

GEG Working Paper 2014/92
October 2014

WTO Accession and the Political Economy of State-Owned Enterprise Reform in Vietnam

Vũ Thành Tự Anh



The
**Global
Economic
Governance**
Programme



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Abstract

Conventional wisdom holds that international trade agreements can be used as external pressures and credible commitments to overcome opposition and lock in domestic economic reforms. This belief, however, underestimates the ability of politicians to use international trade agreements to leverage their policy choices and circumvent these restrictions. As a result, trade agreements may not induce necessary reforms and, in some cases, even become counterproductive. Through an analysis of aggregate and firm-level data as well as interviews with 40 Vietnamese senior politicians, government officials, policy analysts, and state-owned enterprise managers, this paper illustrates these insights by analyzing the political economy of state-owned enterprise reform in the context of Vietnam's accession to the WTO.

Key Words: WTO Accessions, Political Economy, State-Owned Enterprise, Reform, Vietnam

JEL Classification No. F13, F15, P26, P31.

The Global Economic Governance Programme is directed by Ngaire Woods and has been made possible through the generous support of Old Members of University College. Its research projects are principally funded by the Ford Foundation (New York), the International Development Research Centre (Ottawa), and the MacArthur Foundation (Chicago).

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1. Introduction

Conventional wisdom holds that WTO accession, and more generally international economic agreements, can be used as external pressures and credible commitments to overcome opposition and lock in domestic economic reforms (e.g., Staiger and Tabellini 1999; Davis 2006; Allee and Scalera 2012; Lamy 2012; Zoellick 2014).¹ However, the effects of WTO accession on domestic economic reforms have been heterogeneous, even among seemingly similar political-economic systems. For instance, China and Vietnam both have socialist market economies, but while the Chinese leadership was quite successful in using the WTO as a means to impose market disciplines on state-owned enterprises (Fewsmith 2000; Breslin 2004, Thun 2004; Yusuf, Nabeshima, and Perkins 2006; Steinfeld 2010), their Vietnamese counterpart has failed to do so since the country formally joined the WTO in January 2007.² Similarly, Drabek and Bacchetta (2004) shows that the impacts of WTO accession on the policy making and institutional reform differ in Eastern European transitional countries.

So why does WTO accession foster economic reforms in some countries but not in others? Since the existing literature generally takes it for granted that the WTO accession will bring about positive institutional changes, it unfortunately does not provide a good framework for understanding outcome heterogeneity. Moreover, the literature focuses largely on the supply side of institutional changes (i.e., by means of the WTO accession) and implicitly assumes the existence of demand for domestic institutional changes (otherwise why bothers joining the WTO in the first place.) A key problem with this assumption is that successful institutional change requires both supply and demand. Moreover, in the process of institutional change, the interaction between demand and supply also plays an important role.

In this paper, we argue that in order to understand how WTO accession impacts domestic reforms, it is essential to understand the political economic environment of the acceding country, and thereby the interaction between external pressures from WTO accession and the acceding country's response. In particular, we should not underestimate the ability of politicians to use international trade agreements to leverage their policy choices and, at the same time, circumvent these very agreements. As a result, international trade agreements may not be conducive to reforms as expected and, in some cases, even become counterproductive. This paper will illustrate these insights by analyzing the political economy of state-owned enterprise reform in the context of Vietnam's accession to the WTO.

¹ This view was expressed most firmly and explicitly by Pascal Lamy, a former Director-General of the WTO, when he wrote "WTO accession as a tool to enhance competitiveness through domestic reforms [...] WTO membership has proven to be a catalyst for trade-related domestic reforms [...] Moreover, WTO membership also serves as a vital instrument to lock-in reforms. It opens an avenue of support for countries undertaking domestic reforms. Compliance with WTO rules drives governments towards better governance and international cooperation. Binding commitments provide cover for reformers and act as an insurance policy against the temptation to slip into the 'old, uncompetitive ways'."

² Vietnam's WTO Working Party was established on 31 January 1995. The negotiation gained momentum after Vietnam signed the Bilateral Trade Agreement with the US in July 2001, accelerated in the period 2004-2005, and finished in October 2006. The General Council approved Vietnam's accession package on 7 November 2006. On 13 January 2007 Vietnam officially became the 150th member of the WTO.

Through an analysis of aggregate and firm-level data as well as interviews with 40 Vietnamese senior politicians, government officials, policy analysts, and state-owned enterprise managers, we find that in Vietnam, WTO accession not only has failed to foster the long-needed reform of state-owned enterprises (SOEs), but also has been strategically presented as a serious external threat that needs to be addressed by quickly building up the SOE sector, which is, in hindsight, a “reversed SOE reform”. The key reason for this failure lies in the priority of the Vietnamese party-state to preserve the primacy of the SOE sector. Faced with the inevitably looming pressure of competition from liberalization as Vietnam was going to join the WTO, in order to strengthen SOE sector, the Vietnamese party-state decided to consolidate large state general corporations (SGCs) into giant and highly diversified state economic groups (SEGs).

The formation of SEGs, which are considered as the socialist “commanding heights”, has many critical ramifications. As far as the WTO accession is concerned, we find that the SEGs have disabled, at least partly, many potential positive impacts of the WTO accession. First, the formation of SEGs, which inevitably reinforces monopoly or dominant market position of these SEGs, goes against the spirit of fair competition and significantly reduces the effectiveness of the Competition Law. Second, the move to highly diversified business, which includes banking and finance, has created new forms of directed credit and cross-subsidies among the SOEs. Through a complex nexus of pyramidal and cross ownership, these subsidies, which are in principle prohibited by the WTO, have been transformed into internal transactions, and therefore very difficult to detect and/or sanction. Third, as the dominant position of SEGs is reinforced, the government can use general industrial policy, which is supposed to support the whole industry, to deliberately support targeted SEGs without being accused of violating the “national treatment” principle. Finally, the wave of SEGs’ acquiring commercial banks after WTO accession has provided SEGs with abundant sources of capital. The expectation of reform-minded policy makers that competitive pressure, particularly from foreign banks, would force banks to be more profit oriented and thereby hardening SOEs’ budget constraints has not yet been realized.

The rest of the paper is organized as follows. Section 2 will analyze potential positive impacts of WTO accession on SOE reform in Vietnam. Section 3 will show that although the WTO accession is neither the only nor the most decisive factor underlying the formation of the SEGs, it does serve as an important catalyst and adhesive enzyme to facilitate the emergence of a sufficient consensus to help accelerate the expansion of the SEGs in both scale and scope. Section 4 presents a brief history, key characteristics of and reasons for expanding the SEG model in Vietnam, thereby indicating that SEGs are giant but inefficient, implying that it’s now economically costly and politically difficult to reform them. Section 5 analyzes in detail how the SEGs disabled, at least partly, WTO’s potential impacts on SOE reform. Section 6 concludes and presents some policy implications.

2. How Can WTO Accession Potentially Facilitate SOE Reform in Vietnam?

In principle, the GATT, and then the WTO, was designed to be ownership-neutral. Moreover, only member states and their governments are subject to WTO agreements. These facts imply that the WTO has no special rule for SOEs. However, the WTO agreements and their implementation can have important impacts on the operation and governance of SOEs. It is expected that the WTO may facilitate SOE reform in many ways, which can be classified into three main groups and are summarized in Table 1.

Table 1. Potential positive impacts of WTO accession on the reform of SOEs

Changing rules of the game
Legal Framework
National treatment
Reduced tariff and non-tariff barriers
Subsidies and Countervailing Measures
Opening of Financial Service Sector
Improving governance
Commercial basis and SOE autonomy
Separation of regulation and ownership
Strengthening enforcement mechanisms
WTO as a credible enforcement mechanism
WTO imposes disciplines on vested interest groups

2.1 Changing Rules of the Game

Changing Legal Framework

Accession to the WTO has resulted in important changes in Vietnam's legal framework, which must be adjusted to accommodate the core underlying values of the WTO such as free trade, fair competition, and non-discrimination (interview 14.03.21). It is estimated that for Vietnam to meet the requirements of joining the WTO, around 500 laws and regulations have been either created or modified.³ For example, to adhere to the principle of national treatment, the State Enterprise Law was abolished and replaced by the Unified Enterprise Law (2005), which is applied to all enterprises regardless of their ownership. Similarly, the Law on Foreign Investment and the Law on Domestic Investment Promotion were merged into the Common Investment Law (2005). In addition, to reflect the principle of fair competition in the WTO, Vietnam has promulgated the Competition Law (2005), which contains provisions that explicitly prohibit unfair practices of the government and are arguably even more stringent than the UNCTAD model law.⁴

³ See also Pham Duy Nghia, "Từ lệ làng đến Lex Universum: Vai trò của giới luật học trong lập pháp thời nay," ("From Village's Customary Rules to Lex Universum: The Role of Legal Studies Community in Today's Legislation,") available at http://luatvadoanhnhan.com/law_club.php?&id=38, accessed on April 21, 2014.

⁴ For instance, Article 6 of the Competition Law explicitly prohibits State administrative bodies to force enterprises, organizations or individuals to purchase or sell goods or services with an enterprise

According to general view of the policy community in Vietnam, the most important contribution of the WTO lies in its profound impact on institutional change, particularly the legal framework.⁵ After a great expenditure of political effort for making new laws, amending old laws and issuing their implementing regulations, upon WTO accession, Vietnam possessed a relatively complete legal framework which was compatible with the WTO principles, and therefore could be used as a basis for regulating behavior of economic agents in a market economy which has become increasingly more complex and integrated.

National treatment

This principle – giving others the same treatment as one’s own nationals – prohibits the government from using internal taxes and regulatory measures to protect domestic production. As such, products, services or items of intellectual property – either imported or produced by foreign invested enterprises (FIEs) – should receive equal treatment vis-à-vis local companies in general and SOEs’ in particular. Moreover, once equal treatment has been granted to FIEs, it is neither desirable nor feasible to deny the same treatment for domestic private enterprises. As a result, a strict application of national treatment principle will not only effectively prevent the government from tilting the playing field in favor of SOEs, but also help foster the private sector, which in turn will exert competition on SOEs.

Reduced tariff and non-tariff barriers

Lowering trade barriers is a major objective of WTO negotiations. When joining the WTO, Vietnam committed to bind all of its 10,600 tariff schedules, in which the simple average tariffs was reduced from 17.4% to 13.4% over 5-7 years, mostly in equal annual cuts (

Table 2).⁶ Similarly, non-tariff barriers (NTBs) are also subject to reduction and/or elimination⁷.

The lowering of tariff and non-tariff barriers (TBs and NTBs) can have several impacts on SOEs. Directly, they reduce the scope of the SOE monopoly and, at the same time, increase competition, especially from foreign businesses, in domestic markets. Indirectly, along with other forces of internationalization such as reduction in transportation and communication costs, the reduction of TBs and NTBs give rise to changes in the relative prices of goods and services (Jeffrey and Rogowski 1996, p.31). This relative price change has two important consequences for SOEs. First, since relative prices will change in the direction of reducing the share of non-tradable goods, which traditionally are under the monopoly or domination of SOEs, these changes will certainly reduce the relative role of SOEs in the economy. Second, changes in relative prices also lead to the convergence of domestic and international prices,

appointed by such body; to discriminate between enterprises; to force industry associations or enterprises to associate with each other aimed at excluding, restraining or hindering other enterprises from competing in the market.

