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Competition Distortions Dossier

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A. TRADE POLICIES

1. Producers object to special tax for carbonated drinks

Member companies of the American Chamber of Commerce (AmCham) in Vietnam and experts recently expressed strong disapproval of a tax rate of 10 percent for carbonated soft drinks as proposed in the draft Law on Special Consumption Tax.

This is perceived as unfair to foreign investors because American enterprises accounted for 88 percent of the carbonated soft drinks market in Vietnam, and the tax rate is regarded as an act of discrimination if it comes into force.

As carbonated drinks are primarily produced by foreign firms while domestic manufacturers make non-carbonated beverages, the tax will place negative impacts on not only the foreign makers but also sugarcane growers, sugar plants and packaging firms and retailers. The special consumption tax on carbonated soft drinks would also affect consumers, employees and the economy.

http://english.thesaigontimes.vn/Home/business/trade/33782/Producers-object-to-special-tax-for-carbonated-drinks.html

Food for Thought

Despite the nationwide economic slowdown, the beverage industry has experienced steady growth rate in recent years and still remains rich in promise, reflected by the increase in the number of recent investments from major domestic and foreign enterprises. Statistics show that there are currently 134 foreign and domestic enterprises producing drinks in Vietnam and the whole industry accounts for 15 percent of Gross Domestic Product (GDP), due to its high rate of return on equity (ROE). What should be noted is that more competition from competitors does not do harm to domestic companies or domestic manufacturing but in fact, it is the momentum for their development. The Vietnamese beverage market is clearly divided into two important segments. Pepsi and Coca Cola are the two biggest foreign enterprises that dominate the market of carbonated drinks. At the same time, biggest producers of non-carbonated drinks are Vietnamese enterprises, such as Tan Hiep Phat with "Khong Do Green Tea" or "Number 1" brands.

In that context, the tax imposed on carbonated drinks could have a de facto discriminatory effect against foreign investors. If the draft Law is passed, many consequences could be foreseen. First, Foreign Direct Investment (FDI) into Vietnam is much likely to decrease because of foreign dissatisfaction with the regulation and in the longer term, the competitiveness of Vietnamese market would be much lowered compared to that of other countries. Second, the law would be misleading to consumers. Does it mean that consumers should turn to non-carbonated drinks of which the sugar level is equal to or higher than that of carbonated drinks? It should be noted that sugar is the main threat to human health by causing obesity, stomach and digestion problems. Third, the special consumption tax is indirect tax so higher price is ultimately borne by consumers, not producers. According to a statistics by the Vietnam Beer, Alcohol and Beverage Association (VBA), the price will increase by 12 to 13 percent per litre after being taxed. Finally, the tax will have immediate adverse consequences for sugarcane farmers, sugar mills and packaging firms as a decline in consumer demand will inevitably result in their losses.

Despite the fact that the increase in price of goods and services is inevitable in the long term, any sudden price fluctuation may cause an adverse effect on consumers, retailers

CONTENTS

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and even an entire industry. While the reasoning by State authorities is that the draft Law mostly aims to guide and orient consumers towards healthy choices, other alternatives should be considered. For instance, awareness-raising campaigns should be devised to inform consumers of healthy consumption habits, so that they can make their own purchase decisions. At the same time, before enacting any such law, the government is supposed to carry out a thorough analysis of the impact and implementation challenges of the proposed measure and involve all relevant stakeholders in the consultation process. In this specific case, the government must be cautious in imposing special consumption tax on general products, which are widely used by the public, so that not to cause massive effects.

2. Foreign retailers seek looser rules

Foreign business associations have urged the Government of Vietnam to loosen and make more transparent the economic needs test (ENT) that foreign retailers have to pass to establish their second and subsequent outlets.

With a population of nearly 90 million, rapid economic growth, and a youthful population eager to keep up with the latest trends, Vietnam is a potential gold mine for retailers, Hong Sun, Secretary General of the Korea Chamber of Business in Vietnam, told a consultation and dialogue held with businesses on ENT criteria in HCM City recently.

"But foreign distribution companies have not been able to fully penetrate the market due to the ENT process – an effective tool the Vietnam Government has used to control the development of foreign distribution networks in Vietnam," he said.

http://vietnamnews.vn/economy/253041/foreign-retailers-seek-looser-rules.html

Food for Thought

Despite not being clearly defined in the General Agreement on Trade in Services (GATS) of the World Trade Organisation (WTO), ENT is considered as a barrier to market access, under its Article XVI. According to the Organisation for Economic Cooperation and Development (OECD's) Working Party of the Trade Committee, an ENT can generally be characterised as a provision in national regulations, legislation or administrative guidelines imposing a test, which has the effect of restricting the entry of service suppliers, based on an assessment of "needs" in the domestic market. ENT is often applied on the premise that preventing FDI promotes small and medium-scale manufacturing to grow and gives greater room for innovation. Besides, ENT is also a safeguard against possible negative environmental and social impacts.

