion within the political system, given the complexities and sensitivities involved, before the government could endorse it in the SCPL.

The second type of reform measure requires endorsement or formal approval ultimately through the political decision system, in particular, involving the National Assembly. Here the government can "endorse" in the sense of agreeing to submit such measures, but cannot in practical terms approve these measures nor guarantee their ultimate form. The power to approve—and modify—the actual reform measures rests with the National Assembly after the People's Supreme Court submits the revised Bankruptcy Law to the National Assembly (second tranche condition). It should be noted that even the National Assembly's endorsement of a measure such as the revised Bankruptcy Law cannot—or should not—be interpreted as necessarily leading to effective implementation, as discussed earlier in the context of experience with the original Bankruptcy Law.<sup>39</sup>

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<sup>38</sup> For a further discussion in the context of Thailand, see Abonyi (2005a); in the context of Indonesia, Abonyi (2005b).

<sup>39</sup> As noted earlier, the original Bankruptcy Law was the outcome of World Bank conditionality requirements; subsequent support was provided by a number of donors, including UNDP and GTZ.

The third type of reform measure is one that can be endorsed by the government, but such endorsement—even with the best of intentions—cannot guarantee that the reform will indeed be implemented as planned in the level of particular agencies and enterprises (or even by different levels of government). For example, the government could issue a policy directive aimed at corporatizing 60% of SOEs by 2005 (first tranche condition). However, this type of endorsement cannot—or at least should not—be taken to mean that implementation will then necessarily follow, given the gap between government intentions and enterprise behavior in SOE reform. The effective implementation of this reform measure requires *de facto* agreement by the individual enterprises and the agencies controlling them (ministries, provinces, districts).

The above discussion suggests that even if policy reforms are formally endorsed by the government, as in the signing of the SCPL, it may not be certain that all the reform measures will have the necessary approvals—formal or informal—at other points in the policy decision system. Furthermore, as the examples suggest, endorsement and implementation of reforms are closely intertwined. In practice, it may be difficult to identify in the policy decision process a “stopping point” that results in a binding or irreversible commitment to reform in the policy decision system. In some cases only when reforms are actually implemented, e.g., SOEs are corporatized not only in terms of legal status but also in terms of their operational performance, can it be concluded that they have (or had) the necessary endorsements in key points in the policy decision process. The implication is that the “endorsement of reforms” is an on-going activity throughout the policy reform process extending beyond implementation given the possibility of the reversal of reform measures such as restoration of subsidies.

## **D. Implementation**

### **1. Implementing Measures in the Policy Matrix**

In general, ADB’s internal review (Program Completion Report, or PCR) concluded that almost all of the specific reform measures of the SCPL were implemented satisfactorily, including the 15 first-tranche conditions, and 12 of the 13 second-tranche release conditions (ADB 2004a). Given the progress in the implementation of the measures in the SCPL, the program was closed one year earlier than planned, on 31 December 2002.

A number of important contributions were made to Viet Nam’s reform process through the implementation of the reform measures in the SCPL. The adoption of the Enterprise Law (in 2000) was a fundamental reform that improved significantly the institutional environment for private business, for example by greatly reducing the cost and time needed to register new businesses. It also provided the necessary legal framework for transforming SOEs into shareholding/joint-stock and limited liability companies, allowing the implementation of key corporatization measures.<sup>40</sup> The SCPL also supported the establishment of the National Steering Committee for Enterprise Reform

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<sup>40</sup> It should be noted that the approval of the Enterprise Law involved first and foremost a domestic process of consensus building, as discussed earlier. In terms of external support, in addition to the SCPL, it had varying levels of input/support from UNDP, GTZ, Japan’s Miyazawa Initiative, and USAID.

and Development (NSCERD) to oversee the formulation and implementation of the SOE reform strategy. The introduction of the concept of corporate governance through the drafting of model corporate charters by selected enterprises was a further important contribution by the SCPL; as was the strengthening of accounting and auditing standards for all enterprises through the preparation of the Accounting Law.

There was one measure that the government was not able to implement: elimination of the minimum wage differential between domestic and foreign-invested enterprises. As the PCR noted, there were ambiguities in the design of this measure, principally whether the gap should be eliminated by raising the lower minimum wage of domestic enterprises or by lowering it for foreign enterprises. Furthermore, this turned out to be a politically more sensitive and difficult measure than anticipated, since increasing the minimum wage—the measure favored by the government—in SOEs as well as private businesses had potentially significant budgetary implications. ADB eventually waived this condition, after it was satisfied that the planned reform measure of the government of gradually increasing the minimum wage was relevant and appropriate.

A second measure not yet implemented at the time of the closing of the SCPL related to the requirement for the Ministry of Labour, Invalids, and Social Affairs (MOLISA) to submit a Social Securities Act for approval to the National Assembly. This related to a critical issue in SOE reform, that of putting in place an effective social policy to address the impact on workers of enterprise equitization and divestment. The social impacts of SOE reform was an important source of concern to SOE labor unions and of resistance to reform, and will be touched on again later. In terms of the SCPL, MOLISA planned to submit the Social Securities Law to the National Assembly for approval in 2005.

The delay associated with the Social Securities Act is an example of a wider issue: where reform measures in the SCPL involved new or amended legislation requiring approval by the National Assembly, often significant delays were involved. For example, while the SCPL closed in December 2002, in addition to the delay in the approval of Social Securities Act, the Law on Accounting was approved in June 2003 and came into effect on 1 January 2004; implementation of land-use rights measures under the Land Law became effective in July 2004; the revised Law on Business Bankruptcy was approved on 15 June 2004 and came into effect on 15 October 2004; and the law related to the collection of uncontested debt was approved in 2004 and came into effect in January 2005. Therefore although the reform measures in the policy matrix related to such legislations were implemented on time in terms of the government submitting proposed legislation, the actual approval of the legislation often took considerable time, and involved extensive consultations, modifications, and political debate.

## 2. “Nominal Reform” vs. “Implanting Change”

In general, significant steps were taken under the SCPL to support SOE reform. However, viewing policy reform as an extended and complex process of implanting change gives a more cautious perspective on the effective implementation of measures under the Program. On closer inspection, many of the measures in the SCPL involve issuing directives, drafting laws, decrees, and regulations.

