Briefing Paper

Trade in Services and Telecommunications in Vietnam: challenges and opportunities*

Background

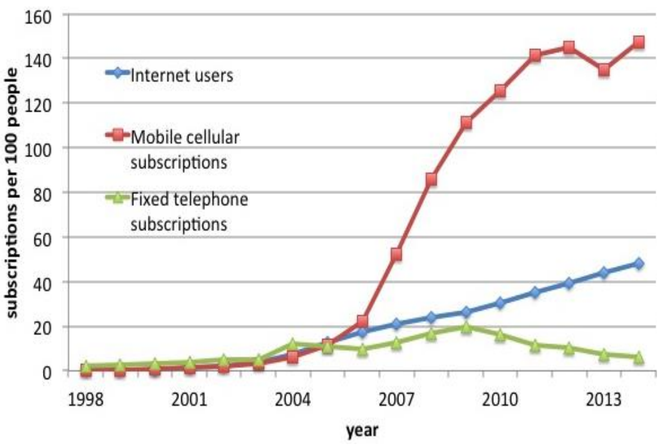
Developing the services sector is increasingly a crucial component of developing countries' economic strategies, with the telecommunications sector experiencing spectacular growth rates over the past two decades. Moreover, small and medium sized enterprises, which are crucial to the inclusiveness of economic growth, benefit from the availability of telecommunications services. Thus, the latter's development has become a key priority on the political and economic agendas of developing countries.

Vietnam began liberalizing its planned economy through the Doi Moi (reformation) framework beginning in 1986 and aiming at the establishment of a "socialist-oriented market economy". Over the past two decades monopolies have been dismantled, market access has been liberalized and the economy as a whole has been integrated in the multilateral trade systems. Yet, the government of Vietnam (GoV) continuously relies on State Owned Enterprises (SOEs) in strategically important market positions.

In the telecommunications sector economic reform has translated into strong economic growth and increased consumer welfare. As depicted in *figure 1* Mobile phone subscriptions have grown from 1 per 100 people in 2000 to 147 per 100 people in 2014. Simultaneously, service availability has increased through a greater variety of offers at lower prices.

Inward FDI via mode 3 offers significant potential for contributing to the sector's development, through technology transfer, additional financial funds and upwards pressure on the sector's productivity. Yet, it has played only a marginal role in the development of Vietnam's telecommunications sector so far. Exports and imports in telecommunications represented roughly 2% and 0.5% of total trade in services figures in 2005 and 2011 respectively.

Figure 1: Telecommunications penetration



Source: Author's depiction of data as derived from World Bank. http://data.worldbank.org

The research paper on which this Briefing Paper is based examines Vietnam's telecommunications sector. It reviews the sector's market structure and legal framework, before turning to consider challenges and opportunities for the future. Selected recommendations for Vietnam are provided in conclusion, which may also prove of interest to other developing countries seeking to strengthen their telecommunications sector.

Current Market Structure

Initial liberalization reforms in the 1990's transformed the telecommunications' monopolistic markets into oligopolistic ones. While the Vietnam Post and Telecommunications General Corporation (VNPT) initially remained in its role as a state-owned monopoly in the telecommunications sector, two newly formed State Operating Enterprises (SOEs) – the Military Electronic and Telecommunication Company (VIETTEL) and Saigon Post and Communication (SPT) - were licensed in 1995. Thus, competition in the telecommunications sector increased but remained exclusively between SOEs.

The trend of liberalization through the licensing of new market participants gradually faded out as Vietnam's WTO-accession was approaching and finally concluded in 2007. The government felt that domestic SOEs might not be able to compete with more efficient global players, which were expected to access the market as a result of the WTO-accession. Consequently the GoV reinforced the economic weight of SOEs through the concentration of various SOEs to even larger State Economic Groups (SEGs). In the telecommunications sector, where two of the first SEGs were established (i.e. VNPT and VIETTEL), the SEG's nominal asset value tripled from 2001 to 2010.

While today's telecommunications market regarded as a whole is dominated by VNPT with a market share of 95%, the degree of competition varies across market segments. The mobile phone services and the rapidly developing 3G services segments are the most competitive ones with market shares of 31.78%, 17.45% and 43.38% for MobiFone, VinaPhone and VIETTEL (all of them state-owned) respectively in 2014. The high degree of competition stems from the fact that VNPT operates with two competing brands, i.e. MobiFone and VinaPhone, and from VIETTEL's strong presence in the segment. The GoV's plan to separate MobiFone from its parent company, VNPT, is likely to further increase competition in these segments in the future.

