Better Investment Climate for Everybody

Financial Service and Infrastructure

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The policy to encourage private persons to invest in the infrastructure building projects is hard to be carried out when the privatization is slow and credit for state-owned companies tends to increase. State-owned companies with financial support from the Government still control the banking sector and infrastructure projects, which leads to worrying waste and corruption. All of these problems must be solved in 2005 with great efforts from the Government if it is determined to create a "better investment climate for everybody."

1. Why is the relation between finance and infrastructure stressed?

In its latest annual report, the WB advises governments to pay more attention to the relation between finance and infrastructure when making economic policies. Meanwhile, the Vietnam Sponsors Conference in Hà Nội suggested encouraging private persons to invest in the infrastructure. This suggestion received favorable responses from the Government. In his visit to Vietnam in late 2004, Professor Joseph Stiglitz, the 2001 Nobel- prize winner, advised the Government to help local companies and peasants to get access to banking and financial services, otherwise the international integration only brings benefits to certain groups.

Good infrastructure could link companies with customers and suppliers. It also helps suppliers cut production cost and apply new techniques. Better road networks in rural areas will not only allow companies to distribute their goods and services, but also increase the number of pupils and students. Good infrastructure and road networks provide companies with more opportunities to buy raw materials directly from peasants and reduce exploitation by monopolies.

A well-managed finance market will serve as a bridge between companies and potential lenders and investors. Directly or indirectly, well-managed finance markets could help reduce the poverty and differences in income, thereby removing barriers to credit sources and providing more investing opportunities for the poor. In addition, improvements in the finance markets could help the poor deal with difficulties, ensure better education for their children and upgrade their housing conditions.

Shortcomings in the financial sector and infrastructure will prevent companies from taking investing opportunities. They are also main causes of increasing costs and risks for companies. These shortcomings will keep companies from engaging in commodity and finance markets, cause damage to creative dynamics and productivity. This is the biggest problem that faces such developing countries as Vietnam in their integration process.

This is a "new awareness" of improvements in the investment climate in the relation between finance and infrastructure. The Government should create a better investment climate for everybody, not for companies only. Companies referred here include all kinds of enterprises, from the big and influential ones to small and medium ones, from foreign-invested to state-owned ones, and private ones. All of them are important to the community. Moreover, they serve the good of the whole community, not only their interests.

2. New approaches to the finance and infrastructure

Countries all over the world have learnt a lot from the past. According to the WB, governments should take new approaches to the finance and infrastructure. They relate to five key factors:

- Ensuring stability at macroeconomic level.
- Encouraging the fair competition.
- Ensuring rights of borrowers, lenders and shareholders.
- Facilitating sources of information.
- Saving banks from too serious risks.

Let's examine these factors in Vietnam. But first of all, we should review failures of this approach. They could be seen as the first lessons the Government should learn when encouraging the private sector to engage in infrastructure projects and opening the finance market.

Due to new knowledge of these key factors, many governments are making efforts to encourage the competition between suppliers of financial services and contractors of infrastructure projects. Governments accept the exchange of interests received for failures of the market that mainly come from asymmetric information and failures of government themselves. These failures are:

(1) Failures of the market

- Failure to repay debts: If financial institutions could estimate exactly the borrowers' ability to repay debts, they could work out the risk degree and interest rate equal to this repayment risk.

- High lending rate: Companies always promise to repay debt. And there is always a risk from this promise. With asymmetric information, the lenders have only a limited knowledge of the borrowers. Therefore, a high interest rate isn't enough to protect the lenders and they tend to require a higher rate, which discourage honest borrowers.

- Risks in the finance market: Projects with high degrees of risk only attract borrowers with low creditworthiness. They consider the projects as a gamble.