⁵ This view is widely shared among the informants in our sample.

⁶ For agricultural products, average tariff was reduced from 25.2% to 21.0%, and for non-agricultural products from 16.6% to 12.6%.

⁷ Import bans; Import licenses; Complex regulatory environment; Determination of eligibility of an exporting establishment (firm, company) by the importing country [144-147]; State subsidies, procurement, trading, state ownership; Export subsidies; Fixation of a minimum import price [168]; Multiplicity and Controls of Foreign exchange market; Inadequate infrastructure; “Buy national” policy; Over-valued currency; Restrictive licenses Corrupt and/or lengthy customs procedures.

and thus expose the domestic economy to external shocks, thereby revealing the economy's structural weaknesses, including the inefficiency of SOEs. All these impacts have one thing in common, which is to change the domestic relative power, as well as public preferences for SOEs, against the interest of SOEs.

Table 2. Summary of Vietnam's WTO Commitments on Tariff Reduction

Product Groups	MFN Tariffs 2006 (%)	Initial Bound Tariffs by 2007 - the Time of WTO Accession (%)	Final Bound Tariffs (%)
Agricultural products	23.5	25.2	21.0
Fish & fish products	29.3	29.1	18.0
Oil and gas	3.6	36.8	36.6
Wood and paper	15.6	14.6	10.5
Textiles	37.3	13.7	13.7
Leather and rubber	18.6	19.1	14.6
Metals	8.1	14.8	11.4
Chemicals	7.1	11.1	6.9
Transport equipment	35.3	46.9	37.4
Non-electrical machinery	7.1	9.2	7.3
Electrical machinery	12.4	13.9	9.5
Minerals	14.4	16.1	14.1
Other manufactures	14.0	12.9	10.2
Total	17.4	17.2	13.4

Source: The WTO Center, Vietnam Chamber of Commerce and Industry, available at <http://trungtamwto.vn/wto/gioi-thieu-chung-ve-cam-ket-thue-quan-doi-voi-hang-hoa-nhap-khau>

Agreement on subsidies and countervailing measures (ASCM)

During the negotiation process, state subsidies, especially for exports and SOEs, emerged as one of the most important issues for negotiating members because the use of these subsidies violates the fundamental principles of the WTO, namely fair competition and national treatment. For a long time, the Vietnamese government has used many different subsidy measures to sustain nonviable SOEs, supporting the equitization and restructuring of SOEs, and to promote strategic SOEs, namely the state economic groups (SEGs), state business groups (SBGs), and state general corporations (SGCs). In response to the concern of negotiating members, in the Report of the Working Party on the Accession of Vietnam (here after Working Party Report), Vietnam confirmed that "all other prohibited subsidies would be eliminated as of the date of accession and that any other remaining subsidy programmes would be brought into conformity with the WTO Agreement on Subsidies and Countervailing Measures. Vietnam would provide notice of measures eliminating these

programmes and any other prohibited subsidies to the WTO” [288]⁸. Vietnam also confirmed that “by the date of accession, a subsidy notification, in accordance with Article 25 of the Agreement, would be provided to the Committee on Subsidies and Countervailing Measures” [288]. These commitments, if strictly followed, will harden the budget constraint facing SOEs and thereby reducing their moral hazard in state subsidies.

It is worth noting that although Vietnam is committed to the ASCM, in contrast to China, the issue of subsidies for unprofitable SOEs is not explicitly mentioned in its WTO Working Party Report, and there is also no provision for invoking countervailing measures.⁹ This implies that for Vietnam only general agreement applies.

Opening of the financial service sector

Upon acceding to the WTO, Vietnam’s rather comprehensive opening of service sectors under the BTA was multi-lateralized to all WTO members. The opening of the financial services sector, especially banking services¹⁰, is arguably the single most important one with respect to SOE reform. When state subsidies are tightened, logically the SOEs have to rely more on bank credits. But the opening of financial markets – which essentially enhances market access and national treatment for foreign financial service providers – will help foster competition in domestic financial markets. This competitive pressure forces state-owned banks to be more profit oriented and thereby reducing subsidized and directed lending to the SOEs. As a result, both major financial sources of SOEs, namely state subsidies and subsidized bank loans, are reduced, which effectively means that the SOEs have to face a much harder budget constraint.

In addition to the opening of financial service sector, market access has also been significantly expanded for some other important services such as distribution, telecommunication, and transportation, those areas in which the SOE sector used to enjoy monopoly or quasi-monopoly status. Again, the opening of this market – even with 5 to 7 year roadmap – has created a significant competitive pressure on the SOEs, forcing them to become more efficient if they wish to stay on the market, or otherwise have to resort to government bailouts to remain afloat.

Although reform-minded politicians and government officials expected that the WTO would provide opportunities to introduce institutional reform, which helped facilitate SOE reform (interviews 13.11.29 and 14.03.21), it is important, however, to acknowledge the limitation of the WTO as a force of institutional changes in Vietnam. A prime example is the Competition Law. Internally, the Vietnamese government neither needs nor wants a competition law, because it has deliberately allowed the SOEs to monopolize or dominate most important industries such as power, transportation, telecommunication, and finance. But under pressures from the WTO, Vietnam must have a competition law. It is not surprising then to observe that although SOEs frequently and publicly abuse monopoly power and restrict competition, they were exempted from the first seven drafts of the law (interview 14.01.13).

⁸ Hereafter, a [number] in square brackets refers to the paragraph quoted from the WTO Working Party Report.

⁹ See Bajona and Chu (2004, p.15) for their discussion on China’s ASCM commitments.

¹⁰ According to Vietnam’s Ministry of Planning and Investment (2013, pp.19-20), the market-opening commitments under the WTO framework for the banking sector are more stringent than the current (i.e., BTA) framework.

While SOEs have now been included in the law, since 2005 only one SOE has ever been sanctioned. In any case, given the fact that the Competition Council is just a department-rank agency within the Ministry of Industry and Trade, it neither has sufficient resources nor enforcement power to discipline violators. This example reminds us of the New Institutional Economics warning that appearances can be deceiving since formal institutions themselves can be undermined by incompatible informal institutions or ineffective enforcement mechanisms.

2.2 Improving Governance

Commercial basis and SOE autonomy

SOEs in a socialist country like Vietnam not only perform business functions but also have to fulfill many social and political responsibilities. For example, Vietnamese SOEs are still required to help ensure social security and contribute to poverty alleviation. Understanding this situation, negotiating members demanded that SOEs (including state trading companies) operate on a commercial basis.¹¹ In response to this demand, the Vietnamese government made the commitment that “Vietnam would ensure that all enterprises that were State-owned or State-controlled, including equitized enterprises in which the State had control, and enterprises with special or exclusive privileges, would make purchases, not for governmental use, and sales in international trade, based solely on commercial considerations, e.g., price, quality, marketability, and availability, and that the enterprises of other WTO Members would have an adequate opportunity in accordance with customary business practice to compete for participation in sales to and purchases from these enterprises on non-discriminatory terms and conditions” [78].

A prerequisite for state-owned or state-controlled enterprises to operate on a purely commercial basis is that they must be given autonomy, which is both a precondition of and driver for its reform. This commitment is confirmed in paragraph [78] of the Working Party Report: “In addition, the Government of Vietnam would not influence, directly or indirectly, commercial decisions on the part of enterprises that are State-owned, State-controlled, or that have special and exclusive privileges, including decisions on the quantity, value or country of origin of any goods purchased or sold, except in a manner consistent with the WTO Agreement and the rights accorded to non-governmental enterprise owners or shareholders” and in paragraph [60] “State-owned shares were held by line ministries [...] and People's Committees. However, pursuant to the new Law, State-owned enterprises were responsible for their own operation and survival, i.e., they had full autonomy in the conduct of their business activities and could make their own decisions on business operations.”

Separation of regulation and ownership

The Vietnamese government has a dual capacity – as regulator and shareholder – in its relationship with state-owned or equitized enterprises. These enterprises, especially state-owned or state-controlled enterprises, themselves also have a dual mandate, i.e., commercial and non-commercial responsibilities. This peculiar governance structure of these SOEs lends themselves vulnerable to violations of the national treatment principle of the

¹¹ Until September 2005, which is one year before the membership negotiation was closed, considerable distance still existed between Vietnam and several members (the US in particular) with regards to the functioning and status of state trading enterprises.

WTO. Even if a firm's policy appears entirely commercial, and even when the legal personality of the firm is distinct from the government (for example, in privatization cases), so long as the firm generally operates under governmental instructions and there exist sufficient incentives for the firm to maintain the policy to fulfill its non-commercial mandate, then the firm's policy can be regarded as government regulation.¹² In other words, the firm's policy runs the risk of being considered to be inconsistent with the national treatment principle articulated in Article III:4 of GATT 1994.

2.3 Strengthening Enforcement Mechanisms

WTO as a credible enforcement mechanism

When joining the WTO, members have to accept the WTO enforcement mechanisms which, as emphasized by many scholars (Bello 1996, Moore 2000, Bown 2004, Davis 2012), have proved to be quite effective. The WTO can, therefore, be regarded as a credible external enforcement mechanism for WTO-related domestic activities. For instance, if after acceding to the WTO, Vietnam continues to grant a prohibited subsidy to its SOEs, any concerned members can take the case to the Dispute Settlement Body (DSB), of course only if all consultation or mediation efforts have failed. At the end of the day, if the DSB decides that the disputed subsidy does indeed break the Agreement on SCM, it then will recommend that Vietnam withdraw the subsidy. If Vietnam fails to follow the DSB's recommendation within the specified time-period, then the DSB "shall grant authorization to the complaining member to take appropriate countermeasures, unless the DSB decides by consensus to reject the request."¹³ This kind of multilaterally enforceable sanction is credible exactly because it is in the long-term economic interest of the violating member to comply with the WTO rules in the first place and with its rulings once the sanction decision has been made. The implication for Vietnam's government is that by committing to WTO agreements, its policies and practices with respect to the SOEs are subject to scrutiny by other members, and its non-compliance runs the risk of being credibly sanctioned.

WTO commitments as effective mechanisms to deal with vested interest groups

In Vietnam, there are many special interest groups related to SOEs. First, many government institutions are supposed to represent the state ownership in SOEs, including central government (particularly the line ministries and the Prime Minister himself), local governments, the State Capital Investment Corporation (SCIC), SEGs and SGCs. In addition, there are also various parties who have interests in the SOEs, of which the most important are the Vietnam Communist Party (VCP), commercial banks (especially state-owned commercial banks) and a number of industrial associations.

Despite the fact that the SOEs' inefficiency has been repeatedly and publicly acknowledged by both the VCP and government for decades, so far the outcome of the SOE reform – according to the conclusions of the party and government – has been very limited.¹⁴ The

¹² During the WTO negotiation process, there existed a concern that some Vietnamese state-trading enterprises involved in trade as well as industry regulation [71]. See Xie (2006) for the discussion of two illustrative cases, namely "Japan - Trade in Semi-conductors" and "Canada – Certain Measures Concerning Periodicals."

¹³ Agreement on Subsidies and Countervailing Measure, Article 4.10.

