Talking Points

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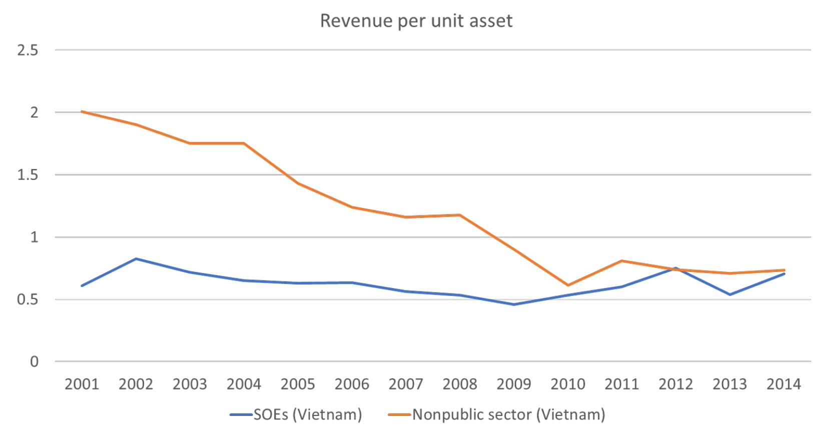
1. Competitive pressures are weak across the ECA region, but especially in the FSU countries. On the OECD-WB Product Market Regulation (PMR) rankings – Belarus, Russia, Turkey, Kazakhstan, Bulgaria, Romania are among the bottom performers. Many others too would have made the list had they been covered by this methodology.
2. A variety of proxy reasons:
    i. These were all part of a central planning system – a lasting legacy of which is the heavy presence of SOEs
    ii. Botched privatizations yielded powerful oligarchs – most notably in Russia and Ukraine.
    iii. The principle of competitive neutrality has been a casualty in the presence of influential incumbents.
    iv. There are major issues with public procurement, with widespread preferences given to domestic firms and SOEs.
    v. Market institutions that have to do with business regulations, contract enforcement, property rights are still in formative stages in many countries. Too much discretion remains in the hands powerful bureaucrats, which leads to an uncertain and inefficient policy environment – not conducive to competition and innovation.
    vi. Difficult political economy of reforms – a non-competitive, rent-seeking system is often a stable equilibrium that can be difficult to change.
3. All that said, it is still a bit puzzling that such low levels of competition and market contestability have survived lowering of barriers to trade and import competition, virtual elimination of price controls, major gains in DB indicators, even limited progress on SOE reforms. Something seems amiss in this picture. What is it?

The case of Vietnam

1. One of the fastest growing economies since 1990. It has of the strongest records ever on the pace and scope of poverty reduction. Incredible progress on human capital measures.
2. But being an extremely ambitious nation, Vietnam is more concerned about doing well over the next 2-3 decades. The country is keen, above all, to be the next East Asian Tiger. In that quest, circa 2015 the government invited the Bank to work on a joint project—Vietnam 2035 Report—to identify the country's blind spots.
3. Let's focus on one especially important one, and it had to do with the observation that productivity growth had fallen to practically zero since the turn of the century. Growth had been led by rapid factor accumulation and structural transformation, while productivity growth within sectors was very low. Not a tenable situation for sustained future growth, and the Vietnamese government was rightly concerned.
4. Why was within-sector productivity growth low despite so many bold reforms. The dominant narrative was that the SOEs were the culprits – they were inefficient and undercut the performance of the rest of the economy as well. The truth, as we discovered, was more

nuanced than that, with useful lessons for ECA too. See attached slide, which shows a massive decline in productivity of private firms, so much so that there is very little difference left in the performance of the average private firm compared to an average SOE



World Bank and Ministry of Planning and Investment of Vietnam. 2016. *Vietnam 2035: Toward Prosperity, Creativity, Equity, and Democracy*

5. Three lessons emerge from the Vietnamese case that are also relevant for ECA FSU countries.
6. **Lesson 1**: A fundamental problem in Vietnam that extends to many transition economies in ECA is its two-speed approach to market reforms– A clear commitment to liberalizing product markets and integrating them with the global economy is accompanied by a more subdued and muddled approach to developing and liberalizing factor markets. In Vietnam, and perhaps in many ECA transition economies too, a combination of weak factor markets and heavy influence of the state over allocation of capital and land has led to significant amounts of fixed assets (land and capital) getting accumulated in construction, real estate, and banking and finance, even though these sectors are among the least productive. It's not just a matter of ensuring competitive neutrality between connected and non-connected firms – but rather of investing in and building functioning factor markets.
7. **Lesson 2**: Ease of market entry in Vietnam—and much of ECA—tends to be conditioned by connections to the state. This plays out directly through easier access to land and capital, but also state-sponsored rationing of business licenses, export quotas, and procurement contracts. The problem with this model is that there is no reason to believe that those who are more adept at exploiting connections are also necessarily better at running businesses. This, again, is an issue that is at the heart of building competition in the transition economies in ECA.
8. **Lesson 3**: A singular focus on public vs. private ownership can be misplaced. What matters more is the presence of competitive market structures. As we saw from the Vietnamese case, even if the ownership structure changes to private, results can be very damaging if insufficient attention is given to building competitive market underpinnings. Sequencing matters, too. The competitive market structures ideally should be built ahead of privatization efforts – or, at least, should not lag too far behind.