However, the fundamental challenge in policy reform is often more the implementation and enforcement of such measures, which generally involve a long-term process of institutional change.<sup>41</sup>

For example, as noted, issuing a Prime Ministerial Decision (No. 833/CP-QHQT) that targets corporatizing 60% of SOEs by 2005 implements issuance by the government of a policy directive, the reform measure written in the policy matrix. However, this is not the same as changing the fundamental behavior and operational performance of a large number of often powerful enterprises—a task that is likely to (and did) prove to be more challenging over an extended time horizon. The limited participation of implementing agencies (SOEs) and related institutions in the design of the SCPL was likely to provide a further constraint, given the need for SOEs and agencies that control them to “buy into” the reform process for effective implementation. The resistance by SOEs to be included in the audit list in preparation for corporatization, a key activity under an SCPL TA, for fear of this leading to privatization is an illustration of the challenges of implementation at the enterprise level.<sup>42</sup> In this context, the establishment of the NSCERD provides a further example of such challenges. Although this institution was nominally established to oversee the SOE reform process as required under the SCPL, its actual capabilities and power to ensure and monitor compliance at the enterprise level were limited.<sup>43</sup>

## E. Sustaining Reforms

Reforms implemented under the SCPL have initiated and/or effected important changes in the SOE sector and related private sector development. In general, these involve strengthening the formal legal, policy, and institutional foundations of enterprise development. In order to sustain reforms a key challenge is operationalizing and enforcing the enacted decrees, legislation, and regulations so that they lead to changes in incentives, behavior, and performance at the enterprise level. Given the track record of implanting changes at the level of individual SOEs prior to the SCPL, this requires strong political support—which in turn requires an on-going national consensus on the reform strategy and its key measures—continuing attention to implementation, institutional capacity to implement, and “buy-in” of individual enterprises into the reform process.

Sustaining reforms implemented under the SCPL requires follow-up at a number of levels. It requires implementation at the enterprise level of planned reform measures such as equitization and corporatization. Follow-up supporting activities at the enterprise level to reform measures such as equitization may also be needed to ensure effective transformation of enterprises. More generally, broader constraints in the Vietnamese economy that condition enterprise development also need to be addressed, and more fundamentally, sustainability of reforms may even require

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<sup>41</sup> See Abonyi (2002) for a discussion of policy reform as an extended and complex process of change.

<sup>42</sup> The supporting TA 3354-VIE: State-Owned Enterprise (SOE) Diagnostic Audit involved, in part, putting together a list of SOEs for audit, in preparation for corporatization. However, enterprises had limited understanding of the concept of corporatization, and resisted being put in the list fearing that it would lead to privatization (based on interviews with senior government officials, ADB staff, and consultants).

<sup>43</sup> Although supported by many donors, in fact NSCERD not only lacked institutional capacity, but also clout in the system: it did not have the “carrots and sticks” to exercise control or ensure compliance. Therefore its role in the “institutional map” related to SOE reform was unclear and its effectiveness uncertain (from R. Mallon, private communication). See more on this from ADB’s Program Completion Report (2004).

a reconsideration of the basic approach to reform. These challenges for sustainability will be discussed in turn.

Examples of the achievements and difficulties of implementing planned reforms since the completion of the SCPL illustrate both Viet Nam's basic commitment to reform, and the challenges of transition from reforms as changes in rules, to inducing and sustaining real changes in incentives and behavior at the enterprise level.<sup>44</sup> In 2001 the government adopted a five-year plan for SOE reform. The target for the first three years was to subject around 1,800 out of around 5,600 SOEs to reform measures, mostly in the form of equitization. These enterprises accounted for around 30% of SOE employment, approximately 11% of state capital, and around 10% of total SOE debt. However, by the end of 2003 reforms were implemented in only around 50% of the targeted enterprises. A series of measures were then announced in 2003, an important transition year of the 5-year economic plan (2001–2005) aimed at accelerating SOE reform. The Plan targeted over 2,000 SOEs, which were subjected to specific reform measures, accounted for around 24% of SOE employment, and 3% of SOE bank debt. However, the government was able to implement only around 60% of the planned enterprise-level reforms after a year. As an example of the government's continuing commitment, at a meeting on accelerating SOE reform in March 2004, Prime Minister Phan Van Khai underlined the need to speed up equitization, warning of possible collapse of SOEs after commercialization, i.e., removing subsidies and protection. At the same meeting Deputy Prime Minister Nguyen Tan Dung placed SOE reforms in a broader context, emphasizing their importance to the successful implementation of Viet Nam's 5-Year (2001–2005) and 10-Year (2001–2010) Development Plans. However, the challenges to implementation were clear, given results at the enterprise level to date, and that the targeted SOEs included powerful enterprises in key sectors such as power, engineering, chemicals, and banking (see *Vietnam Economic News*, various years).

Putting the above in context, SOE reform has had notable successes. Equitization and divestiture has reduced the number of SOEs from almost 6,000 in 1997 to around 4,000 by mid-2004. However, these reforms have involved, for the most part, smaller SOEs averaging around 215 workers at the time of their transformation, as compared with 421 workers in the average SOE. Total capital of these small SOEs accounts for around 10% of the total capital stock of SOEs in 2004 (Joint Consultative Group 2004). Therefore the planned reforms of the large SOEs, once implemented, could accelerate significantly the overall SOE reform process. At the same time, reforms have led to significant improvements in SOE performance. For example, recent enterprise-level data shows that SOEs in the manufacturing sector have expanded their output at an average of 12% per year, with minimal overstaffing in key sectors such as garments, textiles, and food processing (Joint Donor Report to the Vietnam Consultative Group Meeting 2004). Relatively strong SOE performance can be attributed to a large extent to the success of the commercialization and corporatization measures that resulted in the hardening of the budget constraint and forced increased competition in product markets.

More broadly, within the context of Viet Nam's transition, SOE reform through equitization and divestiture should be seen not as the end point, but as initial steps in the transformation to a competitive enterprise (see ADB 2004b). Sustaining reforms in terms of creating vibrant and

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<sup>44</sup> For a detailed discussion of achievements and constraints in SOE reform since the completion of the SCPL, see ADB (2004b).

competitive enterprises from previously state-nurtured SOEs will require efforts and organizational change and business development, particularly in the case of the larger SOEs. Within this context, it should be noted in passing that an emphasis in reform on SOE workers becoming shareholders in enterprises that could prove uncompetitive may entail certain risks.