¹⁴ See, for instance, the Central Committee Conclusion No. 50-KL/TW dated October 29, 2012 titled "Continuing to Reorganize, Innovate and Improve the Efficiency of State-Owned Enterprises."

main reason is that reform efforts have faced strong opposition from vested interest groups. The first source of opposition is political and ideological. To maintain the so-called “socialist orientation”, it has always taken for granted that the SOE sector must occupy the central place in the government’s economic development strategy. The Vietnamese party-state expects the SOE sector to play the leading role, to be the material force for the state to orient, regulate, and stabilize the macroeconomy, to improve competitiveness and business performance, and to fulfill social and welfare responsibilities.¹⁵ The second source of opposition is economic, resulting from the fears of vested interest groups who benefit from the status quo, and thus will severely suffer if SOEs are actually reformed.

Although the extent and scope may vary, the process of SOE reform in China during the pre-WTO (Pei 2013) had also faced similar opposition as in Vietnam. Being deeply conscious of the fact that the toughest opposition came from inside the Chinese political economic system, Zhu Rongji deliberately integrated SOE reform measures into China’s WTO commitments, and then borrowed WTO as a “strategic maneuver” to change the role of government as well as other interest groups in the SOE reform program. As Bajona and Chu (2004) observed, “the SOE reforms become a duty to fulfill an international commitment without the consent of the ministries” and “[g]iven China’s tendency to recognize the legitimacy of international law, the enforcement of reforms is much easier through the WTO and through the domestic bureaucracy.”

¹⁵ See Decision No. 929/QĐ-TTg by the Prime Minister, dated July 17, 2012 on “Restructuring of State-Owned Enterprises with the Focus on the State Economic Groups and State General Corporations during the Period of 2011 – 2015.”

3. Interactions Between Vietnam's WTO Accession and Its Domestic Political Economy

Within the Vietnamese party-state, while a minority of reform-minded politicians and policy makers expected accession to the WTO would become an opportunity for SOE reform, the majority of conservative-minded politicians and policy makers feared that the state-owned enterprises would be dominated right in their home markets, and thus gradually lost their leading role.¹⁶ These conservatives, therefore, faced a dilemma: On the one hand, they were aware that in order to reinforce their performance legitimacy, joining the WTO was inevitable; on the other hand, they feared that the WTO accession would erode the primacy of the SOE sector and, therefore the socialist orientation. The solution to this situation was that in parallel with the WTO accession process, the SOE sector, especially its pillars (i.e., the SGCs and SEGs) were built up quickly. From the policy perspective, this view has been expressed consistently in important documents of the VCP. For example, less than one month from the date Vietnam officially joined the WTO, the VCP's Central Committee issued a specialized resolution (Resolution No 08-NQ/TW dated 5 February 2007) on major undertakings once Vietnam has been a member of the WTO. According to this resolution, in order to enhance the SOEs' competitiveness, it's imperative to:

Effectively transforming some state general corporations into state economic groups, operating as holding companies with the equity participation of domestic private and foreign investors, in which the State holds a controlling stake. Focusing on the reorganization, innovation, and enhancement of efficiency and competitiveness of large enterprises in important sectors in order to effectively perform the role as the main force in international economic integration, and of commercial banks and state financial institutions in order to maintain the leading role in the domestic financial and monetary markets.

As we will see later, although the WTO accession is neither the only nor the most decisive factor underlying the formation of the SEGs (which, in hindsight, is a "reversed SOE reform"), it did serve as an important catalyst and adhesive enzyme to facilitate the emergence of a sufficient consensus to help accelerate the expansion of the SEGs in both scale and scope.

3.1 The WTO Accession as a Catalyst for the Formation of SEGs

In the running up to WTO accession, there had been a genuine fear that many Vietnamese firms, particularly SOEs, would lose market share to, and finally be taken over by FIEs in key sectors. This fear has become an obsession with politicians who worry about the future of SOEs. These politicians fear that a large number of inefficient SOEs cannot stand up to the intense competition from mighty multinational corporations (MNCs), let alone sustain socialist orientation and play the leading role. The logical reaction of these politicians is to find ways to support the SOEs, especially the most important ones – namely the SEGs and SGCs. In general, they have three options, which are not necessarily mutually exclusive. The first option is to protect important SOEs from competition, for instance by means of tariffs and non-tariff barriers. The second option is to maintain an unequal playing field between the SOE and the private sector. And the third option is to increase the competitiveness of the SOEs. In the context of the post-WTO, the first option is difficult for Vietnam's trading partners to accept, and second option obviously violates the basic principles of the WTO.

¹⁶ Interviews 14.01.03, 14.03.21, and 14.03.30.

The third option proves to be most attractive. Putting aside the way in which the SOEs become competitive for a moment, this option – at least in terms of formality – does not conflict with Vietnam’s WTO commitments. Moreover, this option resonates with the party-state goal of “fostering the state sector”, with its principle of “proactive integration”, and with its desire to be “independent and self-reliant”. Most importantly, this option is consistent with Vietnam’s “political economic constant”, i.e., the primacy of the state sector, as well as the personal preferences of the Prime Minister who has decided to fulfill his ambition by means of state corporations.

But how can these general corporations and economic groups become more competitive? As will be discussed in section 4, equating size with strength and competitiveness, in a very short time, Prime Minister Nguyen Tan Dung has decided to push the biggest SGCs into giant SEGs. Our interviews reveal that the hasty pushing of SBGs into SEGs in the mid-2000s can be interpreted as a pre-emptive strategy adopted by the Vietnamese party-state in response to the anticipated competitive pressures upon Vietnam’s joining the WTO.

3.2 The WTO Accession as a “Consensus Builder” for the Formation of SEGs

The decision to form SEGs is a strategically important one, and as such, requires consensus agreement at the very top of the party-state decision making body. It was even more so given the fact that the multiplication of the SEG model went against existing policies adopted by both the party and the government in the first half of the 2000s, in which “[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.” (Abonyi et al. 2013, p.99). Moreover, Prime Minister Phan Van Khai’s original intention was not to quickly extend the SEG model but to experiment with it so that informed decision could be made about the next step of the SGC reform (interview 14.03.21). Indeed, in the early 2000s, both experiments with the business model, namely Vinatex (textiles and garments) and Constrexim (construction), were rolled back.¹⁷

Threats, especially serious ones, have the potential of unifying different interests which, under “business-as-usual” circumstances, are conflicting with each other. As noted above, there had been widely shared fears that Vietnamese SOEs would be “eaten up” by FIEs in key sectors. Arguably, these fears were sufficient to convince even reform-minded politicians that the building up of SBGs in order to confront international competition was not such a bad idea. In this way, WTO threats had played the role of a consensus builder in the expansion of the SEG model.

¹⁷ Phan Van Khai was the Prime Minister for two terms (1997-2006) and was succeeded by Nguyen Tan Dung.

4. The Formation of State Economic Groups since 2005

4.1 From State General Corporations to State Business Groups

In Vietnam, the idea of establishing state business groups on a pilot scale in the early 1990s was inspired by the role of the keiretsu and chaebols in the industrialization success of Japan and South Korea (Perkin and Vu Thanh 2011). The stated goal is to create large corporations that can become internationally competitive with well-known brands such as Sony or Samsung. South Korea, it is argued, built its large conglomerates with substantial support from the government and Vietnam should try to do the same.¹⁸ This idea was first implemented by Decision 91 of Prime Minister Vo Van Kiet dated March 7, 1994 that upgrading current 18 state general corporations (SGCs – tổng công ty nhà nước) into state business groups (SBGs - tập đoàn kinh doanh nhà nước). These 18 SBGs – often referred to as SGCs 91, i.e., after the code of the decision that gave birth to them.¹⁹

In principle, the SGCs 91 should “have an important position in the national economy, ensure necessary requirements for the domestic market, and have the potential of expanding business relationships outside the country.” This criterion implies that SGCs 91 should be very large compared to the average size of the SOEs. Indeed, according to Decision 91, each SGC 91 must have at least 7 members and legal capital of at least VND 1,000 billion (equivalent to about \$92 million).²⁰ In forming the SGCs 91, the government basically used large general corporations as the core and then added on other SOEs by administrative decisions and, at the same time, injected capital to meet the VND 1 trillion legal capital requirements.

4.2 From State Business Groups to State Economic Groups

In the early 2000s, the SOE reform in general and the experiment with state business group model in particular came to a standstill. Despite obvious advantages and the government's preferential treatments, the performance of the SOE sector had not improved. Even worse, the SOE sector was financially outperformed by the private sector. According to the Enterprise Survey data, in the early 2000s, pre-tax returns on total assets (ROA) of the SOE sector is only about two thirds compared with the average of the entire enterprise sector (Figure 1).²¹ Even more disappointing, despite their monopoly position, giant scale, and numerous privileges granted by the state, 10 out of the 18 SGCs had ROA lower than the average of the economy, which was 3.8% in 2001 and 4.3% in 2002. It is obvious that the

¹⁸ But there are at least two fundamental differences between Vietnam's and Korea's efforts to create large well known competitive firms. In Korea most of these firms were private whereas all of the conglomerates in Vietnam are state owned with their boards of directors and top management selected by the government. Second, in Korea all of these large chaebols, in exchange for temporary government support lasting in most cases for only a few years, were expected to become internationally competitive exporters. Vietnam's conglomerates are still largely oriented toward import substitution.

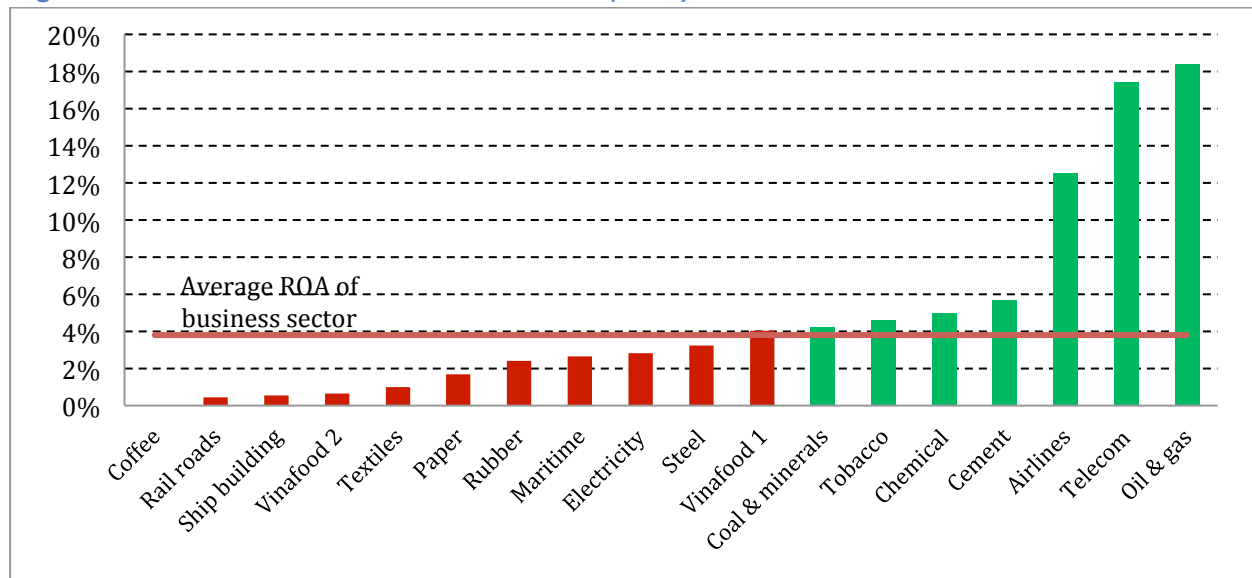
¹⁹ Along with a Decision 91, Vo Van Kiet also issued Decision 90 establishing nearly 80 so-called “state general corporations 90” with lower importance and smaller scale compared with the state general corporations 91. In this paper, the pilot state business groups (SBGs) will be called state general corporations 91 (or SGCs 91) to maintain the consistence in the way they are referred to in Vietnam. Also in this paper, the term state general corporations (SGCs) is used to refer to both the SGCs 91 and SGCs 90.