In the area of retail distribution, ENTs, which are designed to "safeguard" the retail sector in favour of domestic suppliers may have more or less distortive impact on trade. It can be seen that domestic companies' lack of competitiveness is often a justification to limit the participation of foreign suppliers in any sector of the market and the retail sector is no exception. However, everything has two sides. Foreign retailers have advantages in capital, management, logistics and prestigious brand names and if they are allowed to directly distribute on the market, they would be more competitive in the race to gain market shares. This not only poses challenges but also creates opportunities for domestic retailers to improve themselves. Being long-established on the local market, domestic retailers have better understanding of local consumer taste and market behaviour, an advantage, which foreign ones do not have. At the time, when Vietnam joined the WTO in 2007, there were certain concerns as to the flooding of foreign investors into the Vietnamese market and its consequences. However, due to ENT, the scale of change is still small and the development of the retail market does not correspond to its potential. Yet being a dynamic and populous country, Vietnam is still a promising market for retail development in the coming years. From January 11, 2015 Vietnam will have to allow the establishment of wholly foreign-owned retail businesses, which makes competition even fiercer on the local retail market.

All things considered, it is important to develop a well-functioning retail market and free and fair competition is one of the key contributing factors. It is inevitable that some fledgling domestic firms will be wiped out by foreign competition, but those companies, which continually adapt to stay competitive will have many chances to survive and prosper. One of the recommendations is that instead of competing with each other by unfair competition acts, such as selling products under production costs, local enterprises should establish links in order to support each other to overcome difficulties. It is also imperative on the part of the government to devise policies that support human resource development, brand building or application of modern management methods. Another solution is to encourage local enterprises to establish joint ventures with world leading retail corporations to open retail units in Vietnam, from which they can learn experiences, managerial skills and advanced technology.

B. INVESTMENT POLICIES

3. Investment certificates to be ditched

While the Ministry of Planning and Investment is keen to end the issuing of investment certificates for foreign-invested enterprises in order to further simplify business procedures, several investors have opposed the move.

The abolition of investment certificates represents another step in streamlining the administration of FDI. Minister for Planning and Investment Bui Quang Vinh told the first Vietnam Business Forum (VBF) dialogue held in

Ho Chi Minh City that the Ministry was committed to cutting paperwork to the minimum needed to manage the FDI sector effectively.

http://www.vir.com.vn/news/en/investing/investment-certificates-to-be-ditched.html

Food for Thought

Under the current Investment Law, foreign firms when making their first investment in Vietnam must submit an investment project proposal associated with the establishment of an economic entity. The investment certificate issued to the foreign investor is also regarded as the business registration certificate. Though the combination of the investment and business registration certificates is meant to simplify procedures for foreign investors, in reality it has caused a big headache for foreign investors because these two papers are vastly different in their legal natures.

While the amendments are thought of as an attempt on the part of the policy-makers to attract much-needed investment into the Vietnamese economy by supporting foreign investors, it also raised controversy as investors fear that it will limit their rights in certain procedures related to land allocation, construction and the environment. Meanwhile, it is also claimed that the government would have more difficulties in managing foreign investment projects. Hence, the amendments should be given a second thought to take into account of foreign investors' concerns. More importantly, so as to attract a steady flow of investment in Vietnam, the government should work out more comprehensive and consistent measures to ensure a favourable economic environment for foreign investors to work in Vietnam.

C. SECTORAL REFORM

4. Ministry urges power, fuel suppliers to be transparent

A Directive by the Ministry of Industry and Trade calls on Electricity of Vietnam (EVN) and the Vietnam National Petroleum Group (Petrolimex) to publish power and petroleum prices, besides salaries and bonuses for their staff members.

The Directive 11/CT-BCT dated April 22, 2014 is aimed at enhancing transparency in electricity and petroleum business activities.

Accordingly, EVN will have to publish electricity tariffs and list changes in input factors, production costs, average basic prices, and retail prices. The group will also have to publish audited financial reports, business results, and production costs, which should be clearly broken down into power generation, transmission, distribution, and retail.

In accordance with the directive, the Minister of Industry and Trade urged Petrolimex and other relevant agencies to publish petrol prices factors as soon as possible for defining prices along with the usage and management of the petrol stabilisation fund.

http://vietnamnews.vn/economy/254108/ministry-urges-power-fuel-suppliers-to-be-transparent.html

Food for Thought

The underlying reason behind heightening public outcry over recent price hikes may be a lack of transparency in the provision and distribution of essential goods, such as power and petrol. Specifically, consumers find it unconvincing that, when world prices go up, so do local prices, but when they go down, local prices are not adjusted accordingly. Or another issue is that firms always complain of losses but reveal profits in their financial reports, which causes great confusion among consumers.