An important issue, touched on in the SCPL that requires further attention for reform sustainability, relates to the impact of SOE reform on workers, critical stakeholders in the reform process. The SCPL recognizes the problem of labor mobility, and focuses on the issue of making the social insurance system more flexible. However, as the delay of the implementation of the relevant measures in the SCPL (the Social Securities Law) noted earlier indicates, this is a complex and sensitive matter. Labor mobility is part of a larger and deeper problem with important political and social implications: the significant social impacts of reform measures such as equitization and divestiture. The majority of SOEs are small and labor-intensive, involving limited technology and requiring low skill levels. It is estimated that approximately 1.6 million people work in this sector, most of whom are unskilled women with low levels of education.<sup>45</sup> SOE reform for these workers can mean retrenchment or the loss of a range of critical social subsidies and health care benefits. As a consequence, trade unions have played an important role in drawing attention to the social costs of equitization, providing strong political opposition to the SOE reform process in its present form. Their concern is with what they see as an absence of an effective social policy to address the impact of measures related to the delayed measure in the SCPL such as equitization, government's failure to implement effectively the Labour Code, requirement for new types of skills, and difficulties of workers transferring pension rights from the state to the private sector. Furthermore, surveys indicate that a majority of workers in equitized enterprises do not understand the conditions of their new employment. This reflects a basic need for more effective public education of the implications of reform, including the behavioral changes needed for adjusting to a market-based economy. Therefore the sustainability of SOE reform requires addressing effectively the social impacts of key measures.

SOE reform is also a function of the wider reform process. From this perspective, Viet Nam is a success story—but with significant remaining challenges. Despite considerable policy, legal, and institutional changes in two decades of reform, important constraints still remain on enterprise development in Viet Nam. Some of these, touched on earlier, include weak enforcement of contracts and lack of transparency and cumbersome administrative procedures, reflected for example in a still contradictory tangle of requirements for entrepreneurs. To address remaining challenges—to sustain and accelerate reforms—there is need for changes in the historical approach to policy reform. This view asserts that further development of the Vietnamese economy is likely to require substantial reforms aimed at creating more effective institutions necessary to support markets and the increasing role of the private sector in the economy. The implication is that the “step-by-step”, experimental approach to institutional reform may not be as effective in the future as in the past—that it would unduly constrain further private sector development by creating uncertainty and discouraging large, longer-term private investment. This perspective holds that it is necessary to focus on the implementation and enforcement of existing rules to create a stable business environment, rather than creating yet more laws and regulations.<sup>46</sup>

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<sup>45</sup> See Evans (2004), an important source for discussion of this general issue.

<sup>46</sup> For a detailed development of this perspective see Doan Hoang Quang (2004).

In sum, sustainability of reforms initiated under the SCPL is fundamentally a function of continuing strong political support—which in turn requires building and maintaining an on-going national consensus on the reform strategy and its key measures—and the institutional capacity to implement change. These core political economy factors that shape the on-going policy reform process are the focus of the next section.

## **IV. BUMPS ON THE ROAD TO REFORM: POLITICS AND INSTITUTIONS**

Political acceptability and institutional feasibility play a central role in shaping reforms throughout the policy process. It is this role of politics and institutions that transforms the reform process from an exercise in technical problem solving, or “optimal policy design”, into a process of long-term societal change shaped by political economy factors. Many of the key political and institutional issues related to SOE reform in Viet Nam have already been noted at various points in the paper. Therefore this section is more a synthesis of earlier discussions, highlighting briefly key issues related to the role of politics and institutions in SOE reform. These factors are also sources of uncertainty and risk in “government commitment”, the assumed guarantor of reform in policy-based lending, and the focus of the last part of this section.

### **A. The Politics of Policy Reform**

Policy reforms are inherently political in nature, entailing a process of collective choice (see also Abonyi 2005a, 2005b, and 2002). That is, reforms are “political” in that they involve: (i) multiple interests or stakeholders, (ii) with differing perceptions, (iii) conflicting preferences, (iv) diffusion of power to influence outcomes, and (v) no easy way to align diverse and conflicting preferences.<sup>47</sup> Therefore policy reform as politics requires some process of mutual adjustment among different stakeholders involving negotiation, bargaining, and consensus building that shapes and can modify or even block reforms at any point in the policy reform process. Selected issues related to the SCPL provide illustrations of ways in which politics can relate to the policy reform process.

#### **1. Policy Reform as Consensus Building**

SOE reform touches the very core of Viet Nam’s transition to a market-based economy. In managing this transition there is a continuing commitment to retain a key role for the state in the economy, and therefore for SOEs in economic development—but there have been sharp differences and debate among key stakeholders over what that role should be. Therefore SOE reform involves fundamentally political decisions: a problem in collective choice. From this perspective, as discussed, Viet Nam is a politically complex society: a multi-level, “multi-player” environment for SOE reform, where key decisions are made on the basis of national consensus. The politics of reform involves as “players” not only “the government” or the central agencies, but also the Communist Party; National Assembly; different levels of government (provinces, districts, communes)

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<sup>47</sup> For a discussion of this issue, see Abonyi (1986).

and ministries that control particular SOEs; as well as SOE management and labor (trade unions). In addition, some of these players may themselves include differing perspectives that need to be reconciled, for example, as noted, different positions in the Party on the role of the state in the economy, and therefore on SOE reform. Within the policy decision process these players, singly or in combination, may be able to delay, block, or even reverse enterprise-level reforms. Therefore it is necessary to build and maintain consensus for change at various levels in shaping the endorsement, implementation, and sustainability of reforms; where consensus has the game-theoretic meaning of ensuring either a preference for or indifference to such reforms by all players (and coalitions of players) with the power to block proposed reforms.<sup>48</sup> This takes time and resources, and the outcome of the process in terms of both the design and the implementation of particular reform measures may be uncertain. In sum, SOE reform in Viet Nam is fundamentally an extended exercise in political consensus building.