²⁰ By the time Decision 91 was issued, the official exchange rate was US\$ 1 = VND 10,897.

²¹ Similarly, pre-tax rate of return on fixed assets and long-term investment of the SOE sector was equivalent to ¾ of the average.

party and the government could not be satisfied with this poor performance, especially in the context of increasing competition from the private sector, both domestic and foreign, after the Enterprise Law and the BTA.

Figure 1. Return on Assets of the SGCs 91 (2001)



Source: Author's Calculation from various publications of Vietnam's Ministry of Finance

In this context, Resolution of the Third Plenum of the 11th Party Central Committee on SOE reform continued to confirm that:

“The state economic sector plays the decisive role in holding fast the socialist orientation, stability, and economic, political and social development of the country. State-owned enterprises ... must constantly innovate, develop and improve the efficiency, hold key positions in the economy, be an important material instrument for the state to orient and regulate macroeconomy, be the core force, the main contributor for the state economic sector to perform the leading role in the socialist-oriented market economy, is the main force in international economic integration.”

Also in this document, for the very first time the concept of “state economic groups” was formally introduced as the next step of the state business group model, with the aim to “compete and integrate into international economy.” Following this Resolution, the government issued Directive 01 (January 16, 2003), asking the Steering Committee on Enterprise Innovation and Development to coordinate with the line ministries to conduct studies and surveys in order to build the state economic group project. This began with four industries; oil and gas, post and telecommunication, construction, and electricity, which happened to be either natural resource exploitation or effectively non-tradable. Since the introduction of this policy, the first SEG – Vietnam Coal Corporation (Vinacoal) – was established in August 8, 2005. By the time Vietnam officially joined the WTO (January 13, 2007), Vietnam had established 8 SEGs, and by mid-2011, there were total 13 SEGs (Table 3).

Table 3. Time of Establishment and Ownership of State Economic Groups

State Economic Groups	Year of Establishment	State Share in Holding Company
Vietnam Insurance Company (Baoviet)	11/28/2005	74.17%
Vietnam National Textile and Garment Group (Vinatex)	12/2/2005	100%
The Vietnam National Coal - Mineral Industries Group (Vinacomin)*	12/26/2005	100%
Vietnam Posts and Telecommunications Group (VNPT)	1/9/2006	100%
Vietnam Shipbuilding Industry Group (Vinashin)	5/15/2006	100%
Vietnam Electricity Group (EVN)	6/22/2006	100%
Vietnam Oil and Gas Group (PVN)	8/29/2006	100%
Vietnam Rubber Group (VRG)	10/28/2006	100%
Viettel Telecommunication Group (Viettel)	12/14/2009	100%
Vietnam Chemical Corporation (Vinachem)	12/23/2009	100%
Vietnam Industry Construction Group (VNIC)	1/12/2010	100%
Housing and Urban Development Group (HUD)	1/12/2010	100%
Vietnam National Petroleum Group (Petrolimex)	5/31/2011	94.99%

Source: Author's compilation from decisions of the Prime Minister to establish the holding company of the state economic groups.

Note: * Vietnam Coal and Minerals Corporation (Vinacomin), formerly known as Vietnam Coal Corporation, which was established in August 8, 2005.

4.3 Important Features of the State Economic Groups

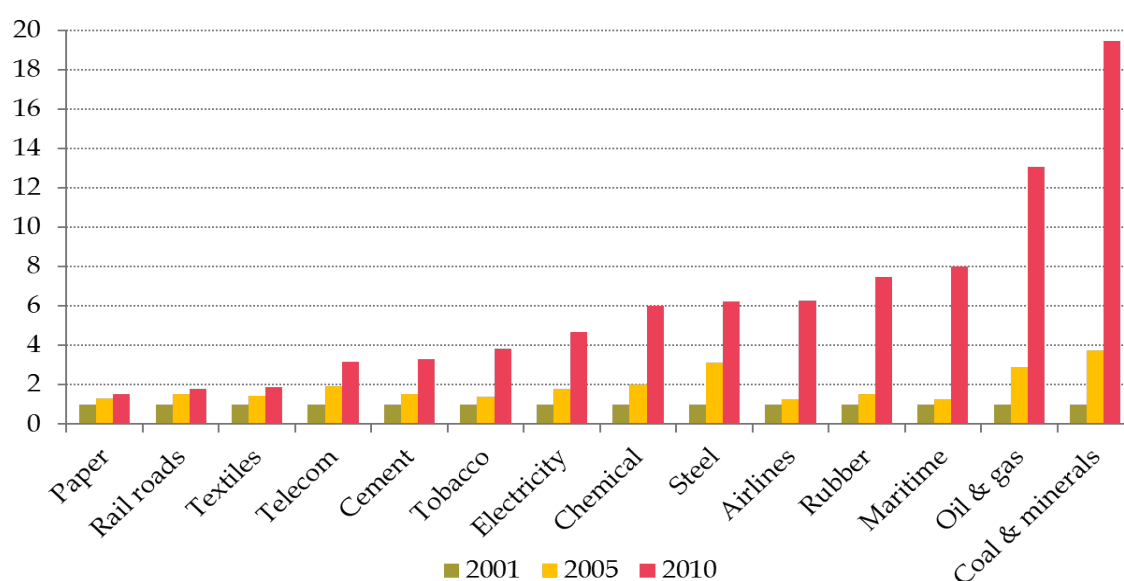
So what are the similarities and differences between the SEGs and the SGCs 91? Obviously, the most important similarity is that both are expected to become the “commanding heights” of the socialist-oriented economy. In exchange, they are granted monopoly or dominant status in all markets where they operate, and given generous access to capital, credit, land, natural resources and business opportunities. In addition, the two models were formed by administrative measures, which was through assembling smaller SOEs into a large SOE and injecting capital to meet legal capital requirement.

The SGC 91 and SEG models are different in some important dimensions. Essentially, since the connotation of the term “economic” is much broader than “business”, therefore the SEGs should have a bigger role, size and scope compared to the SGCs 91.

SEGs: New roles, much bigger size, and far larger scope

The government gave the SEGs several new roles, in which the most notable is that they become instruments to ensure the major macroeconomic balances, thereby orienting, regulating, and stabilizing the macroeconomy. Besides, the SEGs are supposed to enhance competitiveness to become a main force in international economic integration. In order to perform these macroeconomic and strategic roles, SEGs need to be built up in terms of both scale and scope.

Figure 2. SEG Nominal Asset Growth (2001 = 100%)



Source: Author’s calculation from various reports published by Vietnam’s Ministry of Finance. If the SGCs were designed to be large, than the SEGs were designed to be very large.

Although the government does not define their legal capital, the process of capital accumulation of the SEGs has happened at breakneck speed, especially since 2005. Figure 2 shows that, among those SEGs whose data is available, the nominal asset of the median SEG had increased six times during the period of 2001-2010 (equivalent to an average annual growth rate of 22% over the same period). Not too surprisingly, two natural resource exploitation SEGs – PetroVietnam (oil & gas) and Vinacomin (coal & mineral) – had experienced the highest rate of asset growth.

The significance of the SEGs is also reflected in their coverage of the economy in comparison with similar business model in other regions such as Northeast Asia, Southeast Asia, and Latin America. As shown in Table 4, in terms of sales, the share of the Vietnamese biggest 10 SOEs is significantly higher than that of the comparative countries and only seconds to the South Korean cabals in their golden age in 1995.

Table 4: Sales and Diversification of the 10 Biggest Business Groups

Countries	Sales ⁽¹⁾ (% GDP)	Diversification ⁽²⁾
East Asia		
China	9.4	2.3
South Korea	49.0	1.7
Taiwan	19.0	1.6
Southeast Asia		
Indonesia	25.0	2.1
Philippines	-	3.1
Thailand	-	3.5
Vietnam	37.3	6.4

Latin America		
Argentina	11.0	-
Brazil	8.0	1.4
Chile	-	5.1
Mexico	10.0	2.7

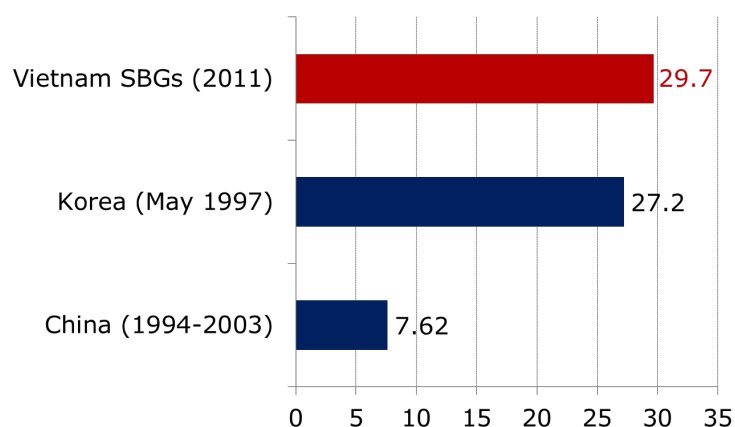
Notes on the data:

- The data on Vietnam is of year 2010 and is collected directly from the website of the SEGs
- The sales data is of 10 largest corporations. The data of Vietnam is of 2010, China is of 2005, and that of rest is of 1995.
- The degree of diversification of the corporation is calculated by the number of 2-digit industries in which the corporation has activities. The data of China is the average of ten years (1994-2003) collected from Lee (“Business Groups in China, 2010). The statistics of the rest is of the end of 1990s collected from Khana and Yafeh (“Business Groups in Emerging Markets: Paragons or Parasites?”, 2007)

The scope of activities of these corporations in the economy can be measured by the degree of diversification of these companies which is calculated by the number of ISIC 2-digit industries in which the corporation has activities. In 2010, the Vietnamese SEGs on average were active in 6.4 two-digit industries while the second highest level of diversification was 5.1 of Chile (Table 4). More importantly, many SEGs expanded their operation into real estate, finance, and banking although these fields hardly related to their core businesses.

It is worth emphasizing that under Decision 91 (1994), in principle, SGCs 91 were allowed to diversify into other activities and create a finance company to raise funds for itself. However, if these SGCs 91 wished to diversify into un-related industries or non-core businesses, they were supposed to seek permission from relevant state authorities.²² In contrast, by default, the SEGs were allowed to diversify into virtually any industries, and certainly into banking, securities, and real estate businesses.