(2) Failures of governments

- High costs: Private investment in infrastructure projects, such as ones to build roads or supply power in remote areas, requires high costs that become burdens to local residents. After many conflicts caused by the Government's caution about the private investment in the infrastructure projects, foreign donors, after examinations of depressed and remote areas, have felt sympathy for this policy. This means that, to a certain extent, government interventions in these projects under some conditions are necessary.

- New inequality: Competition for infrastructure project is not always good. In the power supply for example, only companies in cities could enjoy this service while poor peasants in rural areas couldn't. Thus, the competition for the supply of better infrastructure could lead to new inequality.

- The public fund is limited while the private sector is reluctant to make investment: If we link these two facts, we could see that the new approach to the finance and infrastructure requires Vietnam to allow more private investment in these sectors. To secure capital for fields that require huge investment and long payback, the Government couldn't rely on the public fund. And it couldn't rely on investment from individuals too. That is why the Government should open the finance market and remove monopoly in the banking service in order to help private investors get access to bank credits. This is the only way to lift restraints and barriers to sources of finance for all sectors. And it is also the only way to establish a close relation between the finance and infrastructure in an effort to gain the sustainable development.

3. No encouragement to the private investment in infrastructure projects

Due to the fear of failures of the market and the Government to encourage the private investment in the infrastructure, there appear many cautious views that we must share in various approaches. However, the encouragement to the private investment is a must. The problem is how to encourage reasonably this source of finance. The situation originates from the fact that besides the economic stability appreciated by the international community, Vietnam has to solve a lot of problems in the coming years to improve the finance market and infrastructure building, thereby creating a better investment climate for everybody.

Infrastructure requires huge investment: All estimates affirm that investment in the infrastructure is enormous. The power supply service, for example, needs some US$2 billion a year. In the year 2005-2010, HCMC alone requires the same fund to develop the water supply. The system of sea ports needs US$1.86 billion, railroad 1.5 billion and national routes 8.71 billion. Sea ports are so few but very important to Southern provinces. If they are not built now, the demand for transport of exports by 2007 will be never met.

Meanwhile, many donors remark that the ODA source will reduce drastically and last for only 10 years more while Vietnam couldn't rely totally on the public fund.

Private investment has never been encouraged: Both foreign and local investors have complained that there is no open legal infrastructure for the participation of the private sector in important fields, such as infrastructure building. Decrees on BOT projects issued in 1993 have become obsolete and seen no amendments. Besides the Phú Mỹ Power Plant that attracted some investors, most other infrastructure projects in HCMC and Vũng Tàu have all ended in failure. No private investors appear in communications building projects.

4. Monopoly and discrimination in the finance market

Limited bank credit for the private sector: Total credit for the private sector in recent years has increased but it only equaled some 25% of the GDP. Strange to say, the credit supplied to state-owned companies didn't decrease while the number of them reduced because of the privatization program. Moreover, it showed an upward tendency, from VND89,300 billion in 2003 to 92,300 billion in 2004.

The policy to encourage private investment in the infrastructure seems infeasible when the privatization program is carried out too slowly and more credit is supplied to the public sector. The credit for the private sector didn't increase as fast as the growth rate of this sector in the past few years. This means that few private companies could be financially strong enough to invest in the infrastructure projects.

Discrimination in legal matters: The private companies, especially small and medium enterprises, are of the opinion that the banking system is not responsive to their demand. Legal infrastructure and absolute and open support given by the Government to state-owned companies have prevented private companies from securing bank loans.

When the Government tries to remove these barriers to official sources of credit, other forms of prejudice still exist, especially in policies adopted by both state-owned and joint stock commercial banks on the supply of loans to the private sector. For example, all banks are now allowed to supply fiduciary loans to private companies but this could only be done on the condition that the company should make profit in the last two years. This unnecessary regulation prevents private companies, especially newly founded ones from securing bank loans. In addition, bank managers are reluctant to supply credit to private companies because of repayment risk that they are free from when doing business with state-owned companies.