## 2. Political “Ownership” of Reform

The concept of “ownership” of policy reforms is fundamentally a political concept.<sup>49</sup> It means that a coalition of stakeholders supports a set of reforms (e.g., prefers them to the status quo); *and* has sufficient power within the context of the existing institutional framework to ensure that these reforms are placed on the policy agenda, endorsed, implemented, and sustained. It is important to stress that having preference for a set of reforms is necessary but not sufficient; it also requires the power to ensure that these reforms work their way through the policy process. Given the multi-player, consensus-based environment of reform in Viet Nam, the concept of “ownership” of reforms is complex and potentially uncertain. It requires that all key players with the *interest and power* to influence policy reform decisions and their implementation “buy into” the reform process. In this context, ownership of reforms by government represented by a central agency such as the State Bank of Viet Nam or even by Prime Ministerial decrees is necessary, but far from sufficient. Ownership of reform in this context requires a collective ownership of reforms by all relevant political players.

## 3. Role of Bureaucratic Politics

Although implicit in the above discussion, the role of bureaucratic politics requires added emphasis. The SCPL reflects a bias toward “high level” political decisions on reform in the form of specified government decrees and approvals by the National Assembly. However, an equally important factor in SOE reform relates to the role of “lower level” bureaucratic politics associated with the preferences, behaviors, and relative influence of both individual state enterprises—particularly the larger SOEs—and the institutions that control them (ministries, provincial and local governments). As noted, these agencies through their actions can modify or even block the implementation of “high level” policy decisions. Therefore effective reform requires ensuring in practical terms their support for particular measures at the enterprise level, or creating conditions under which they cannot exercise a *de facto* veto over planned change. In the case of the SCPL,

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<sup>48</sup> This formulation of “ownership of reforms” involves a game theoretic perspective. See for example, Howard (2004).

<sup>49</sup> See Abonyi (2005b) on this issue in the context of Indonesia.

as discussed, setting targets for the corporatization of SOEs without an appreciation of the likely position of the enterprises involved introduces significant uncertainty and risk. Similarly, the limited involvement of state enterprises and associated agencies in the SCPL design process led to a lack of cooperation in the audit process required in the preparation for corporatization.

#### **4. Politics as “Preparation for Change”**

People react to perceived threats to their quality of life; and what is not understood can be seen as threatening. Politics (formal and informal) is a way for groups in society that feel threatened by particular developments to modify proposed reforms, or, at the limit, exercise a veto over such reforms. Therefore a lack of understanding of the implications of SOE reform and the corresponding behavioral adjustments needed in a new type of economy is an important factor in opposition to reforms. As noted earlier, surveys indicate that perhaps a majority of workers in equitized enterprises do not understand the conditions of their new employment. Confusion over the implications of equitization should not be surprising given the complexity of the changes involved, as reflected in higher-level political debates or in the extended negotiations over corporatization between ADB and the government. The new employment conditions can be threatening to workers in terms of loss of social support, loss of historical privileges, demands on them for new types of skills, uncertainty of job tenure. These issues need to be addressed through effective measures (retraining programs, social safety net). However, a further implication of the experience with Viet Nam’s SOE reform is that in addition, it is important to prepare people through effective public education on the reform measures that touch their lives, and on the fundamental behavioral changes needed to adjust to what is emerging as a radically new economic and social environment.

### **B. Institutions: Shaping and Implementing Change<sup>50</sup>**

Policy reforms are fundamentally “institutional” in nature. This involves: (i) institutions as “rules of the game”, including property rights, political system, judiciary, and bureaucracy; and (ii) institutions as organizations implementing policy reform measures.<sup>51</sup> Institutions relate to policy reform in two ways: (i) they influence the policy process and therefore the shape of planned reforms by providing a framework for how issues get on the policy agenda, for the decision making process on policy reforms such as the passing of legislation, for program design; and (ii) they help determine the outcome of reforms or the output of activities of implementing agencies. In this context, institutional capacity, including the capability for different agencies to coordinate and work together, conditions the implementation of reforms. Selected issues related to the SCPL then illustrate ways in which institutions can relate to the policy reform process.

#### **1. Institutions as “Rules of the Game”**

The SCPL was aimed to a large extent at helping to change the “rules of the game” of economic management in Viet Nam. As discussed, many of the reform measures involved introducing new

<sup>50</sup> For further discussion, see also Abonyi (2005a, 2005b, and 2002).

<sup>51</sup> The first meaning corresponds to the use of the term in “the new institutional economics” (see Williamson 2000). The second meaning corresponds to the traditional use of the term in the management literature.

regulations, laws, and legislation intended to change the institutional foundations of the economy. A key issue in this context is ensuring that the new rules of the game are effectively implemented to bring about desired changes in behavior over the long term. In this context, while the focus was on the introduction of institutional changes as “new rules of the game”, there was relatively less attention in the design of the SCPL to the behavioral and organizational requirements for implanting such change over time.

## 2. Institutional Capacity Constraints

A critical success factor in policy reform involves assessing and building the necessary institutional capacity for implementing change at the level of specific institutions and organizations. From this perspective, as noted, equitization is in effect the “end of the beginning” of an extended process of organizational change required for transforming an enterprise from its previous state as an SOE to a viable firm. Change in legal status or transfer of ownership rights do not automatically bring about the necessary organizational skills needed for success in highly competitive product markets. Therefore additional support may be required to build the necessary organizational and business-related capabilities that effectively transform a former state enterprise into a competitive enterprise.