Figure 3: Average Branches of Business Groups in Vietnam, South Korea, and China



Source: Vietnam: Author’s calculation from Trần Tiến Cường and Nguyễn Cảnh Nam (2011)

²² See paragraph 4 of Article 7 of Decree 39-CP (dated June 27, 1995) on the model charter for the state general corporations.

South Korea: OECD (1999), quoted from Graham (2003)

China: Author's calculation from data provided in Lee and Kang (2010)

Not only investing in the fields that are speculative and rent-seeking, the SEGs also jumped into the fields that they neither have comparative advantage nor expertise.²³ For instance, Vinatex – the textile and garment SEG – used to be allowed to establish businesses totally unrelated to its core business such as buying and selling beer, wine, and tobacco as well as processing agricultural, forestry and fishery products. The uncontrollable diversification of the SEGs results in an over-expansion of these corporations. By the end of 2011, on average each SEG had almost 30 branches, which was even higher than that of the chaebols during their golden period (1995) and four times higher than the figure of China (Figure 3).

The SEGs were put directly under the management of the Prime Minister

Less than two months after taking office, Prime Minister Nguyen Tan Dung issued Decree 86 (August 21, 2006) amending some articles of Decree 132 (October 20, 2005) on exercising the rights and obligations of the state owners of the SOEs. In this decree, the most important amendment was the list of 19 SEGs and SGCs, considered to be of special strategic importance, that were put under the Prime Minister's direct management.²⁴

Under Prime Minister Phan Van Khai, the state owners at the SGCs were either line ministries or provincial governments. In contrast, both the ownership and management functions at the SEGs were centralized and placed under the direct control of the Prime Minister Nguyen Tan Dung from the very beginning of his term. This is probably the most important difference in terms of governance between the SGCs and SEGs. Another important difference between the two models is that the SEGs are organized as a holding company, while the former SGCs were not. Other than these two differences, the governance of the SEGs and SGCs – e.g., ownership and board structure and CEO appointment – is quite similar.

It is important to emphasize that in both stages of development, namely from the SGCs to SBGs (or SGCs 91) and then to SEGs – the concept of the SBGs and SEGs has never been well-defined. Consequently, the legal framework for their operation was very incomplete. According to Tran Tien Cuong et al. (2005), although Decision 91 was “the first document that sets forth criteria for state business groups, it nevertheless does not address the nature and characteristics of the model, management and operation of these corporations. Consequently, the SGCs 91 failed to develop into SEGs.”

²³ During the most robust expansion, Vinashin had had over 400 branches, producing from consumer to heavy industrial products.

²⁴ According to Article 40 of Decree 101/2009/ND-CP (May 11, 2009), with respect to the parent company of these SEGs, the Prime Minister has the rights to decide on establishment, dissolution or ownership transformation; to approve objectives, strategies, long-term plans and business lines; to approve charter and its amendments and supplements; to decide on capital investment for the formation of charter capital and its adjustment; to decide on the investment projects; to decide on appointment, re-appointment, dismissal, removal from office, commendation and disciplining of chairpersons and members of Boards of Directors; to permit the Boards of Directors to decide on appointment, re-appointment or dismissal of general directors or enter into labor contracts with, commend or discipline general directors..

Subsequent legal documents such as the State Enterprise Law (2003) and the corresponding guiding documents can only serve as the initial legal premise for the conversion of SGCs 91 into SEGs since many important contents of the SEG model remain unclear, such as legal status, financial policies, corporate governance, as well as relations, authorities, responsibilities and obligations of the members of the group (interview 14.03.28). The absence of an adequate legal framework for the SEGs, together with the centralization of management in the hands of the Prime Minister implies that he has almost complete power (i.e., both de jure and de facto rights) to control the SEGs.

4.4 A Brief Account of the Emergence of SEGs Since the Mid-2000s

In addition to the WTO accession, other factors also contributed to the quick build up of the SEGs. This section briefly reviews these factors, thereby providing an overview of Vietnam's political economy in the mid-2000s, which is the immediate pre-WTO period. As observed by Grindle and Thomas (1989), a good knowledge of circumstances surrounding a particular policy initiative is essential in understanding the nature and dynamics of decision making – how the policy initiative got into the agenda, who the stakeholders were, what types of public official involved in decision making, how and to what extent changes were introduced, and the timing of decision making.

A political economic “constant”: The leading role of the state sector

Since the 1992 Constitution, Vietnam has considered itself a socialist market economy. In the spirit of a “market economy”, official documents of the party-state have always insisted that all economic sectors are important to the national economy. However, because of the “socialist orientation”, despite the fact that the party-state publicly admits the relative inefficiency of the state vis-à-vis private sector, the leading role of the state sector has always been an immutable constant in the nation's economic development strategy.²⁵ In this strategy, the SOEs are instruments for the state sector to perform the leading role, and the SEGs and SGCs are the “commanding heights” of the state sector.

The dominant role of the SOEs in Vietnam has been maintained not by market competition, but thanks to comprehensive favors of the state. The SOEs used to enjoy a separate legal playing field until 2005 and the promulgation of the Unified Enterprise Law, which was only possible under the pressure to fulfill the WTO requirements. However, today the SOEs still enjoy monopoly or dominant position in many strategic industries.²⁶ Moreover, they are allowed favored access to critical resources such as land, credit, natural resources, and lucrative opportunities such as public investment and government procurement.

In addition to credit and investment, the SOEs are also entitled to many other privileges vis-à-vis private enterprises. The SOEs were allowed to use state capital without paying dividends until very recently.²⁷ They are generally not subject to hard budget constraints and

²⁵ This role has just been reaffirmed in the 2013 Constitution.

²⁶ According to the Report on Economic Concentration of the Ministry of Industry and Trade (2012), the state economic groups occupy a dominant position in the most key industries and sectors of the economy. In particular, the state economic groups hold monopoly or dominant position in the oil and gas industry, coal and minerals, infrastructure, transportation, aviation, rail, and electricity.

²⁷ See Decree 204/NĐ-CP/2013 dated December 5, 2013.

virtually never face bankruptcy.²⁸ The SOEs were designated to disburse the majority of ODA capital.²⁹ In many cases, they are also granted state-owned land for free, or if they must lease land then the rent is substantially subsidized. Moreover, they then can use the leased land as collateral for bank loans, while private businesses do not have such an option. SOEs, backed by the state, are also given priority access to credit and scarce foreign exchange for less than the market value.

Aspiration of economic independence and proactive integration

Since the first Five-Year Plan (1961-1965), economic independence and self-reliance have always been a key objective of Vietnam's industrial development strategy in particular and economic development strategy in general.³⁰ During the war time and until recently, this "independence and self-reliance" dogma has been understood in the framework of an inward looking import substitution economy. Ideally, this economy must have a relatively complete industrial structure so that it can satisfy most of the domestic demands, in which the most important are key heavy industries such as energy, chemical industries, mining, steel, machinery, cement, oil refining, shipbuilding etc.

The industrialization and modernization for building an independent and self-reliant economy is a legitimate aspiration of a poor nation trying to catch up with the more developed world. The issue is that the Vietnamese way of realizing this aspiration contains some fundamental paradoxes. The first paradox is that the government wants rapid industrialization and modernization even when the starting point of the economy is very low, and thus lacks most necessary material, technical, management, and institutional foundations. In the 2000s, the government determined to resolve this conflict by investing lots of resources and, at the same time, granting many institutional privileges and trade protection for the SGCs and SEGs.

The second paradox is that during the war, when global trade and production were almost closed between the socialist and capitalist worlds, the motivation behind the independent and self-reliant viewpoint is fully understandable. However, in the 1990s when the Vietnamese economy started opening up, and especially in the 2000s when the country has become integrated into a world economy which is increasingly inter-dependent and globalized, the independent and self-reliant objective, understood as the old dogma, proved unjustifiable. In particular, hiding behind this independence and self-reliance slogan is a system of import substitution policies, subsidizing and protecting the SOEs, especially in sectors considered to be strategically important.³¹

Recently, along with the process of international economic integration, the "independence and self-reliance" objective has been combined with the fashionable phrase of "proactive

²⁸ The number of SOEs totally owned by the State declines from about 6,000 in 1994, i.e. when the Law on Bankruptcy was promulgated, to about 3,000 by mid-2000s. In about 3,000 SOEs that were subject to reform measures, only 17 were forced to go bankrupt [59].

²⁹ According to Vu Quoc Tuan (2008) the SOEs' share in ODA capital disbursement in 2006 was about 70%.

³⁰ See "Resolution of the Third Party Congress and Five-Year Plan (1961-1965)".

³¹ Report of the government (October 2010) titled "Summary of the nationally important works of Dung Quat oil refinery," states that "when the refinery goes into operation, it will meet about 30% of domestic demand for petroleum products, reducing the dependence on imports from outside markets, and ensuring the energy security ..."

international integration.” The SEDS 2001 – 2010, adopted at the Ninth Party Congress (2001), was the first official document that mentioned the goal of “fastening the objective of building an independent and self-reliant economy with international economic integration” (*italics is added*). However, this document explicitly acknowledged that the connotation of “independent and self-reliant economy” and “international economic integration” is still unclear, even incoherent, making the policy planning and implementation inconsistent and hindering further reform.

The failure to give a clear industrial development priority in the SEDS 2001-2010 implies that the actual priority may well be subject to subjective interpretation and depends on the specific case under consideration. For example, the policy to selectively build some heavy industries such as oil refining, shipbuilding, and metallurgy through the formation of SGCs and SEGs was justified by the “independence and self-reliance” mantra. Also under this slogan, the industries in which the state sector has the dominant position enjoy many privileges and generous protection from the state (see Athukorala 2006, Perkins and Vu Thanh 2011).

The SOE sector has been on the decline

The SOE has always played a central role in government’s economic development strategies. As a matter of fact, until the end of the 1990s, it made sense that the government chose the SOE sector as the key driver of growth. However, with the continuous expansion and development of the private sector since the Enterprise Law was enacted (1999) and the US – Vietnam BTA was signed (2001), the role of the SOE sector relative to the private sector has been declining.

Table 5 shows that the contribution of the SOE sector to the economy is completely disproportionate to the favors and resources that this sector enjoys. In addition, it also reveals that in all comparative dimensions, from GDP to industrial production value, job creation, and budget, the relative contribution of the SOE sector has dropped significantly between 2000 and 2006. If in 2000, the SOE sector was still the biggest contributor in terms of GDP growth, industrial production value, employment, and non-oil budget, then by 2006 it’s no longer the case. Even more disappointing, the SOE sector’s contribution to the growth of industrial production value was just a little more than 10% and to the new job creation was even negative in 2006.³² For the party-state, given its objective of “becoming an advanced industrial country by 2020” and given the fast growth of its young labor force, this situation is indeed a very serious problem. The fundamental reason for such a decline and poor performance of the SOE sector is that in all comparative dimensions, its growth has been much lower than that of the private sectors and continues to trend downward.³³

Table 5. Relative contribution to the economy of the three sectors 2000-2006 (%)

Indicators	SOEs		Non-SOEs		FIEs	
	2000	2006	2000	2006	2000	2006

³² Thanks to the acceleration of equitization program, the SOE sector cut 137,723 jobs while the private sectors created 615,493 new jobs between 2005 and 2006.

