

International Economic Integration as Leverage for Reform?

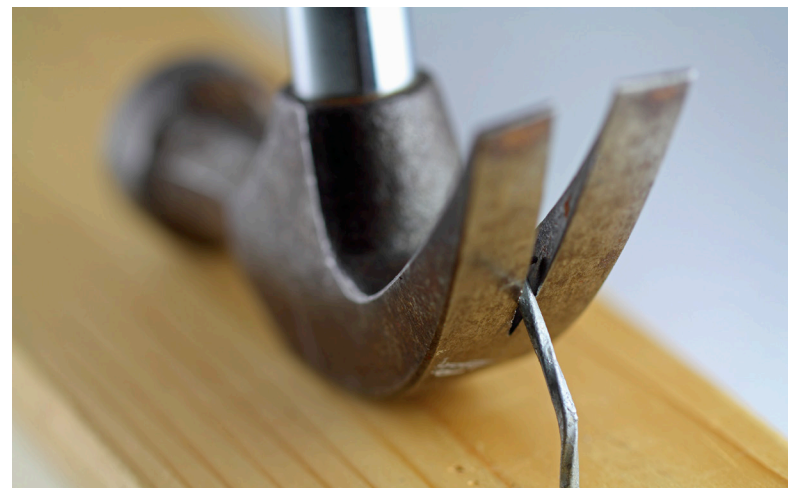
LESSONS FROM VIETNAM'S ACCESSION TO THE WTO¹

Tu Anh Vu Thanh

EXECUTIVE SUMMARY

Vietnamese reformers hope that the Trans-Pacific Partnership (TPP) will be a catalyst for SOE reform. Yet, Vietnam's most important international trade agreement so far – the WTO – has brought unsatisfying results. Joining the WTO by itself proved insufficient to fulfill reformers' hope of changing big-yet-weak state-owned enterprises (SOEs). The emergence of state economic groups (SEGs) on the verge of WTO accession significantly undermined the WTO's potential positive impacts on SOE reform. External economic commitments can be a catalyst for SOE reform, but they lose much of their impact if they are not supported by an internal political coalition, which is the decisive factor for domestic reform. To make future international trade commitments truly a catalyst for SOE reform, it is recommended that:

- Government and National Assembly should stay focused on the performance of SOEs by regularly publishing the data of SOEs in general and SEGs in particular, benchmarked against the private sector, on key dimensions such as investment, credit, employment, industrial production, and budget contribution.
- Government should publish the audit report on every SEG in the 3rd quarter of the following year, and the National Assembly should ensure this deadline is enforced.
- Ministry of Planning and Investment should enforce the current plan of SEGs' restructuring. Ministry of Finance should implement the equitization program and impose hard budget constraints on SEGs. Ministry of Industry and Trade (MOIT) should implement agreed upon competition policy by regulating monopoly effectively or reducing economic concentration of SEGs in their relevant markets.



- Government – MOIT in particular – should make SOE reform part of its duty to fulfill international commitments, and then use TPP as a “strategic maneuver” to reform SOEs.

THE URGENT NEED TO REFORM BIG-YET-WEAK SOE SECTOR

The number of SOEs in Vietnam has declined from about 12,000 in 1992 to 4,500 in 2012, of which nearly 650 (or 14%) are pending dissolution. The SOE sector has always been given favorable access to land, capital, natural resources, and business opportunities. SOEs are also entitled to many other privileges vis-à-vis domestic private enterprises (non-SOEs) and foreign investment enterprises (FIEs). SOEs were allowed to use state capital without paying dividends until very recently. They are generally not subject to hard budget constraints. SOEs were designated to disburse the majority of ODA. They are also granted state-owned land for free or at a substantially subsidized rate. Moreover, they then can use leased land as collateral for bank loans, while private businesses cannot. Large SOEs, backed by the state, are also given priority access to credit and scarce foreign exchange for less than the market value.