## 3. Institutional Design and Uncertainty

Policy reforms often involve the creation of new institutions, and/or the extensive redesign of existing institutions. Although this may be an important and necessary part of the reform process, new institutions and institutional redesign involve significant uncertainty and risks (Smith 2002). The establishment of the National Enterprise Reform Committee in 1998 (transformed in 2000 into the National Steering Committee for Enterprise Reform and Development, or NSCERD) to oversee SOE reform is an important element of both the SCPL and the reform process, and an example of the issue. Although in principle, the overall role of NSCERD is clear, as reflected in the SCPL,<sup>52</sup> its effectiveness in practice is as yet uncertain. As a new institution with a mandate to oversee overall SOE reform, it is meeting resistance from existing institutions (government agencies, local governments) that have controlled particular SOEs to date, as well as from powerful SOEs. It is also constrained in its technical and organizational capacity to address key issues related to reform, in particular, in its capabilities to monitor and enforce change at the level of implementing agencies and enterprises. Therefore creating new institutions or modifying significantly existing institutions involves an extended process of organizational design/change that requires building the requisite capacity for expected performance, and “negotiating” the effective role of the organization in the context of the existing network of related institutions.<sup>53</sup>

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<sup>52</sup> The key measures in the policy matrix is as follows: “The Government to establish a National Enterprise Reform Committee (NERC), integrating the steering committees on enterprise reform and on equitization. The Government to empower the NERC to (i) formulate a national and integrated reform strategy and specific measures for restructuring, corporatization, equitization, and divestiture of SOEs as well as other reforms; (ii) publicize and mobilize public support for the Government’s reform plans and measures; (iii) issue and enforce regulations and instructions to line ministries, state corporations, and government departments to implement reform policies, measures and targets; and (iv) undertake pilot experiments to reform” (ADB 1999a, Appendix 2).

<sup>53</sup> See Abonyi (2002) for further discussion of institutional assessment related to policy reform.

### C. Government Commitment: Stability of Expectations<sup>54</sup>

Government commitment is assumed to be the guarantor that planned reforms will be implemented and sustained, providing a level of stability of expectations and reducing risk and uncertainty for policy-based lending. Changing government commitment to reforms is seen as a key proximate cause of risk in policy reform and policy-based lending. Changes in commitment can result from shifts in the government's *intent* to implement reforms, or from constraints on its *capability* to do so. These are very different in nature, and are closely related to political economy factors in policy reform.

Government commitment is usually used to refer to the intent of government to carry out reforms. In the case of the SCPL, indications are that the (central) government was committed to the reform measures in terms of the intent to undertake them. In fact it was not prepared to commit to any proposed reforms until that stage. The debate with ADB over corporatization is an example, as are the extended negotiations with the IMF over structural reforms. In both cases the government was not prepared to agree to proposed reform measures until it felt they were consistent with its own reform agenda—the product to a large extent of a process of national consensus building—and therefore it was ready to act on them. At that point government formally committed to the SCPL, which was perceived as generally credible.

With respect to government commitment in undertaking reforms, the SCPL example suggests that different types of reform measures can have widely differing implications. One type of policy reform involves implementations that are within the power of the central government. An example of this is the issuance of prime ministerial decrees. A second type of reform measure is dependent on the formal political decision process. In this case “government commitment” means submitting measures to this process, although government cannot guarantee the outcome such as time taken for approval and ultimate form of the reform measure. An example is the submission of draft legislation to the National Assembly. A third type of reform measure is where government can enact reforms but cannot guarantee, even with the best of intentions, that they will be implemented as planned at the level of particular agencies and enterprises. This uncertainty arises because there is a diffusion of effective political power related to the implementation of particular measures at the ministries, lower levels of government, and individual enterprises; or because the institutional capacity to implement is not in place. The unmet targets for SOE equitization provide a recurring example.

Therefore even if “government commitment” is in place in terms of *intent*, it is essential to understand what that means in terms of the *capability* to implement with respect to particular reform measures. That is, to what extent can government control the policy reform process sufficiently to act as a guarantor that specific reforms will be endorsed, implemented, and sustained. In this context, seeming shifts in government commitment can be the result of changes in intent, as when political pressures alter the policy agenda, for example trade union resistance to the existing approach to equitization. Alternatively, it could be the result of constraints on the capabilities of government to manage key stages in the policy reform process, including implementation at the enterprise

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<sup>54</sup> For a more detailed discussion of government commitment in policy reform see Abonyi (2002).

level. In the case of the SCPL, as discussed in some detail, SOE reform is politically sensitive and institutionally complex, and therefore “government commitment” has to be carefully assessed and monitored in this context.

## V. CONCLUSION: IMPROVING THE ODDS

The SCPL case presents relatively few “bumps along the road to reform”, as compared with the ADB’s Agricultural Sector Program Loan in Thailand (Abonyi 2005b) and the Financial Sector Governance Reforms Program Loan in Indonesia (Abonyi 2005a). However, placed within the broader context of SOE reform in Viet Nam, the “bumps” become more visible, and are to a large extent related to political economy factors conditioning the policy reform process: the role of politics and institutions. The concluding question then is what general lessons may be drawn from the SCPL case with respect to the political economy of reform—lessons that can be applied, if not to remove the ever present bumps on the road to policy reform, then at least to allow for more effective ways of navigating around them. That is, how can the odds be improved for design and implementation of reforms, and in particular, supporting policy-based lending, so that they are both relevant and feasible in facilitating the reform process. Since many of the issues have been discussed elsewhere in the paper, this section builds on earlier discussion to present briefly selected lessons of potential general interest.

The lessons<sup>55</sup> from the case may be grouped into three general categories relating to (i) pre-conditions for effective policy reform and policy-based lending, (ii) role of politics in the policy reform process, and (iii) institutional feasibility of reforms. These lessons are likely to be relevant to both governments and external donors (IFIs) involved in the policy reform process.<sup>56</sup>

### A. Preconditions for Policy Reform and Policy-based Lending

#### 1. Understanding the “Players” and the “Game”

SOE reform in Viet Nam touches the very core of the country’s economic and social transformation. Therefore policy reform decisions are politically sensitive and institutionally complex, being the outcome of a distinctly national process of consensus-building and mutual adjustment. In this context, it is essential to understand the policy reform process *as it operates in Viet Nam with respect to SOE reform*. This includes an appreciation of the key players—their potential power (individually and in coalitions), motivations, capabilities, constraints and interrelationships—as relevant to SOE reform issues and potential reform measures; the political decision process, including how issues are placed on the policy agenda and endorsed for implementation; and how implementation of reforms is facilitated or constrained by the existing political and institutional environment.

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<sup>55</sup> These are meant to be general lessons related to policy reform. For lessons specific to ADB, and perhaps of wider relevance to IFIs in approach policy-based lending, see ADB’s Program Completion Report (PCR) on the SCPL, ADB (2004).

<sup>56</sup> See Abonyi (2002), particularly for implications of political economy factors for donors such as ADB.