³³ According to Bui Trinh’s research, State owned sector’s ICOR increased from 6.9 in the 2000-2005 period to 9.7 in 2006-2010, while the private sector’s in these two periods were 2.9 and 4.0 respectively.

GDP	34.9	34.2	53.2	51.9	11.9	14.0
GDP growth	41.6	24.1	39.6	52.9	18.9	23.0
Industrial value	41.8	30.7	21.6	30.6	35.9	38.3
Industrial value growth	32.8	11.7	23.2	44.0	43.2	44.1
Employment	59.0	28.3	29.0	50.2	11.5	21.5
New job creation ^(*)	6.5	-28.8	60.0	81.8	20.6	47.0
Budget (non-oil)	65.0	49.2	15.7	27.4	19.2	23.4

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

Notes: ^(*) New job creation data are of 2001 and 2006.

Another troubling fact facing the party-state leadership was that the SOE sector in general and the SGCs in particular failed both the competitive and crisis resilience tests (e.g., the Asian Financial Crisis during 1997-1998) when the economy became more liberalized and open. By the mid-2000s, the party-state faced a strategic dilemma, which was how to reshape and foster the declining and inefficient SOE sector so that it could really play the leading role in the economy. It also had to answer a big question: could the SOE sector stand post-WTO competition, which was surely even more intense?

A new generation of leadership

In July 2006, at the threshold of joining the WTO, Vietnam experienced the transfer of political power to the 4th generation of leaders.³⁴ Since the second generation of leaders came to power, the leadership regime in Vietnam no longer features the existence of a party paramount leader, and it has been even more so over time. This gives rise to power sharing, which effectively implies that the Party Secretary General can no longer arbitrarily impose his ideas on other members of the Politburo. This fact in turn implies that the Prime Minister has more leeway in maneuvering the trajectory of economic policy. The scope of and degree to which this leeway is taken depends on the circumstances as well as on the personality of the Prime Minister himself.

In 2006, at the age of 57, Nguyen Tan Dung became Vietnam's youngest Prime Minister since the reunification (1975). According to Huy Duc (2013), an important reason - if not the most important one - behind the rapid political promotion of Nguyen Tan Dung is thanks to the support of all three "party senior advisors", two of them were considered iconic leaders of the conservative group within the party.³⁵ From the hindsight, one could see much affection of these two leaders in Nguyen Tan Dung's major decisions related to the state sector (interview 14.01.14).

³⁴ In normal conditions, this power transfer occurs in every ten years (i.e., two terms). Unlike the position of VCP's general secretary, it's relatively more straightforward to predict the next Prime Minister since this position is usually taken by the standing Deputy Prime Minister (in charge of the economy).

³⁵ The position of Senior Advisor of the VCP Central Committee existed from the 6th Party Congress (December 1986) until the end of the 9th Party Congress (April 2001). The Senior Advisory Board consisted of only three members, who were the most senior leaders of the VCP in previous terms. For political, institutional, and personal reasons, although these senior advisors already retired, they still had great influence, or in some cases even the final say, on both policy and personnel issues.

The new and young Prime Minister is very ambitious. He is longing to leave his personal imprint right in the first term by striving to accomplish key targets of the Five Year Plan 2006-2010 in just three years. As described above, it seems that all the necessary conditions, from economics to politics, from domestic to foreign affairs are ready for him to shine.

Notably, the new ambitious Prime Minister determined to realize his ambition by means of the large SOEs, namely the SEGs, SBGs, and SGCs or the socialist “commanding heights.” Phan Van Khai – the former Prime Minister – believes in the market economy, in the equality of all economic sectors, in the need for the state to restraint itself from competing with private sector in doing business. Therefore, although the pilot experiment with the business group model has been launched since 1994 under Prime Minister Vo Van Kiet (Decision No. 91), Phan Van Khai had been still very cautious.³⁶ But by the end of the first term of Prime Minister Nguyen Tan Dung (i.e., 2011), the number of SEGs went up to 13 despite the fact that officially the SEG model was still in their experimental stage. As described by a former senior policy maker who was directly involved in the drafting of various Social-Economic Development Strategies in the 1990s and early 2000s (interview 14.01.07), the SEG policy under Phan Van Khai was perceived as a pilot experiment, while under Nguyen Tan Dung was quickly elevated to become the government’s development model.

In summary, facing the declining role of the SOE sector and intensifying competition from the WTO accession, the new Prime Minister was able to rally a wide support for quickly expanding the SGCs into the “commanding heights” SEGs, thereby not only meeting party-state overriding objectives (i.e., revitalizing the leading role of the SOEs, maintaining economic independence and self-reliance, and promoting proactive integration), but also fulfilling his personal ambition.³⁷

○ ³⁶ Although there were six (out of thirteen) SEGs were established in the last year of his last term, all decisions that established these six SEGs were not signed by Phan Van Khai himself but by then Deputy Prime Minister Nguyen Tan Dung. In contrast, all the remaining SEGs were established in the first term of Nguyen Tan Dung and their decisions were signed by Nguyen Tan Dung himself, except for the very last one, which was signed by a deputy Prime Minister, when the SEG model had already undergone heavy criticism.

³⁷ Decision 929/QĐ-TTg (2011).

5. How Have the SEGs Disabled WTO's Potential Positive Impacts on SOE Reform?

As outlined in section 2, WTO accession can potentially bring about many positive impacts on the reform of the SOEs. However, the realization of these effects depends critically on the internal political economic response of the member country. This section will show that in Vietnam, once established, the SEGs can disable, at least partly, many potential positive impacts of the WTO accession on themselves. Our interviews reveal that there has been suggestive evidence that SEGs were designed in part to get around some of the WTO restrictions on the protection of the SOEs.

5.1 Evasion of Competition Policy

Vietnam issued the Competition Law in 2005 to meet the requirements of WTO accession. By enacting the Competition Law, the Vietnamese government commits to ensure the freedom of all businesses to compete in a fair environment. Indeed, a whole section of the Working Party Report is devoted to clarify Vietnam's commitment on its competition policy (paragraphs [104] to [109]).

Nevertheless, the formation of SEGs, which inevitably reinforces monopoly or dominant market position of these SEGs and thereby hinders competition, goes against this spirit and significantly reduces the effectiveness of the Competition Law. In many cases, the state economic groups are formed by merging or consolidating a number of state-owned enterprises which operate in the same or related fields. In principle, since the act of merger and/or consolidation leads to economic concentration, it should necessarily be placed under the supervision of the competition agency. Specifically, 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 (50) per cent." If this Article were ownership-neutral and strictly applied, then the formation of all SEGs would obviously violate the Competition Law since, according to Vietnam Economic Concentration Report 2012 published by Vietnam Competition Authority (VCA) in 2008, there were as many as 23 SEGs and SBGs with more than 50% share of their relevant markets. However, according to Article 25 of the Competition Law, it is the Prime Minister who is entrusted to make decision on the 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," and since SEGs were established by the Prime Minister himself to lead the country's development, they were eligible for exemption by default.

More recently, admitting that mistakes and failures had resulted from the extension of the SEG model and expansion of the SEGs into non-core businesses, the party and government demanded that the SEGs and SGCs urgently restructure their business lines, focusing on a number of key areas and sectors of the economy.³⁸ Unfortunately, this correct policy seems to be carried out in ways that go against the spirit of the Competition Law, as illustrated by the following two cases.

³⁸ See "Documents of the Eleventh Party Congress" (2011).

In the first case, Vietnam Electricity Group (EVN) was forced to abandon EVN Telecom, which is almost irrelevant to the group's core business. Instead of requiring EVN Telecom to be dissolved, the government, by administrative order and completely bypassing the Competition Law, merged EVN Telecom with a military-run telecommunication company - Viettel – which already occupied 37% market share on the country's mobile phone market.³⁹

In the second case, Vietnam Airlines and Jetstar Pacific are effectively the only two competitors in Vietnam's domestic aviation market. By the end of 2011, Vietnam Airlines and Jetstar Pacific accounted for 80% and 17% market share of the domestic aviation market in Vietnam. Vietnam Airlines is a SGC 91 corporation, wholly owned by the state. Jetstar Pacific is a shareholding company with three owners. In 2011, the State Capital Investment Corporation (SCIC) was the major shareholder and held 70% of shares, Qantas Airways (Australia) held 27% and Saigon Tourist (an SOE owned by Ho Chi Minh City government) held 3% of shares.⁴⁰ In an effort to "restructure" the state economic groups and general corporations, in 2012 (February 21, 2012) Prime Minister decided to transfer the entire state capital managed by SCIC at Jetstar Pacific to Vietnam Airlines, thereby turning Jetstar's biggest competitor (i.e., Vietnam Airlines) into their controlling shareholder. Again, this decision totally disregards the Competition Law.

5.2 New Forms of Directed Lending and Cross-Subsidies Among the SOEs

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. It should be noted that these subsidies, which are prohibited by WTO, have been transformed into internal transactions, and therefore very difficult to detect, and even if detected, it is still very difficult to sanction in accordance with the WTO regulations.

Imagine a SGC originally had a core business and a few related businesses. Now this SGC is upgraded to a SEG with all accompanying "usual suspects" such as banks, financial and insurance companies as illustrated in Figure 5. Originally, as a SGC, the corporation has only three main sources of credit, namely grants or soft loans from the state, bank credit (including directed credit), and trade credit, in which the first two sources are the most important. As discussed in section 2, upon WTO accession, direct credit from the state and the directed lending will be prohibited, and so in principle these sources would vanish. This credit crunch is clearly a big shock for the SGC which used to rely almost entirely on easy credit without having to worry about its efficiency.

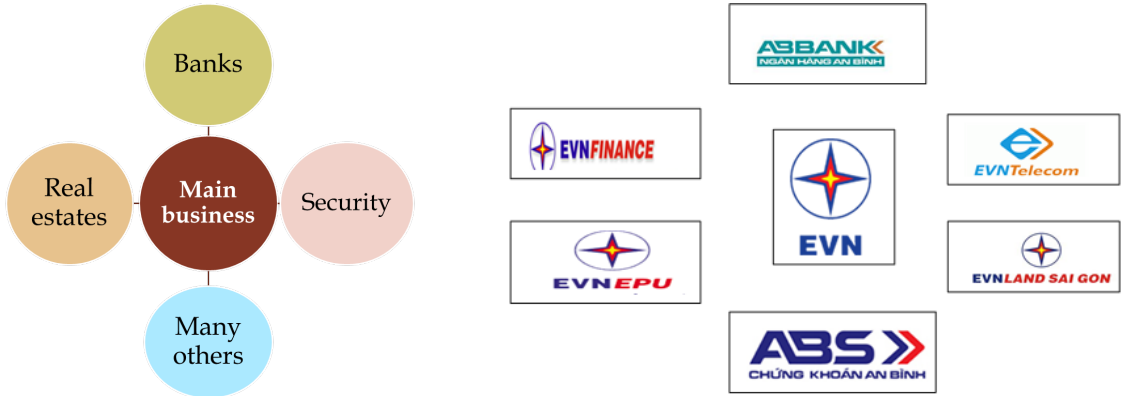
³⁹ According to Article 20 of the Competition Law: "In the case where enterprises participating in an economic concentration have a combined market share in the relevant market of from thirty (30) per cent to fifty (50) per cent, the legal representative of such enterprises must notify the administrative body for competition prior to carrying out the economic concentration."