Transparency is very important to promote a healthier economic environment. Consumers can exercise their right to information as to enterprises' trading activities, especially prices and pricing components. More transparency also tends to lead to a more accountable system. Enterprises of which steps easily followed by the citizens are expected to report and explain those steps and to be prepared to justify and assume responsibilities for possible misconducts. Furthermore, the public will also have an idea of how the market is regulated by relevant State authorities or whether the stabilisation fund is effectively operated.

With this Directive, there is no doubt that the government has taken a progressive step to bring greater transparency and accountability to public utilities operations. However, there is still much to be done given some limitations in the Directive itself. In fact, the handing over of control rights in the domestic fuel market from the Ministry of Finance (MOF) to the Ministry of Industry and Trade (MOIT) has raised some concerns as to whether Petrolimex, the country's largest wholesaler, will enjoy preferential treatments. It should be noted that MOIT is the governing body of Petrolimex. So the question is whether transparency could be obtained if the MOIT regulates fuel import and supply, and regulates prices at the same time.

To conclude, even though these concerns are valid to some extent, it takes time to ascertain the effectiveness of the Directive. Transparency is a long process which requires not only business efforts but also those of the government and the society at large. The government should come out with a better regulatory framework for the two industries so as to enhance transparency and accountability. Consumers themselves should also proactively engage in monitoring enterprises' activities and their compliance with relevant laws and regulations.

5. M&A in Vietnam's banking sector to catch fire in the current year

Vietnam's banking sector has seen a sharp uptick in mergers and acquisitions (M&A) as at least three banks have announced plans to merge.

Petrolimex Bank (PG Bank), 40 percent owned by Vietnam's top fuel importer and distributor Petrolimex, has drafted a plan to merge with VietinBank, the country's second-largest bank by assets, in a report sent to shareholders recently.

If shareholders approve the plan, PG Bank will be acquired by VietinBank but its organisational structure and name will remain the same.

http://thanhniennews.com/business/ma-in-vietnams-banking-sector-to-catch-fire-this-year-25308.html

Food for Thought

M&A is becoming a strategic choice for organisations in an increasingly competitive market. In fact, the restructuring process in the banking sector in Vietnam has entered the second phase, after the first phase with completed restructuring or merging of nine small-sized banks. The M&A trend announced by banks in the current context is consistent with the policy to restructure credit institutions in the second phase previously given by the State Bank of Vietnam (SBV). It is expected that 6-7 banks will be restructured in 2014, raising the total number of banks to be dissolved and withdrawn to about 7-10 banks.

It is observable that the M&A trend has new features this year. First, some joint-stock banks have been restructured to limit cross-ownership, typically the case of Sacombank merging with Southern Bank, and Maritime Bank merging with Mekong Development Bank. Second, big state-owned commercial banks, such as Vietcombank, Vietinbank are also putting forward M&A plans. Third, there could be unprecedented models of merger, that is a merged bank owning good services and substantial customer database will be able to keep its own brand name after merging.

It seems that State authorities are considering M&A as the optimal choice to deal with current problems of local banks. But the real effectiveness of M&A in each specific case should still be questioned. Would mergers of weak banks help to settle their bad debts or would acquisitions of weak banks by strong banks help them to become healthier? Another concern is that, even though these M&A may not do harm to the participating banks, they are much likely to negatively affect the heath of the whole banking system. There is no doubt that if the whole system is increasingly in the hands of a few State-owned commercial banks, competition problems may arise in the long run. Due to these banks' huge size and their direct influence on policies, it would be difficult for the government to monitor and control them. In addition, they would become too large to adapt to market changes, which is not good for the whole system.

In conclusion, it is essential that the government should come up with cautious approaches and measures to regulate M&A activities effectively and not to leave the playing field entirely to big State-owned giants. Hence, there should be a balance between the private sector, specifically strong joint-stock commercial banks and state-owned banks. Above all, mergers and acquisitions should be only considered as a temporary measure to deal with cross-ownership or bad debts in the short term. In the longer term, it is advisable that the government should think of other sustainable measures to restructure and reform the financial system of the country.

6. Drastic changes in store for the railway system

The Ministry of Transport has vowed to take drastic measures to restructure and improve the country's stagnant railway industry.