## 2. Scope and Focus of Policy Reform Program and Related Diagnosis

Program design defines the scope and focus of reform, and sets both its political and institutional boundaries. Given the complexity of policy issues, defining program scope and focus—what to include and exclude, where to concentrate attention and resources—is a balancing act that requires effective diagnosis of the policy issues and identification of potential leverage points where reform initiatives can make a difference.<sup>57</sup> In the case of the SCPL, the policy matrix embodies a very wide, diverse, and ambitious reform agenda. There are potential advantages to focusing on fewer essential reforms in defining the scope and focus of a program to ensure both relevance and feasibility of reform measures from the longer-term perspective of effective implementation and sustainability. More fundamentally, a variety of program designs are likely to be consistent with a given set of reform objectives. In the SCPL case, as discussed, an alternative formulation of the program could have led to a very different scope and focus, specifically on removing domestic impediments to private sector development arising from a large number of small SOEs, with very different political and institutional implications for implementation. Therefore it is important to explore explicitly alternative program designs, particularly from the perspective of implanting feasible and sustainable reforms under existing conditions in a given setting.

## 3. Timetable for Reform

Formulating, implementing, and sustaining policy reform generally involves a complex, uncertain and long-term process of change. Given the particular political and institutional complexities of SOE reforms in Viet Nam, time is a critical variable in the reform process. In general, sufficient time is needed to build political consensus; to strengthen institutional capacity; and to put in place necessary enabling conditions for SOE reform in a transition economy like changes in the tax system and social safety nets. Therefore if the objective of reform and associated policy-based lending is to implant change, as distinct from simply putting in place rules, regulations, and decrees, then program design has to reflect the long-term and uncertain nature of the reform process.

### B. Political Acceptability

#### 1. Assessing Political Acceptability

Particular reform measures, to be feasible, require support from stakeholders with an interest in such reforms and the political power to ensure that they are placed on the policy agenda, endorsed, implemented, and sustained. In the case of the SCPL, there were important uncertainties in the political acceptability of core reforms. As a consequence, the endorsement, implementation, and sustainability of key reform measures—in the sense of implanting change—were uncertain. Examples include the enterprise corporatization targets; effectiveness of the National Steering Committee

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<sup>57</sup> See Abonyi (2002) for a discussion of the complexity of policy issues and its implications.

for Enterprise Reform and Development in managing the SOE reform process given powerful competing interests; and implementation and enforcement of various legislation. Therefore a key requirement for effective reforms and supporting policy-based lending is to assess the political acceptability of specific proposed reform measures with key stakeholders and coalitions likely to support particular reforms and with the stakeholders likely to attempt to block such reforms, including to determine options for action under given conditions (see Abonyi 2005b on this issue). This is not a one-time issue. As the experience with equitization illustrates, political support for particular reform measures may fluctuate over time. Within this context, as reflected in the SCPL case, implementing agencies are also important “stakeholders” in the reform process, and may have the incentive and the power to modify or even block the particular reform measures.

## **2. Promoting Public Awareness**

As reflected in the case, there was limited public understanding of the implications of key reforms such as equitization; and of options for adjustment to their impacts. Therefore an important requirement for feasible reforms is to promote effectively public awareness and understanding of both the nature of the policy issues and of the implications of proposed policy responses (reform measures). This is particularly important when reforms fundamentally change the “rules of the game” in a society with respect to jobs, incomes, and social services. Certain vested interests, “reform losers”, are inevitable in a process of change. However, it may be possible to expand the base of support—or at least reduce the “resistors to change”—through effective public education, supported by appropriate economic and social adjustment programs.

## **3. “Linked” Nature of Policy Issues and “Political Sequencing” of Reform**

Policy issues are often interrelated, or linked. As noted, the SOE reform program touches on the very core of the economic transition in Viet Nam, and as such, it is intertwined with a wide range of policy issues and reforms. For example, reform of the financial system has direct implications for SOE reform given the role of state-bank related SOE debt; moreover, the implementation and reform of the Labour Code and social safety net legislation has important implications for the social impact of measures such as SOE equitization and divestiture. In this context, in addition to a “technical sequencing” of reforms in economic adjustment, “political sequencing” of reforms is equally important. That is, if certain conditions are needed to be in place for particular SOE reform measures to be politically acceptable, then introducing the SOE reform measure prematurely is not likely to be effective and may undermine introducing those reforms again at a more appropriate time. For example, if the social impact of labor displacement or changes in labor conditions arising from changes in enterprise ownership and operations—through measures such as equitization, corporatization, and divestiture—is not seen as being addressed effectively prior to or at the time of SOE reforms, then introducing such changes may result in resistance by politically powerful groups to such reforms, and may lead to social and political instability.

## C. Institutional Feasibility

### 1. Assessing Institutional Feasibility of Proposed Reforms

As the SCPL case illustrates, policy reforms are generally “institution intensive”, requiring institutions/organizations that have both the capability and the incentive to implement such reforms. Therefore a key challenge in designing feasible reforms is to assess the institutional requirements for implementation, and to ensure that the necessary organizational capabilities are in place, in time (see Abonyi 2002 on this issue). Unless there is an appreciation of the institutional feasibility of planned reforms at the design stage, there is a high risk that reforms may not be feasible, and/or that an organizationally overambitious reform program may result. If institutional analysis reveals significant gaps between existing and required capacity, then either the program design needs to be adjusted, or the capacity of implementing agencies needs to be strengthened. In the case of SOE reforms and the SCPL, examples of institutional constraints relate to the capabilities and intentions of individual enterprises to implement planned reforms such as equitization, and to make the transition to market-driven organizations; and the capabilities of NSCERD to manage the implementation of the SOE reforms at the enterprise level. Therefore policy reform is fundamentally about ensuring that the requisite institutional capacity is in place in time, which in turn, may require considerable time and resources, particularly if it involves significant changes to existing organizations and/or the creation of new institutions.