⁴⁰ See Mai Hà, "Thị trường hàng không nội địa thật lụi", Thanh Niên Online Newspaper, May 12, 2011.

Figure 4. Business Structure of a SEG – The Case of Vietnam Electricity (EVN)

Typical SEG business structure

A real example: EVN

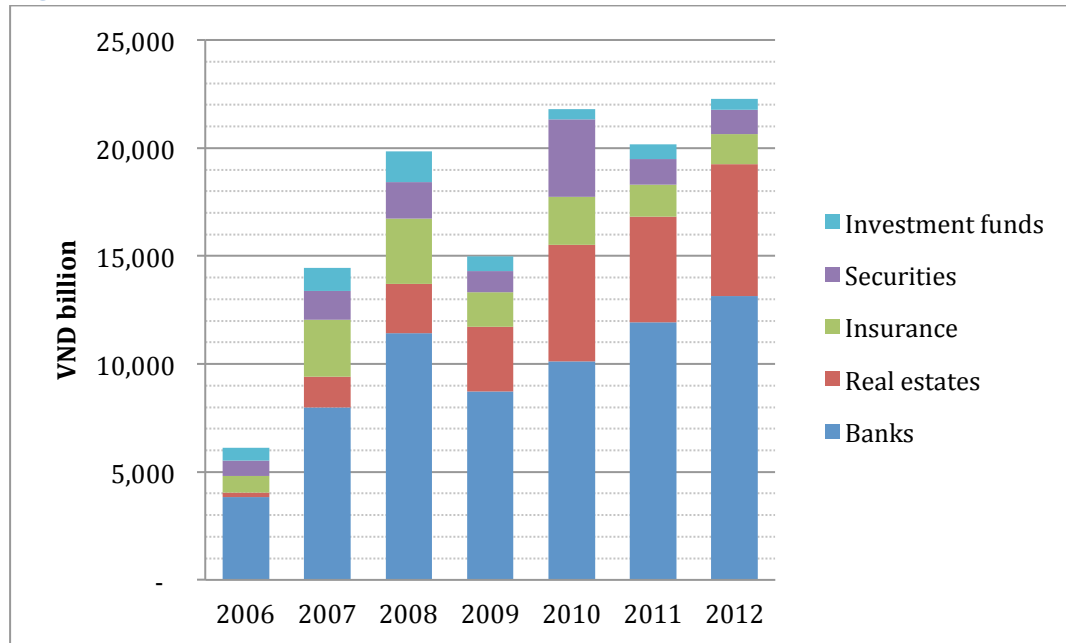


In this context, the Prime Minister’s policy of upgrading SGCs 91 to SEGs with diversified business has solved the problem of credit depletion. With this new business model, the SEGs can raise capital from a variety of sources – from the financial company, from idle funds of the insurance company, and most importantly, from the commercial banks owned by itself – then channel credit to its various business activities. In favorable economic conditions, with these abundant internal sources of capital, the SEGs no longer need government subsidies or directed credit from other commercial banks. Ironically, it is the capital surplus - rather than lack of funds – that has led many SEGs to collapse.

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 and to secure an abundant and stable source of funding. This is the reason why during the period 2006-2008, the investment of the SEGs and SGCs in the financial sector experienced such a sharp increase (Figure 5), in which investment in banks alone accounted for nearly 60%. In 2009, due to the effects of Vietnam’s anti-inflation policy and the global financial crisis, the investment of the SEGs and SGCs in banking sector somewhat decreased but increased again immediately in 2010. Moreover, despite the government’s policy of forcing the SEGs and SGCs to divest their non-core businesses since 2010, investment in the banking sector continued to increase in 2011 and 2012. By the end of 2013, all 10 surviving SEGs owned at least one bank with different ownership levels.⁴¹

⁴¹ The three SEGs that were converted back to SGCs are Vinashin, VNIC, and HUD due to their financial insolvency, if not bankruptcy.

Figure 5. Investment into Non-core Businesses of SEGs and SGCs (2006-2012)



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

Of course, raising capital and internal loans faces certain limitations since they are supposed to comply with government regulations (although not strictly enforced), especially in the banking sector. For example, according to the Law on Credit Institutions (2010), the bank can only lend to any single borrower (including its owners) maximum of 15% of its charter capital, and to a group of related borrowers maximum of 25% of its charter capital. However, again, this provision can be circumvented easily since, for instance, corporation A can borrow from the bank owned by corporation B and vice versa. This act, if not proved to be collusive, cannot be sanctioned by either domestic financial regulations or the WTO rules.

5.3 National Treatment in Disguise

For a long time in Vietnam, there has existed an explicit discrimination between public sector and private sector, both domestic and foreign. In principle, after joining the WTO, thanks to the "national treatment" principle, the discrimination was to be eliminated. In practice, however, the emergence of mammoth SEGs inevitably reinforces the discrimination or disguises it under legitimate forms. Thus, even though the degree to which the government can favor the state sector over the others has been reduced by WTO membership, the government favor has by no means been eliminated.

Almost by default, the SEGs are given privileged access to state-controlled resources, the most important of which include land, natural resources, development assistance credit, public investment (especially infrastructure) and public procurement. The WTO accession largely leaves these privileges in tact.

In addition, the monopoly or quasi-monopoly status of the SEGs lends themselves to being the game setter in most industries where they operate. Moreover, this monopoly position also gives the SEGs many other advantages. First, the government can use industrial policy,

which is supposed to support the whole industry, to deliberately support a targeted SEG. Formally, a policy targeted at an individual industry is in line with the WTO as long as it is non-discriminating. However, since a SEG happens to be the only firm in that industry, then the industry-supporting policy in practice becomes a SEG-supporting policy.

Second, if a SEG is the only company in the industry and since it is owned by the state then it is this SEG that is responsible for drafting the strategy and development plan for the whole industry. In other words, SEGs naturally become the agenda setter and policy maker in almost every sector where they operate. Thus, one of the potential benefits of joining the WTO, i.e., encouraging the separation of regulation and ownership, 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 the state economic groups.

5.4 The Role of Foreign Banks Has Been Modest Even After Financial Opening

China's experience shows that the opening of the financial services market induced by WTO accession fosters competition among commercial banks, including foreign banks, and thus forcing state-owned commercial banks to become more profit oriented (Justin Yifu Lin 2001a). Consequently, the SOEs have to accept interest rates which are closer to market rates. As a result, their budget constraint becomes harder. Quite contrarily, in Vietnam because the SEGs and SGCs are allowed to own banks, this competitive effect is significantly reduced since the market relationship between SEGs and banks has been transformed into internal transactions within SEGs.

Table 6. Structure of Vietnam's Commercial Bank System (2001-2012)

Types of Bank	2001	2006	2007	2008	2009	2010	2011	2012
State-owned banks	5	5	5	5	5	5	5	5
Joint-stock banks	39	34	34	40	37	37	35	34 ^[1]
Joint-venture banks	4	5	5	5	5	5	4	4
Branches of foreign banks	26	31	41	39	40	48	50	50
Wholly-owned foreign banks	0	0	0	5	5	5	5	6
Total	74	75	85	94	92	100	99	99

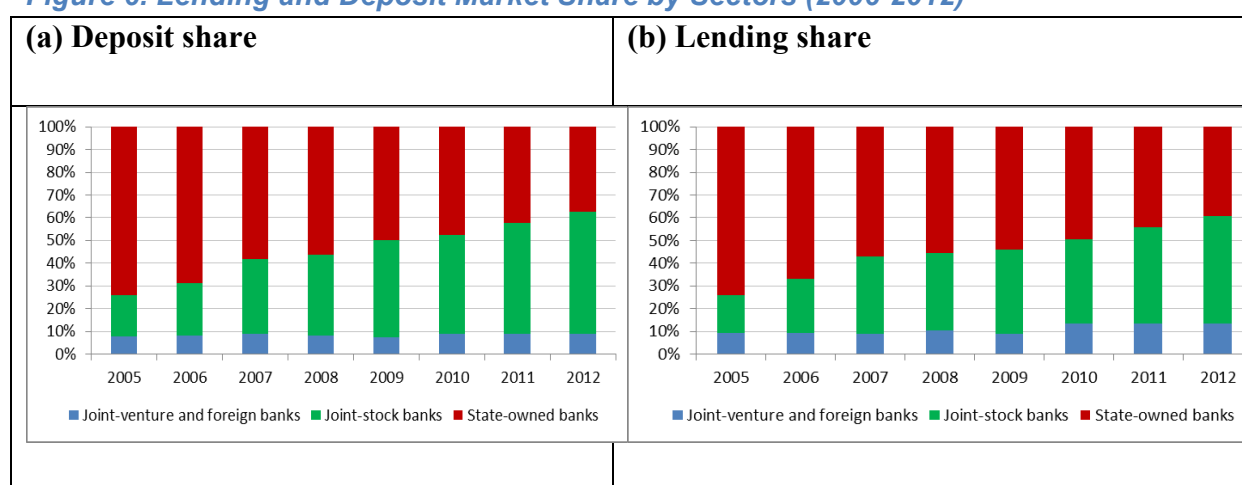
Source: State Bank of Vietnam Annual Reports

Note: ^[1] At the end of 2010, the total number of joint-stock banks was 37. By the end of 2011, this number decreased to 35 after three banks SCB, TNB and FCB were merged. In 2012, Habubank SHB was merged into SHB, and the total number of joint-stock banks dropped to 34.

In 2006, shortly before WTO accession, Vietnam had 5 joint-venture banks, 31 branches of foreign banks, and none that were wholly owned by foreign capital (Table 6). Shortly after joining the WTO, the number of foreign branches soared, and by 2012 this figure reached 50. Similarly, a series of wholly-owned foreign banks were opened soon after Vietnam joined the WTO and remained relatively stable since then. Thus, the entire increase in the number of banks during in the period 2006-2012 was from the foreign sector.

However, the foreign sector's market share had not experienced significant change during the same period. In contrast, the most important changes happened in the domestic banking sector (Figure 6). Market share of the private joint-stock banks 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 had declined from more than two thirds to just less than 40%.

Figure 6. Lending and Deposit Market Share by Sectors (2006-2012)



Source: State Bank of Vietnam

At the first glance, it looks like the changing role between state-owned and domestic private banks is very positive. However, there is indicative evidence that an important part of this so-called private credit is indeed lent by joint-stock banks to their very owners – the SEGs and SGCs – sometimes via roundabout and complicated mechanisms (Vu-Thanh et al., 2014). Between 2005, when the SEGs and SGCs started owning joint-stock banks, and 2012 there were 15 out of 34 joint-stock banks owned by the SEGs and SGCs (Appendix 5)). This fact partly explains the strong correlation between the increased share of joint-stock banks and the level of investment in the banking sector of the SGCs and SEGs during the period 2006-2012 (see Figure 5 and Figure 6).

Moreover, the city and provincial government, who can also be owners of SGCs, also joined the banking investment fever (Appendix 6). Obviously, the local government could use its influence to direct credit from their banks to their SGCs.

