The Economist

State capitalism in Vietnam

Blowing in the trade winds

Will an American-led trade deal aid Vietnamese reformers?

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BY SOME measures, Vietnam's economy is moving at a brisk clip. The double-digit inflation that prevailed in 2011 has subsided, and exports of textiles and electronics are booming. Foreign direct investment is up by 36% year-on-year, according to Fitch, a ratings agency.

Yet GDP growth is rumbling along slowly: just 5% last year, the slowest pace since 1999. The trouble stems in large part from the ruling Communist Party's failure to discipline state-owned enterprises (SOEs) and clean up the bad debts lurking in the banks. As in neighbouring China, party bigwigs and their chums are loth to tamper with a status quo that serves their interests well.

Yet the government's legitimacy hinges on making life better for the country's 90m people. In recent months, officials have started to plan substantial economic reforms. Encouraging signs include an April resolution by the party's Politburo that made economic integration its top priority, and recent debates among Vietnamese lawmakers over how to "equitise", or partially privatise, SOEs. Nguyen Tan Dung, the prime minister, also pledged in September to treat the country's 1,300 SOEs like private companies and raise from 30% to 49% the share in any local bank that foreign investors may own.

One Western diplomat says the question now isn't whether real reform will happen, but how fast. If that is true, the pace of change may depend on the fine print of the Trans-Pacific Partnership (TPP), a planned American-led free-trade agreement among a dozen countries. TPP would, among other things, require its members to curb the excesses of SOEs.

TPP's focus on SOEs has provided political cover for reform-minded Vietnamese legislators to pursue their agenda, says Phung Duc Tung, an economist. Just how far they will get is an open question, but Mr Tung thinks privatising most SOEs would boost the economy and lay the foundations for a better corporate tax base.

SOEs, which account for 40% of economic output, are dangerously entwined with state-run banks—the same lenders that financed the SOEs' high-risk expansion into property during the boom that accompanied Vietnam's 2007 accession to the WTO. The failure of some of those investments forced a downgrade of Vietnam's sovereign debt and left the property market in tatters.

Today the SOEs are actively "restructuring", says the state-controlled press. No one expects a repeat of their massive credit binges. Yet the SOEs remain inefficient; some are so saddled with debts that they cannot afford to pay their employees.

None of this bodes well for the hundreds of thousands of young people wading into Vietnam's anaemic job market, much less those who are fed up with corruption and rising inequality. Combined with widespread frustration over education, health-care and land-tenure policies, such issues could some day fuel an explosion of social unrest.

Meanwhile, American trade negotiators are itching to close the TPP negotiations. The attraction for Vietnam is better access to the American market for some of its labour-intensive industries such as clothes and shoes. But the American ambassador to Vietnam, David Shear, has said the country needs to show "demonstrable progress" on human rights to help kindle support for TPP in America. In this respect it did not help that Vietnam this month jailed Le Quoc Quan, a human-rights lawyer, on spurious charges of tax evasion. In spite of that, it is likely both sides will sign the agreement some time next year.

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