The remaining market segments are characterized by the dominant position of VNPT, which holds 76.5% in fixed line telephone services and 56.6% in internet service provisions.

As these statistics show, domestic and foreign private actors play only a very marginal role in the telecommunications sector. In fact, foreign firms, such as Comvik (Sweden), SK Telecom (South Korea) and Vimpel Com (Russia) withdrew from the market after incurring financial losses. This illustrates a paradox faced by foreign market participants, i.e. their inability to compete with domestic SOEs despite being internationally competitive elsewhere.

Legal Framework

Development of trade in services is highly dependent on the regulatory and legal framework guiding economic activity in the market. For trade in services to flourish, a stable legal environment is required, one that encourages private (domestic and foreign) investment, guarantees a reasonable degree of competition between market participants, and integrates the domestic economy with the global.

Considering the crucial importance of the development of the telecommunications sector for Vietnam's socio-economic development, the GoV controls the entry of market participants through a licensing regime. Since 2002, private domestic corporations can legally obtain a license as a Service-Based Operator (SBO), while only SOEs are granted licenses as Facility Based Operators (FBOs).[1] Additionally, the 2009 Law on Telecommunications established a *Telecom Business Service Licensing* regime. However, by distinguishing between basic services and value-added services without further definition of these categories or procedures, it rather adds confusion to the current licensing regime.

Prior to joining the WTO, foreign investors' only means to invest in domestic service telecommunications companies were Business Cooperation Contracts (BCCs). Under BCCs, earnings are shared between domestic partners and foreign investors while the latter are excluded from direct equity participation and management control. While BCCs still exist today, other possibilities for FDI have been gradually introduced.

The Vietnam Investment Law (VIL), implemented in 2006, harmonizes previous legal sources that regulated private businesses, SOEs, domestic investment and foreign investment separately. In order to make these investment regulations consistent with their WTO

[1] A facilities-based operator (FBO) is a telecommunications service provider owning, as opposed to leasing, networks used to provide telecommunications services.

commitments, the principal of *non-discriminatory treatment* of private investors as well as exceptions to this principle in the form of lists (that either restrict or prohibit FDI in particular sectors) were introduced. Concerning telecommunications, the GoV's strategy was to promote partial opening of the sector. Similarly, in line with their GATS commitments, different limits on foreign capital participation are imposed on investments in FBOs and on non-FBOs. As of 2010, foreign ownership could not exceed 65% in non-FBOs and 49% in the case of FBOs.

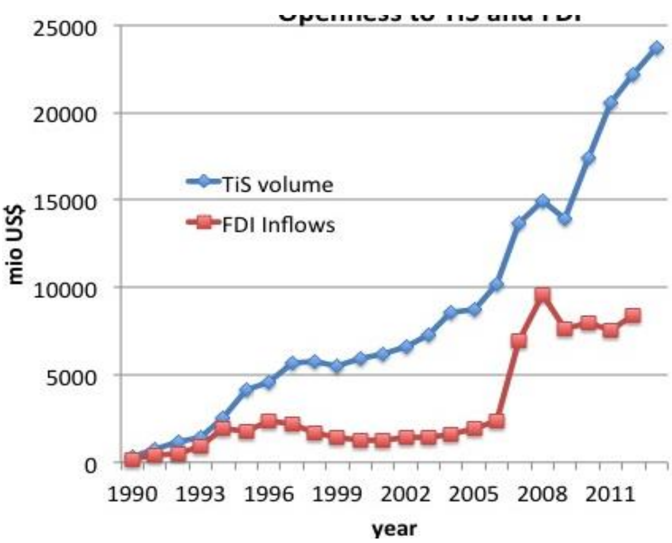
Integration in Multilateral Trade Agreements

Vietnam is a member of the WTO and ASEAN and is a signatory country of the recently concluded Trans Pacific Partnership (TPP) agreement. Various Free Trade Agreements (FTAs) have furthered Vietnam's economic integration in regional and world trade.

Figure 2 illustrates the development of net FDI inflows and of trade in services volume. These growth rates point to increasing engagement with the global economy. Both series indicate a strongly positive overall trend during the reform period, suggesting a steady integration in the multilateral trading system since the beginning of the 1990's. The crucial role of Vietnam joining the WTO in 2007, resulting in the reduction of barriers to trade and investment is depicted by surges in FDI inflows and in the trade in services volume in the subsequent years. Although trade in services volume has grown from 308m USD in 1990 to 23700m USD in 2013, corresponding to an annual average growth rate of 19.8%, only a minor share of this growth can be attributed to the telecommunications sector, which is still under strong government control. Similarly, most of the FDI inflows were directed to the manufacturing sector.