Third, if in 2005 the total outstanding credit of 14 SGCs 91 with which the data is available was VND 186,000 trillions, then in 2010 it amounted to VND 733,000 trillions, equivalent to

30.3% of the total domestic credit.⁴² One consequence of this situation is that nonperforming loans (NPLs) skyrocketed, reaching approximately 15-20% of total outstanding domestic credit in 2012, in which it is estimated that the SEGs and SGCs in particular and the SOE sector as a whole respectively accounted for 53% and 70 % of total NPLs (Đình Tuấn Minh 2012).

⁴² **Source:** Reports of the National Assembly Committee of Economic Affairs.

6. Conclusion

Conventional wisdom holds that WTO accession can be used as an external pressures and credible commitment to overcome opposition and lock in domestic economic reforms. However, the effects of WTO accession on domestic economic reforms have been heterogeneous or even negative. Unfortunately, since the existing literature generally takes it for granted that WTO accession will bring about positive institutional changes, it does not provide a good framework for understanding either heterogeneous or negative outcomes. Moreover, the current literature often takes the supply-side approach and largely underestimates the role of the domestic political economy as well as the interaction between the WTO accession on the one hand and the institutional and policy responses of the acceding country on the other hand. As a result, it does not reflect the whole range of impacts – both positive and negative – that the WTO accession may have on acceding countries.

During the process of Vietnam's acceding to the WTO, there had been expectations among the more reform-minded politicians that the WTO accession would be an opportunity to improve the institutional system of market economy in Vietnam, and equally important, it would create pressure on SOEs – the core of the socialist market economy – and forced them to reform and become more competitive.

In reality, the WTO accession has helped improve the Vietnamese legal framework toward a market-oriented economy. However, the potential threats to the SOE sector were utilized to largely convince both reform-minded and conservative-minded politicians of the urgent need to foster the growth of the SOEs, particularly the “commanding height” SEGs. As such, in a way, the WTO accession has contributed to the emergence of the SEGs that have not only been “too big to reform” but also effectively disabled many potential positive impacts of the WTO accession on themselves.

This paper argues that not all of the effects of WTO accession are positive simply because any external impact also creates internal reactions, many of which are to protect the status quo, and that the interaction between these internal and external forces will determine the final outcomes. This paper also argues that we should not underestimate the ability of politicians to use international trade agreements to leverage policy choices to serve their personal interests, and these policy choices, in turn, may even circumvent these very agreements. Consequently, international trade agreements may not necessarily be conducive to reforms as expected and, in some cases, even become counterproductive. It follows that the degree to which the positive effects of the WTO accession can be realized depend critically on the domestic political economy factors of the member country under consideration, and that in order to understand the real impacts of the WTO accession, it is essential to deeply analyze its interaction with and the reaction of the domestic political economy.

It's worth emphasizing that the case analyzed in this paper goes beyond the “mock compliance” described by Walter (2008) in his discussion of the compliance heterogeneity adopted by Indonesia, Malaysia, South Korea and Thailand after the Asian Financial Crisis with respect to the international regulatory standards. In the case of Vietnam's WTO accession, obviously there have been elements of mock compliance. For instance, new laws

and regulations in line with the WTO principles were issued; outright subsidies to the SOEs as well as other differential treatments were removed. But at the same time, as shown in the paper, the policy of building up the SEGs is indeed a “reversed SOE reform” and has effectively made many of these changes irrelevant.

Looking forward, in light of the findings of this paper, it seems that both the positive expectations of the proponents and the negative reactions of the opponents with regards to the so-called “21st-century” Trans-Pacific Partnership (TPP) agreement are over exaggerated. Once again, this paper suggests that domestic political economy factors will determine the heterogeneity of both compliance outcomes and institutional change in the participating countries.

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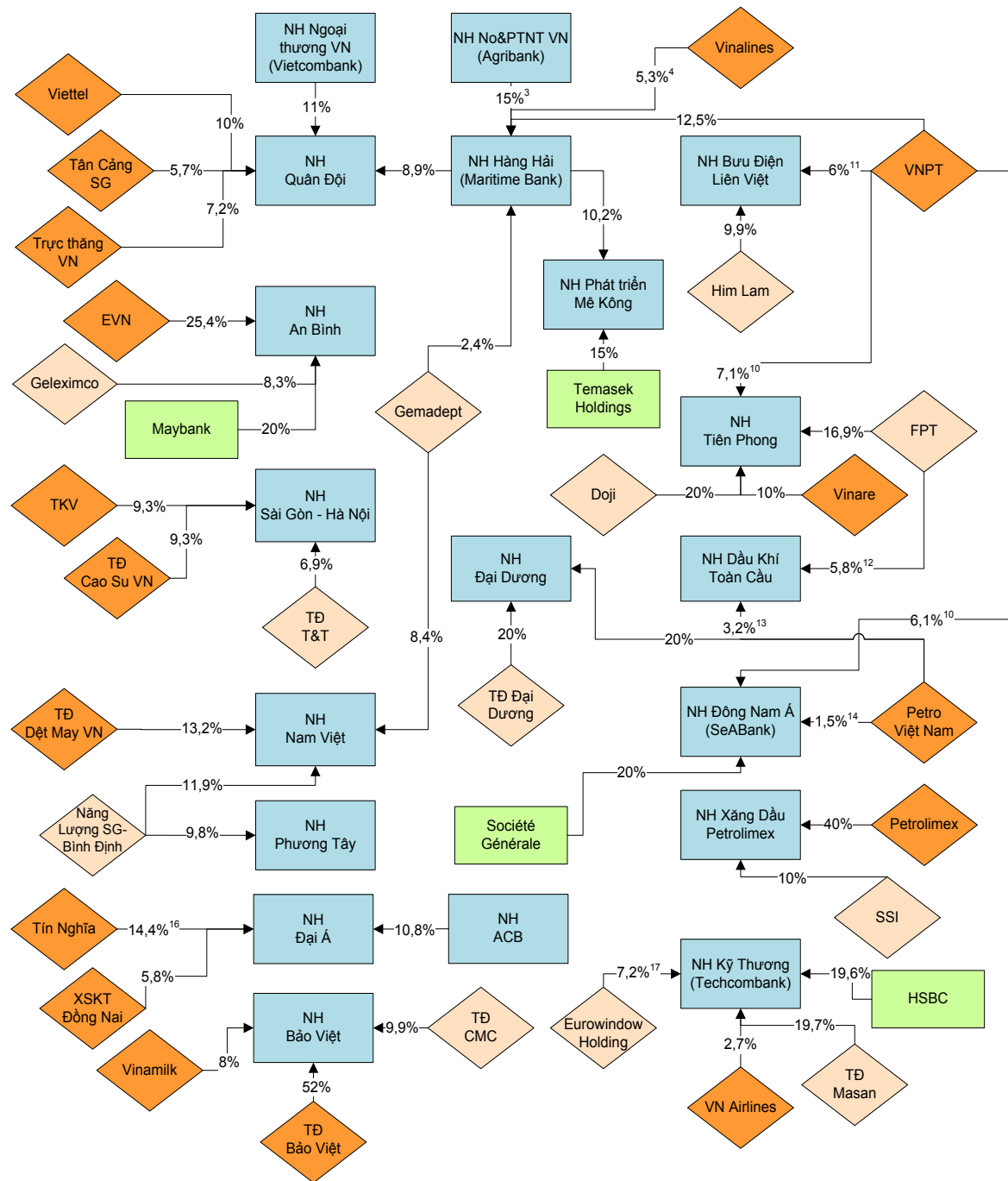
Appendix 1. List of SEGs and SGCs Under Direct Management of the Prime Minister⁴³

Vietnam Electricity Group (EVN)
Vietnam Oil and Gas Group (PVN)
The Vietnam National Coal - Mineral Industries Group (Vinacomin)
Vietnam Posts and Telecommunications Group (VNPT)
Vietnam Shipbuilding Industry Group (Vinashin)
Vietnam National Textile and Garment Group (Vinatex)
Vietnam Maritime Corporation (Vinalines)
Vietnam Aviation Corporation (Vietnam Airlines)
Vietnam Railways Corporation (VNR)
Vietnam Rubber Corporation (VRC)⁴⁴
Vietnam Cement Industry Corporation (Vicem)
Vietnam Steel Corporation (Vnsteel)
Vietnam Chemical Corporation (Vinachem)
Vietnam Northern Food Corporation (Vinafood 1)
Vietnam Southern Food Corporation (Vinafood 2)
Vietnam Coffee Corporation (Vinacafee)
Vietnam Paper Corporation (Vinapaco)
Vietnam National Tobacco Corporation (Vinataba)
State Capital Investment Corporation (SCIC)

⁴³ Government Decree 86/2006/NĐ-CP dated August 21, 2006.

⁴⁴ This corporation later became Vietnam Rubber Group (VRG).

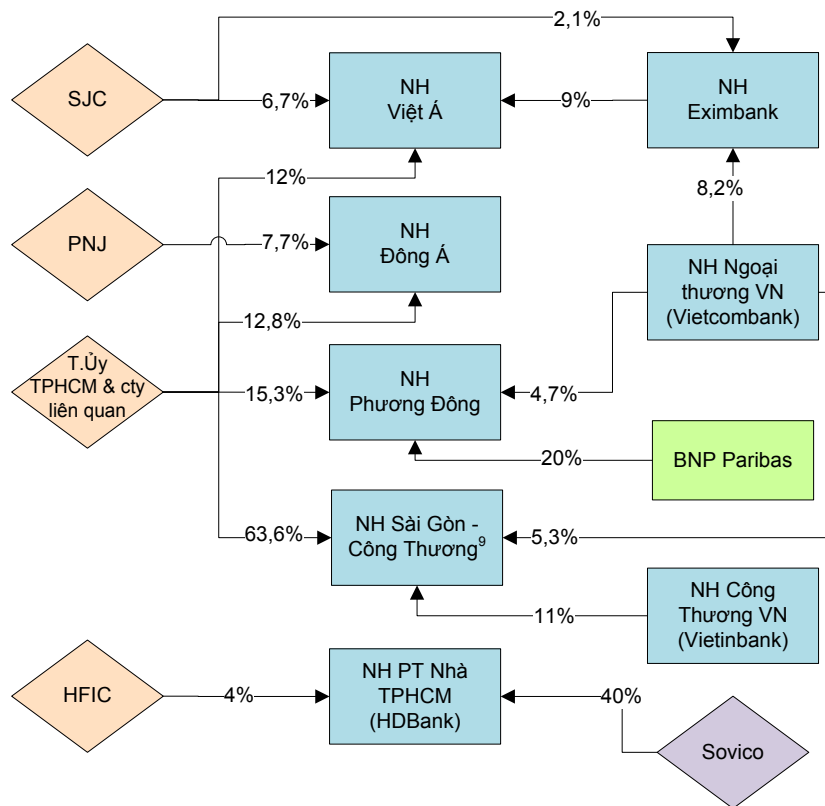
Appendix 2. Ownership Relationship Between SGCs/SEGs and Banks (May 2012)⁴⁵



Note: Orange boxes are SOEs

⁴⁵ Source: Vũ Thành et al. (2014).

Appendix 3: Bank Ownership of Ho Chi Minh City's Party Committee and People Committee (May 2012)⁴⁶



⁴⁶ Source: Vũ Thành et al. (2014).

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