It is said that Vietnam Railways holds a monopoly over the sector, controlling both infrastructure and the business. Another expert said that Vietnam Railways is highly vulnerable to corruption, as they use the maintenance fund to award contracts to one of their subsidiaries without bidding and regardless of the cost. In addition, Vietnam Railways even allows unlicensed companies to rent their train cars.

http://thanhniennews.com/commentaries/railways-have-to-shape-up-or-ship-out-24119.html

http://english.vietnamnet.vn/fms/business/100447/business-in-brief-22-4.html

http://www.dtinews.vn/en/news/018/34107/drastic-changes-in-store-for-railway-system.html

Food for Thought

Not many changes have been witnessed, since the railway was first open for service in Vietnam more than 100 years ago. The railway sector now even lags behind other transportation sectors, such as aviation, road, etc. in terms of revenue, employment generation or reliability. There are many complaints regarding poor service quality or outdated infrastructure. Meanwhile, there are not many business plans for development in the sector.

In fact, monopoly and subsidy are the main issues to be blamed for the lack of development of the railway sector. The more the State subsidises the sector, the more it becomes old-fashioned and eventually it would contribute less to the whole economy. Meanwhile, the people, especially low-income

people, have no viable choice but to use the poor-quality service at high price. Therefore, it is high time that monopoly should be abandoned and privatisation is often said to be the quickest and most effective measure to bring changes. Given the economic context, partial privatisation could be explored, and there should be a clear and balanced division of role between the state and market forces. Some possible measures, such as introduction of competitive bidding or consumer/public consultation during the law drafting process could bring in reforms into the sector. However, to revive the Vietnamese railway industry, it is of utmost importance that the government should work out solutions to increase productivity, improve infrastructure and upgrade services.

D. COMPETITIVE NEUTRALITY

7. TPP creates drive for economic reform

The Trans-Pacific Partnership (TPP) Agreement would include a broader scope with higher requirements and greater impacts on economic institutions. Contents that have not been committed yet in WTO will be put into the TPP Agreement, such as public investment, governmental procurement, competition policy and State-owned enterprises, said former Minister of Trade Truong Dinh Tuyen.

According to Tuyen, the TPP Agreement would create drives for economic reform and be an opportunity for Vietnam to comprehensively establish market economy mechanisms, contributing to ensuring efficient allocation of resources.

Vietnam must develop its economic institutions towards strongly reforming State-owned enterprises (SOEs) and creating fair competition among enterprises when participating in the TPP Agreement. In addition, Vietnam needs to consistently implement the market price mechanism and eliminate all forms of subsidies that are inconsistent with WTO rules.

http://ven.vn/tpp-creates-economic-reform-engine_t221c197n48212.html

Food for Thought

A major content of the TPP negotiations is related to SOEs. This becomes a highly contentious issue for the reason that, in some countries, SOEs have been enjoying many privileges as compared to the private sector. Hence, it is thought by some parties, especially the US, that transparency is required to ensure fair competition among SOEs and the private sector. Transparency and fair competition will definitely make SOEs work more effectively and provide better goods and services to the public. On the other hand, it is argued that SOEs help to correct market failures by operating in some unprofitable sectors and regions, in which the private sector is not interested. In this case, fair competition would be considered an act of discrimination against SOEs. Some also think that countries should apply rules to enterprises based on their behaviours, and not type of ownership.

In the case of Vietnam, SOEs reform and equitisation have long been recognised as essential parts of the economic reform process. The country is featured by the high volume of SOEs, which form the main driving force of the national economy. Many SOEs hold dominant positions in their / markets or enjoy a monopoly in their respective industries, which is mainly due to the government links that these enterprises are privileged to have. This has paved the way for market distortions, such as subsidies or protectionist tariffs, information asymmetries or abuse of market power, which significantly favour large SOEs at the expense of the private sector development.

As Vietnam is integrating more into the world, the challenges of SOE reforms are becoming more urgent than ever. As a signatory party to the TPP agreement, Vietnam will be expected to provide for open and fair competition amongst domestic and foreign, State-owned and non-State market players and this in turn would give great momentum for a serious and efficient reform process in Vietnam. By addressing competitive distortions at their root, the reforms are much hoped to help competition prosper and ultimately has the effect of encouraging healthy business operations and increasing competitiveness, in the end benefits of consumers at large.

However, the WTO-plus rules of the TPP also constitute a big concern for Vietnam since SOEs and goods produced by SOEs could still receive subsidies from the government, under WTO law rather than being forced to cut subsidies as per the current TPP requirements. Another concern is that without state subsidy policy, Vietnam's products would be at a disadvantaged position as compared to those of other countries.

Despite existing concerns, Vietnam's entry into free trade agreements, such as the TPP is inevitable in the context of global and regional integration and SOE reform should be a significant part of it.

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30 1983 2012 CUTS International

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