As highlighted by the World Bank's Services Trade Restrictions Index (STRI), there is scope for further opening of Vietnam's telecommunications sector; reforms which could help the sector realize its full potential. Like most South East Asian countries, Vietnam scored 50 in the STRI, corresponding to "significant trade restrictions" compared to the scores of 0-25, i.e. "open" to "virtually open" for most high-income OECD countries.

Figure 2: Openness to Trade in Services



Source: Author's depiction of data as derived from World Bank (http://data.worldbank.org/).

Competition Policy

While a competition-based market structure is not a prerequisite for trade in services, it facilitates the integration of the domestic economy into multilateral trading systems by increasing its productivity, encouraging private sector participation, and creating a business friendly environment for foreign investors. In Vietnam, competition policy, which was nonexistent in the completely state-controlled market in 1986, has been gradually developed into a comprehensive legal framework.

Today, the Competition Law (VCL), a general law passed in 2004, and the Law on Telecommunications (LoT), a telecommunications-specific law passed in 2009, guide competition matters in the sector. Together, they have created new institutional structures (e.g. the regulator TSMA) for investigation and law-enforcement purposes, define relevant notions, such as *significant market power* or *abusive actions* and introduce general market principles.

The principle of *interconnection* obliges FBOs to grant other telecommunications providers access to their network against a leasing fee and without discrimination. Moreover, dominant market players engaging in abusive behavior, such as competition restricting economic concentrations or agreements on prices, can be heavily sanctioned. In practice however, the powers granted by the relevant regulations have not been utilized in such a manner.

Challenges and Opportunities

Throughout the reform period, the GoV maintained its firm grip on SOEs in strategic positions, the rationale being that these SOEs serve as a steering tool for the country's socio-economic development. This has resulted in a number of challenges. At the same time, recent moves raise the possibility of increased future opportunities.

SOE dominance: Competitive advantages, discrimination, and political influence

SOEs fulfill a business as well as social function; they have both a governmental mandate to guarantee the provision of basic services or infrastructure and a commercial role of generating profits. Unlike regular corporations, SOEs often operate under *soft budget constraints*, meaning that the government fills the financial gap in case of financial distress. Furthermore, preferential treatment, such as access to credits at below-market prices, favorable tax regimes, exemptions from bankruptcy rules, and information asymmetries can lead to competitive advantages over private market participants.

The reduction of costs through preferential treatment of SOEs, such as the FBOs in Vietnam, results in fierce price competition between SOEs in the telecommunications market. However, this price reduction largely derives from government support and not productivity increases.

Control over basic infrastructure adds additional weight to the economic and political dominance of FBOs, inducing them to repeated abuses of power:

Example 1: Interconnection disputes

In 2004 an agreement between VIETTEL, an SOE run by the Vietnamese military, and VNPT, the dominant telecommunications FBO, granted VIETTEL access to VNPT's network in exchange for a leasing fee. Subsequently, VIETTEL complained about connection jams, leading to client dissatisfaction and difficulties in competing with VNPT. In the unfolding dispute, VIETTEL proved that VNPT could indeed provide more ports, while VNPT insisted on technical difficulties in its network being responsible for the interconnection jams.

A similar case has been reported between EVN Telecom and VNPT in the early 2000s

As the example illustrates, FBOs have an economic incentive to violate their legal obligation of granting access to all service providers in order to preserve their dominant market positions.

A study of the Global Economic Governance Programme (University of Oxford) casts doubt on the assumption that joining the WTO in 2007 led the GoV to accelerate privatization in the telecommunications sector. It argues rather that the GoV countered the perceived threat of more efficient global players accessing the domestic market by merging SOEs into State Economic Groups (SEGs) of even greater economic weight and importance for economic steering. These SEGs were then utilized to pursue diversification strategies into fields unrelated to their core businesses, such as real estate, finance and banking (GEG 2014). The potential for similar measures to be deployed alongside future rounds of reform remains a possibility.

Legal framework: Structure of regulators and policy makers

Example 2:

VIETTEL, Mobifone and Vinaphone, all run by SOEs, simultaneously increased their monthly 3G subscription fee by 20% and their fee for unlimited packages by 40%. In spite of its resemblance to a competition-violating price agreement, the price increase was not considered detrimental to competition by the Vietnam Competition Authority (VCA).

Although a comprehensive legal framework to promote competition in the telecommunications sector exists, its application produces equivocal decisions, illustrated by example 2. As noted in the GEG study (2014), only one SOE has ever been sanctioned under the Law of Competition since its establishment in 2005.