Contribution of the SOE sector to the economy is, however, disproportionate to favors and resources it enjoys. Table 1 shows that in all comparative dimensions, from GDP to industrial production value, from job creation to budget contribution, the share of SOE sector has dropped significantly in the last decade.

ABOUT THE AUTHOR

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TABLE 1. RELATIVE CONTRIBUTION TO THE ECONOMY OF THE THREE SECTORS 2000-2012 (%)

Indicators	SOEs			Non-SOEs			FIEs		
	2000	2006	2012	2000	2006	2012	2000	2006	2012
GDP	34.9	34.2	32.6	53.2	51.9	49.3	11.9	14.0	18.1
Industrial production value	41.8	30.7	18.4	21.6	30.6	38.4	35.9	38.3	43.3
Employment	59.0	28.3	14.7	29.0	50.2	61.8	11.5	21.5	23.6
Non-oil budget	65.0	49.2	43.5	15.7	27.4	27.0	19.2	23.4	29.6

Source: Calculated from statistics published by the General Statistics Office and Ministry of Finance

THE REFORMERS' HOPE

Vietnam is in the process of bustling international economic integration. It is expected that both the Trans-Pacific Partnership (TPP) and EU-Vietnam FTA will be concluded this year (2014). Reformers hope that these international trade agreements can be used as external pressures and credible commitments to overcome opposition and lock in domestic economic reforms, particularly SOE reform, widely recognized as the most urgent economic reform in Vietnam.

Vietnam's experience with WTO accession shows this hope may be misplaced. Reform-minded politicians and policy makers hoped that WTO accession would foster SOE reform by transforming the rules of the game in which SOEs operate. Indeed, Vietnam had to create or modify around 500 laws and regulations to accommodate WTO's core underlying values such as free trade, fair competition, and non-discrimination. Both trade and entry barriers were brought down, and Vietnam had to commit to eliminate all prohibited subsidies to SOEs. Thus, it was expected that SOEs would be subject not only to stronger market competition and more credible government disciplines, but also to harder budget and credit constraints.

At the same time, there was a genuine fear during WTO accession that powerful MNCs would dominate SOEs and harm their "leading role". A big question facing the Vietnamese party-state was how to maintain the primacy of the SOE sector and, therefore, the socialist orientation. As it turned out, the adopted solution was that in parallel with WTO accession process, SEGs – the core of the SOE sector – were quickly built up to be "the main force in international economic integration" and to "maintain the leading role in domestic financial and monetary markets."¹ For instance, according to annual audit reports, when Vinashin was established as the national ship building group in 2006, it had 93 subsidiaries and VND 15 trillion of total assets. By the time it collapsed in 2009, it had 435 subsidiaries and VND 102 trillion of total assets.

¹ According to a recent report published by the Central Institute of Economic Management, by 2011 these SEGs (excluding Vinashin) together accounted for 30% of total assets, 51% of equity, and about 40% of employees in the SOE sector. Taking the business sector as a whole, these SEGs accounted for 10% of total assets, 14% of equity, 9% of account payables, and 7.6% of long-term contract employees.

WTO accession is neither the only nor the most decisive factor underlying the formation of SEGs. Yet WTO accession clearly helped create consensus to accelerate the expansion of SEGs. There is suggestive evidence that SEGs were designed in part to get around some of the WTO restrictions. It's no surprise that these SEGs, once established, can partly disable many potential positive impacts of WTO accession.

FROM HOPE TO REALITY: HOW HAVE SEGs DISABLED WTO'S IMPACTS ON SOE REFORM?

COMPETITION POLICY HAS BEEN QUIETLY UNDERMINED

Vietnam issued the Competition Law in 2005 to meet the requirements of WTO accession. Nevertheless, many SEGs were established by merging or consolidating a number of SOEs operating in the same or related fields. As a result the formation of SEGs significantly reduces the Competition Law's effectiveness.