### 2. Participation of Key Central and Implementing Agencies in Program Design

Reform is ultimately about implementation. In this context, it is essential to ensure that key central agencies with the power to influence outcomes are part of the design process. Furthermore, the institutional feasibility of program design can be significantly strengthened through participation of key implementing agencies that must ultimately undertake the proposed actions. In the case of the SCPL, the primary participants in the program design process involved SBV and the ADB team. Powerful central agencies—the Ministry of Finance, Ministry of Planning and Investment; line ministries that controlled particular SOEs; as well as key enterprises responsible for implementing specific reforms, although consulted, were generally not core participants in the program design process. As a consequence, the likelihood of effective and timely implementation of core reforms particularly corporatization targets at the enterprise level was uncertain. There was clear evidence of resistance to change based in part on insufficient understanding of planned reforms or reluctance to participate in pre-corporatization audits. Considerable time and resources, to a large extent not sufficiently anticipated at the program design stage, were needed to enlist the necessary cooperation of individual enterprises and related agencies to obtain necessary enterprise-level information and undertake required enterprise-level change. The implication is that it is important to involve organizations with key roles in the implementation of policy reforms early in the design process to ensure that the planned reforms are feasible and that the implementing organizations understand and do not block such reforms.

## EPILOGUE "RETHINKING CONDITIONALITY": AN ALTERNATIVE PERSPECTIVE

The effectiveness of policy-based lending has been the subject of on-going debate since its origins in the early 1980s.<sup>58</sup>

The discussion has often focused on the nature and role of conditionalities that set out the policy measures that must be implemented by a country borrowing from IFIs to support policy reform. As a consequence, the approach to policy-based lending and associated conditionalities has evolved over time. For example, there is an extensive review of conditionality under way by the World Bank (World Bank 2005); and the British government's Department for International Development (DFID) recently issued a fundamentally revised approach to conditionality and policy based lending (DFID 2005). The purpose of this concluding section is to suggest the implications of this and related case studies (Abonyi 2005a and 2005b) for the ongoing debate. In this, it ventures beyond the confines of the particular case study to make more general observations.

At the risk of caricaturing the very rich discussion on policy-based lending and conditionalities, some of the emerging lessons are as follows:

- (i) Policy reform, and therefore policy-based lending is a difficult and uncertain undertaking for both governments and supporting IFIs
- (ii) In this, policy reform is fundamentally a domestic process of change.
- (iii) Country ownership is critical to the success of reforms.
- (iv) Emphasis is increasingly on customizing reforms to the local country contexts as distinct from a uniform focus on generic "best practice" as the basis for policy reform in very different settings. The conclusion increasingly drawn from these lessons (Dollar and Svensson 1998, World Bank 2003, DFID 2005) is that policy-based lending should focus on outcomes and/or completed prior actions, not on reform-related intentions or promises of future action. The implication is that countries with good policies should receive support; those that have not demonstrated good policies should not.

The results of this and related case studies are consistent with the above lessons; however the implications for policy-based lending are seen somewhat differently. The stated assumption in focusing policy-based lending on countries that have demonstrated good policies is that "donors cannot 'buy' or induce reforms": countries have to own reforms, which is demonstrated either through the selection of "good policies" (World Bank 2003) or by achieving "good outcomes" (DFID 2005). Therefore according to this perspective, policy-based lending will/should be given if and only if the recipient country is already implementing donor-approved reforms. The implication is that countries that do not already have key domestic factors and a certain level of capabilities in place for formulating and implementing effective policy reform will not be helped by policy-based lending. That is, such lending and associated technical assistance can play little useful role in bringing

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<sup>58</sup> Examples in the literature include Jayarajah and Branson (1995); Schadler et al. (1995); Dollar and Svensson (1998); ADB (1999 and 2000); World Bank (2003, 2004, 2005); and DFID (2005). See Abonyi (2002) for additional references and discussion of this issue.

about the transition to "good" from "bad" or problematic policies: it cannot induce change, only help in maintaining what are good (donor-approved) policies already in place.

This and related cases suggest a different perspective. It is not at all clear that there is an agreed upon standard for "good policies and institutions" in a variety of settings and circumstances, even if tailored or redesigned for local contexts. As experience of a diversity of *developed* economies shows, there is no one-to-one correspondence between a well-functioning market economy and a corresponding set of policies and institutions such as labor markets and state/public enterprises. Although there is a growing stock of knowledge about characteristics of well-functioning economies, and "international best practice" in selected policy areas, there is significant uncertainty and room for choice in the relationship between economies, policies, and institutions in particular settings (see for example Rodrik 2004, Nelson et al. 1997). For example, there were fundamental differences in perspective between the IFIs and the Government of Viet Nam about how to proceed with SOE reform within the particular context of Viet Nam. As the reform process evolved, the IFIs adjusted their perspective and approach, as did the government through acceptance and implementation of "corporatization" as part of the SOE reform process.

In this context, the perspective reflected in the case studies is that policy-based lending can indeed be more useful in supporting policy reform—even in countries that are not yet implementing "good policies" or that as yet have not achieved "good outcomes"—if it were approached differently. That is, policy-based lending can be more effective in contributing to a *process* of inducing policy change if the design and implementation of such programs better reflected the role of politics and institutions that condition the policy reform process. Therefore the focus of this and related cases is on how to better understand and accommodate political economy factors in the program design process in order to support policy reform more effectively. This is the thrust of the earlier section on "lessons learned."

In sum, launching reform is a bit like a "local earthquake": it upsets not only the existing policy mix, but sets in motion over an extended time horizon, often unpredictable and unanticipated changes in structures, systems, processes, incentives, expectations, behaviors, relationships, power alignments, and institutions. This is further complicated in times of crisis. Therefore policy reform requires a high tolerance for uncertainty and risk by both governments and donors. In this context, programs cannot be designed up front with any certainty, however extensive the preparations. Good applied research is essential, including effective use of local knowledge to provide an appreciation of the realities of the reform environment. However, policy reform and associated programs are ultimately more in the nature of an unfolding experiment, where expected outcomes or conditionalities are best seen as "working hypotheses." In this context, the implication of the cases is that a better appreciation of the role of political economy factors in particular settings can perhaps help improve the odds for reform.