Poor competition, transparency and inspection of the banking system: The system of state-owned banks has suffered poor management, corruption and complicated procedures for ensuring repayment. In addition, their monopolist position not only hinders the private sector but also destroy the finance market. The fact that the stock exchange failed to develop in the past few years also originated from this monopolist position.

The competition between banks is very poor. Foreign investors are prevented from entering into the banking sector. Current regulations only allow the formation of joint-venture banks, foreign-invested non-banking institutions and branches of foreign banks. Foreign investors are not allowed to buy shares from local banks. At present, there are some 30 foreign banks in Vietnam but they are limited to a few operations. Paradoxically, foreign insurance companies are allowed to attract premiums in the VND while foreign banks are prevented from opening accounts in the VND. Some 53 rep offices of foreign in Vietnam today are only allowed to work as agents for foreign banks and prevented from supplying any banking services.

These problems, if not be solved in 2005, will become great obstacles to local companies when Vietnam joins the WTO.

5. Some solutions

- Actively encouraging the private in vestment in infrastructure projects: At present, there are two different opinions about the role of private investment in infrastructure projects. Foreign investors argue that the private investment could help reduce service fee, especially in telecommunications. On the other hand, many government officials maintain that the private investment in infrastructure, such as in the power supply service, will lead to higher prices, which causes bad effects on the poor. Anyway, the common trend in the world is to support the private investment in infrastructure. In my opinion, the public tends to share this opinion but many things must be taken into consideration before carrying out this policy (administrative procedures, auditing in state-owned infrastructure developing companies, amendments to the BOT regulations, etc.)

- Encouraging non-banking institutions to invest in infrastructure projects: The insurance industry seems to act as an intermediary between long-term sources of finance and the banking system. However, many signs show that the source of finance mobilized by insurance companies was put in real estate, which could lead to increasing prices in this market. In addition, we could see that flows of capital between sectors of the financial system is not strictly controlled, which make this system fail to meet different needs of the economy, including infrastructure projects.

The Government had better inspect regularly the mobilization of capital carried out by both banking and non-banking institutions with a view to orienting it towards major projects, and encourage non-banking institutions to investment in the infrastructure projects by offering tax incentives.

- Separating concessionary credit supply from commercial banks: In recent years, the task of supplying concessionary credit to social programs has been separated from state-owned commercial banks and transferred to specialized ones, such as Bank for Social Policies and Fund for Development Support (FDS). By doing so, the Government has moved risks from commercial banks to other institutions. However, these institutions gain only poor performance, such as the program to develop the deep-sea fishing carried out by the FDS for example. The Government had better revise the organization of these institutions with a view to ensuring a better performance for them.

- Privatization of state-owned commercial banks: To improve the competition in the banking system, the SBV has agreed to privatize the VCB in a pilot scheme by allowing foreign banks to buy VCB shares. This program not only improves the competitiveness of the system but also increases the source of capital. According to a rough estimate, four state-owned commercial banks need VND117 billion more to obtain the capital safety rate of 8% as recommended by international practices. Urgent measures to carry out now are:

+ The privatization must be completed in 2005 at any price. This requires the determination from the Government and SBV.

+ In preparation for the privatization, an international auditing company could be invited to review all books and statements of the VCB.

+ The SBV must find a reliable partner for the VCB. This partner will be a strategic investor in the privatization of all state-owned commercial banks. According to the UNDP, as long as these banks are still under the Government control, there will be conflict between state-owned companies – major customers of these banks- and cautious regulations imposed on these banks. These regulations prevent all investors from securing long-term loans needed for infrastructure projects.

6. Conclusion

The policy to encourage the private investment in infrastructure projects could hardly be carried out when the privatization of state-owned companies is realized too slowly and the volume of credit supplied to the public sector is on the increase. The monopoly in the supply of banking services and infrastructure building is leading to waste and corruption. The Government should be determined to solve these problems in 2005 if it wants to ensure a better investment climate for everybody.■