According to Article 18 of Vietnam's Competition Law, "[a]ny economic concentration shall be prohibited if the enterprises participating in the economic concentration have a combined market share in the relevant market of more than fifty per cent." If this Article were strictly applied, then the formation of all SEGs would violate the Competition Law. By 2008, there were 23 SEGs and SGCs with more than 50% share in their relevant markets.

However, according to Article 25 of the Competition Law, the Prime Minister can create an exemption for "economic concentration (that) has the effect of extension of export or contribution to socio-economic development and/or to technical and technological progress." Since SEGs were established by the Prime Minister himself to lead the country's development, they were eligible for exemption by default.

NEW FORMS OF DIRECTED LENDING AND CROSS-SUBSIDIES AMONG SEGs

The wave of SGCs and SEGs investing into the banking sector began in 2005 when bank shares became hot and banks rushed to issue shares to raise capital. The SEGs found that it was their golden opportunity to own banks to secure an abundant and stable source of funding. This is the reason why during the period 2006–2008, the investment of SEGs and SGCs in financial services experienced such a sharp increase (Figure 1), in which investment in banks alone accounted for nearly 60%. By the end of 2013, all 10 surviving SEGs owned at least one bank.

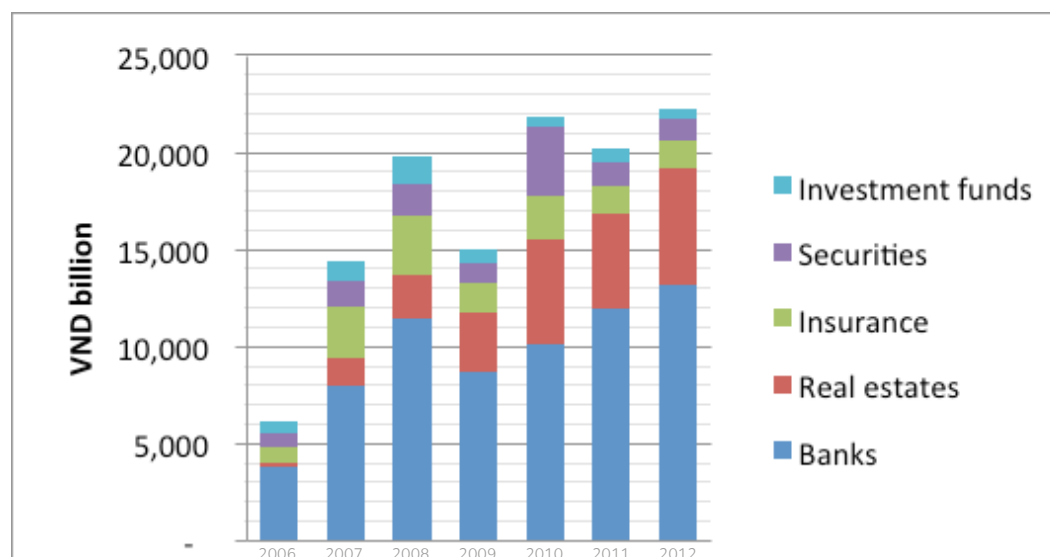


FIGURE 1. INVESTMENT INTO NON-CORE BUSINESSES OF SEGs AND SGCS (2006–2012)

Source: Author's calculation from data published by Vietnam's Ministry of Finance

The move to widely diversified business, which includes banking, insurance and financial companies, has produced new forms of directed credit and cross-subsidies among the SOEs. These subsidies, which are prohibited by WTO, have been transformed into internal transactions, and therefore are very difficult to detect. Even if these sanctions are detected, they are still very difficult to sanction in accordance with current WTO regulations. SEGs can borrow from their own banks and from each other. This act cannot be sanctioned by either domestic financial regulations or the WTO rules unless it is proved to be collusive.

NATIONAL TREATMENT HAS BEEN UNDERMINED

For a long time in Vietnam, there was explicit discrimination between public sector and private sector. In principle, this discrimination should be eliminated after Vietnam's joining the WTO in accordance with the "national treatment" principle. In practice, however, the emergence of SEGs has reinforced the discrimination or disguised it under legitimate forms.