**APPENDIX**  
**POLICY MATRIX (VIE: STATE-OWNED ENTERPRISE AND CORPORATE GOVERNANCE PROGRAM)**

FOCUS OF REFORM	POLICY ACTIONS TO BE TAKEN PRIOR TO FIRST TRANCHE RELEASE	POLICY ACTIONS TO BE TAKEN
<p><b>A. Facilitate Foreign Direct Investment</b> 1. Create a More Conducive Environment for FDI and Improve Incentives for Efficient Investment</p>	<p>Ministry of Planning and Investment (MPI) to establish a "one stop shop" for foreign investment approval and licensing at the national level.*</p> <p>MPI to extend the "one stop shop: to all 61 provinces.*</p> <p>Government to issue a decision allowing foreign investment in equalized state-owned enterprise.*</p> <p>MPI and Ministry of Labor, Invalids, and Social Affairs (MOLISA) to allow foreign invested enterprises to denominate labor contracts in Vietnamese dong.*</p>	<p>MPI to implement a transparent system of approvals for foreign investment projects that require no investment privileges, meet domestic regulations (for example, zoning, environmental, and safety regulations) and are not in areas explicitly prohibited for foreign investment.**</p> <p>MPI to remove restrictions on foreign and domestic investors' purchase of additional shares in joint ventures.**</p> <p>MPI to submit a draft legal instrument to the Prime Minister to eliminate the minimum wage differential between domestic and foreign invested enterprises.**</p>
<p><b>B. Private Sector Development</b> 1. Facilitate Private Enterprise Access to Credit Market     a. Summary Judgment Procedure</p>		<p>People's Supreme Court in cooperation with Ministry of Justice to submit the draft Civil Procedure Code, including the procedure to obtain summary judgment for collection of uncontested debt, to National Assembly for public consultation.**</p>
<p>    b. Bankruptcy</p>	<p>People's Supreme Court to establish a drafting committee to amend the Bankruptcy Law.*</p>	<p>The People's Supreme Court to submit the revised Bankruptcy Law, consistent with the legal framework of Viet Nam and satisfactory for the Asian Development Bank and National Assembly.**</p>

ANNEX. CONTINUED.

FOCUS OF REFORM	POLICY ACTIONS TO BE TAKEN PRIOR TO FIRST TRANCHE RELEASE	POLICY ACTIONS TO BE TAKEN
		<p>The purposes of the amendment will be, among other things, to provide procedure leading to bankruptcy, where undisputed debts are unpaid for a specific number of days and restructuring is not approved by the majority of creditors; remove the requirement for support by unsecured creditors representing two thirds of the total unsecured debt for bankruptcy proceeding to continue; make explicit the ability of secured creditors to stand outside a reorganization or bankruptcy and enforce the security rights; and streamline administration of bankruptcy by allowing creditors to appoint an expert to carry out day-to-day management of liquidation.</p> <p>Government issues a revised implementing decree within six months of passing the revised Bankruptcy Law.</p>
2. Facilitate Private Enterprises Access to Foreign Direct Investment	Government to issue a decree allowing nonstate enterprises to use land use rights as equity contribution in joint ventures.*	Government to issue a decree to unify tax treatment of transfer of foreign equity to domestic enterprises regardless of ownership.**
<p><b>C. Industrial SOE Restructuring</b></p> <p>1. Improve the Institutional and Policy Framework</p> <p>a. Institutional Framework</p>	Government to establish a National Enterprise Reform Committee (NERC), integrating the steering committees on enterprise reform and on equitization. Government to empower the NERC to (i) formulate a national integrated reform strategy and specific measures for the restructuring, corporatization, equitization, and divestiture of SOEs as well as for other reforms; (ii) publicize and mobilize public support for the government's reform plans and measures; (iii) issue and enforce regulations and instructions to line ministries, state	

ANNEX. CONTINUED.

FOCUS OF REFORM	POLICY ACTIONS TO BE TAKEN PRIOR TO FIRST TRANCHE RELEASE	POLICY ACTIONS TO BE TAKEN
	<p>corporations, and government departments to implement reform policies, measures, and targets; and (iv) undertake pilot experiments in reform.*</p>	
<p>b. Policy Framework</p>	<p>NERC to formulate and publicize provisional guidelines on procedures and options for transparent modalities and methods for sale of shares and assets of SOEs to the public under equitization and divestiture program.*</p> <p>National Assembly to enact the Enterprise Law.* The Law will contain provisions for (i) regulating domestic enterprises, including limited liability enterprises, joint-stock (shareholding) companies, partnerships, and private enterprises; and (ii) transformation of an SOE to a limited liability or shareholding company.</p>	
<p>2. Accelerate Industrial SOE Reform</p>	<p>Government to issue a policy direction aiming to corporatize 60 percent of all medium civilian industrial SOEs by 2005. Corporatization refers to the conversion of SOEs into corporate entities defined in the Enterprise Law. All corporatized SOEs to operate according to commercial principles and under the new Enterprise Law.*</p> <p>NERC to classify and publicize annual list of all industrial SOEs in Hanoi and Ho Chi Minh City for (i) corporatization, (ii) equitization, (iii) divestiture, and (iv) majority and minority state ownership.*</p> <p>State Security Commission to allow trading of shares of prequalified equitized enterprises on a pilot basis.*</p>	<p>NERC to draft and publicize comprehensive 5-year SOE reform strategy with indicative quantitative annual targets of SOEs to be corporatized, equitized, and divested.</p> <p>NERC to develop a program to (i) corporatize medium and large industrial SOAs into limited liability or joint-stock (shareholding) companies, (ii) equitize medium and large industrial SOEs, and (iii) divest small local industrial SOEs with less than D1 billion in capital.</p> <p>NERC to complete the corporatization of at least 50 large and medium industrial SOEs (based on the size of fixed assets) into limited liability or joint stock (shareholding) companies.**</p>



*ANNEX. CONTINUED.*

FOCUS OF REFORM	POLICY ACTIONS TO BE TAKEN PRIOR TO FIRST TRANCHE RELEASE	POLICY ACTIONS TO BE TAKEN
	<p>The government to grant labor Supervisory Agency legal authority to penalize enterprises for noncompliance with insurance payment for workers.*</p> <p>MOF to issue a decision for the adoption of accounting and auditing standards.</p>	<p>MOLISA to submit Social Securities Act to the National Assembly.</p>

Note: \* First tranche conditions  
\*\* Second tranche conditions

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