A possible underlying reason for this flaw is the Ministry of Information and Communications' (MIC) *dual capacity*, which attributes to the MIC the roles of both a stakeholder and sector regulator. Under the LoT, a new Telecommunications Specialized Management Agency (TSMA) was put under the control of the MIC, leaving the MIC's *dual capacity* unchanged. This organizational structure makes the application of competition policy prone to favoring SOEs in legal disputes.

Trade agreements: TPP as an example

The TPP aims, amongst other things, at fostering trade in services between signatory countries. Chapters that are specifically dedicated to SOEs reform, competition policy, and the telecommunications sector require signatory countries to guarantee competition between private market participants and SOEs on more equal terms. Although it remains unclear how the GoV will harmonize these commitments with current market conditions, Vietnam's participation in TPP may lead to further liberalization in the telecommunications sector, including the reduction and/or elimination of limits on foreign capital participation.

Recommendations

As this analysis shows, liberalizing a centrally planned economy is a dynamic process that depends on both internal and external factors. Internally, the pace of liberalization is accelerated by increasing consumer demands and slowed down by the persistence of vested interests between political and economic elites, leading to only partial reform. As for external factors, trade agreements stimulate both incentives and resistance among the political elite, thus having a mixed overall effect. How can these external and internal factors be leveraged to boost services trade in the telecommunications sector?

SOE reform: creating an even playing field

Liberalization of the state-owned sector in telecommunications has to take into account a trade-off between higher productivity and consumer welfare on the one hand, and secure employment conditions and a stable telecommunications infrastructure on the other. In order to reconcile these opposing effects on Vietnam's economic development, the World Bank suggests the GoV adopt a pro-cyclical restructuring strategy to preclude mass lay-offs and to maintain a certain level of state-presence in SOEs in strategic positions (i.e. FBOs) in order to guarantee stable infrastructure.

More precisely, the World Bank outlines key aspects of successful SOE reform in the case of Vietnam. Commercial SOEs (i.e. non-FBOs) should be equitized and opened for private investment, while infrastructure-providing SOEs should undergo restructuring through the implementation of market economy elements, such as hard budget constraints or financial incentives and financial accountability for SOE managers. They proposed increased transparency and improved commercial governance to counter anti-competitive behavior (i.e. interconnection and licensing issues) by market incumbents. Where privatization is not feasible or desirable, public-private joint ventures are a means to strengthen the private sector. Through this approach, they guarantee provision of infrastructure while opening up room for private investment. The GoV's decision in 2014 to privatize MobiFone, a commercial provider in the mobile phone segment, can thus be interpreted as a signal consistent to the reform path encouraged by the World Bank.

Allowing foreign participation in Vietnam's telecommunications sector could prove helpful to the further development of the sector. In particular, FDI into existing operators has the potential to help catalyze technology transfers and related efficiency gains. Following their WTO accession in 2007, Vietnam experienced a surge in FDI from $2.4 bn. to $9.6 bn. However, foreign investors' reluctance to invest in the Vietnamese market persists due to imprecise definitions in the licensing scheme of private sector participants. Therefore, clear definitions and guidelines, e.g. for foreign investors who want to convert BCC-contracts into new licenses introduced by the LOT, will be required to reduce investment uncertainty and to encourage FDI.

As noted above, Vietnam's participation in the recently concluded TPP is likely to help spur some of the above reforms.

Regulator Independence & Capacity

Although Vietnam's regulatory framework in terms of competition policy has made remarkable achievements, competition in the telecommunications market would certainly benefit from a government-independent regulator. The fact that FBOs and the regulator TSMA are placed under government and ministry control respectively, engenders doubts regarding the regulator's impartiality. Thus, the TSMA should be separated from the ministry responsible for policy/decision-making, i.e. the MIC. A more independent TSMA could coordinate and support the VCA and the VCL in investigations and enforcement, thereby increasing the quality of their work. The suggested structure would make the regulatory system less prone to abuse of dominant positions through anti-competitive behavior, e.g. opposing the licensing of new competitors and deliberately limiting interconnectivity.

At the same time, being outside government proper, TSMA would require support to bolster its capacity, notably for personnel at the entry level. Hence capacity building initiatives would need to be taken in order to create a pool of skilled graduates from which the TSMA would be able to recruit in the future.

References

All references for sources mentioned can be found in the original research paper: Pham A. (2015). 'The Vietnam Telecommunication Sector: Good Practices in Regulatory Reform in Relation to Competition Policy & Law Issues'. Toronto, Geneva and Brighton: ILEAP, CUTS International Geneva and CARIS

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