Almost by default, the SEGs are given privileged access to state-controlled resources, and the WTO accession largely leaves these privileges intact. In addition, the monopoly or quasi-monopoly status of SEGs means they are the game setter in most industries where they operate. Moreover, this monopoly position also gives the SEGs many other advantages. Firstly, the government can use industrial policy, which is supposed to support the whole industry, to deliberately support a targeted SEG that happens to be the only firm in that industry. Secondly, the monopoly SEG is also responsible for drafting the strategy and development plan for the whole industry. Thus, one of potential benefits of joining the WTO, i.e., encouraging the separation of regulation and ownership functions, is not only unrealized but moreover, the multiple roles of the state – as owner, regulator, manager, and policy maker – become even more ambiguous with the formation of SEGs.

THE ROLE OF FOREIGN BANKS HAS BEEN MODEST EVEN AFTER FINANCIAL OPENING

The opening of the financial service market was expected to foster competition among commercial banks, including foreign banks. This in turn was expected to force state-owned commercial banks to become more profit oriented. It would follow that the SOEs have to accept interest rates which are closer to market rates and their budget constraint becomes harder. Since the SEGs and SGCs are allowed to own banks, however, this competitive effect is significantly reduced. The market transactions between SEGs and banks have been transformed into internal transactions within SEGs.

Although the foreign sector accounts for the increase in the number of banks during the period 2006–2012, its market share has been relatively stable, at around 10%. The most important change comes from the domestic banking sector, whose market share increased sharply from about a quarter in 2006 to more than half in 2012. In the same period, the share of state-owned commercial banks declined from more than two thirds to just less than 40%.

At the first glance, this market structural change seems positive. However, evidence suggests that an important part of this so-called private credit is lent by domestic private banks to their owners – the SEGs and SGCs – sometimes via roundabout and complicated mechanisms such as cross lending. As a result, total outstanding credit of 14 SGCs whose data is available increases from VND 186,000 trillions in 2005 to VND 733,000 trillions in 2010, equivalent to 30% of the total domestic credit.

CONCLUSION AND POLICY RECOMMENDATIONS

During the process of WTO accession, reform-minded politicians in Vietnam have focused on getting the WTO agreement signed. They have paid little attention to building political coalitions to ensure its effective implementation, and to prevent counter-reform measures. As a result, the rapid growth of SEGs has generally dismantled the WTO's potential positive impacts on SOE reform. In order to make future international economic integration truly a helping hand for SOE reform, the Vietnamese reformers should focus their attention much more on domestic political implementation by:

STRENGTHENING THE POLITICAL WILL AND BUILDING STRONGER COALITION FOR SOE REFORM

- Government and National Assembly should stay focused on the performance of SOEs by regularly publishing the data of SOEs in general and SEGs in particular, benchmarked against the private sector, on key dimensions such as investment, credit, employment, industrial production, and budget contribution.
- Government should publish the audit report on every SEG in the 3rd quarter of the following year, and the National Assembly should ensure this deadline is enforced.

ACCELERATING THE CURRENT SOE REFORM PROGRAM:

- Ministry of Planning and Investment should enforce the current plan of SEGs' restructuring.
- Ministry of Finance should implement the equitization program and impose hard budget constraints on SEGs.
- Ministry of Industry and Trade (MOIT) should implement agreed upon competition policy by regulating monopoly effectively and/or reducing economic concentration of SEGs in their relevant markets.

INTEGRATING SOE REFORM INTO INTERNATIONAL ECONOMIC INTEGRATION PROGRAM:

- Government – MOIT in particular – should make SOE reform part of its duty to fulfill international commitments, and then use TPP as a “strategic maneuver” to reform SOEs.

FURTHER READING

Vu-Thanh, Tu-Anh (2014). “WTO Accession and the Political Economy of State-Owned Enterprise Reform in Vietnam.” *GEG Working Paper*.



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