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The political economy of industrial development in Vietnam

Impact of state-business relationship on industrial performance, 1986-2012

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Abstract: Vietnam's industrial development since doi moi is a success, but only a partial one. This paper provides a political economy account of Vietnam's industrial growth since 1986. It shows that the key determinant of Vietnam's industrial growth lies in the relationship between the party-state and the private sector. It also shows that the level of distrust and discrimination against the private sector—and therefore the level of industrial growth—depends on the degree of the tradeoff between the political ideology and economic legitimacy, on the internal structure of the state, and on the quality of leadership.

Keywords: state-business relationship, political economy, industrial development, Vietnam
JEL classification: O25, O43, P21, P26

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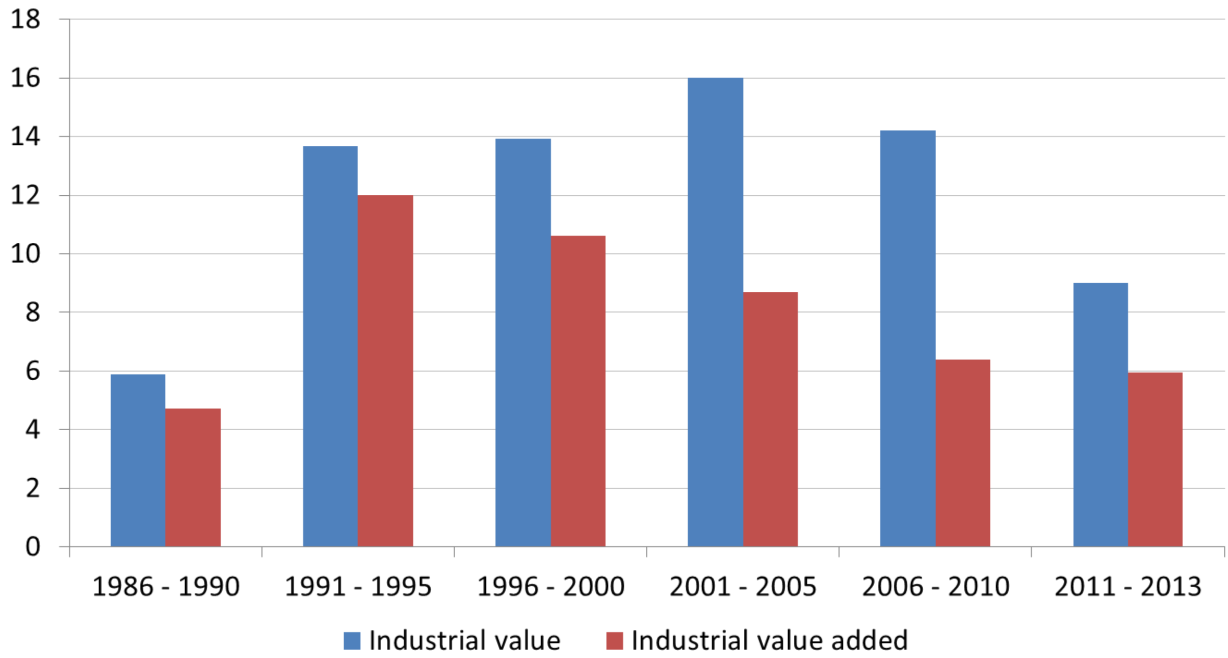
1 Introduction

Since doi moi (economic renovation), Vietnam has experienced an impressive industrial growth (Figure 1). Between 1986 and 2012, in spite of serious economic downturns caused by the collapse of the Soviet Block, the Asian Financial Crisis and the recent Global Financial Crisis, industrial value-added grew at an average annual rate of 8.3 per cent, or an 8.6 fold increase over that period.[1] This rapid industrial development has induced structural changes in the economy. Between 1986 and 2012, the share of agricultural workers in the labour force decreased from 78.2 per cent to 47.4 per cent. The competitiveness of the manufacturing industry has significantly improved, and its structure has diversified. Until the late 1990s, rice, oil and food still accounted for more than half of the country's export basket, and there were absolutely no high-tech exports. By 2012, the share of these three commodities decreased to about one-quarter, while the share of manufactured goods accounted for nearly 70 per cent, of which 15 per cent are classified as high-tech products.

Figure 1: Average rate of industrial growth in Vietnam since doi moi (%)



Source: Author's calculation based on Vietnam's Statistical Yearbooks (1986 to 2013) and data published by World Development Indicators.

However, after nearly three decades of extensive development, Vietnam's industry now seems to have reached a 'glass ceiling'. The rate at which labour moves out of agriculture during the period 2006-12 is less than a third of the rate during 2000-06. In the last five years, the manufacturing value-added (MVA) growth rate has significantly declined to 7.5 per cent from 12.2 per cent in the previous period. The share of MVA in GDP has declined to under 18 per cent, and MVA in 2012 accounts for only 17.4 per cent in the gross industrial value compared with 36 per cent in the early 2000s. Similarly, the ratio between industrial value-added and total industrial production value has nearly halved, from about 50 per cent in the late 1990s to just 25

[1] This rate was, however, still lower than the extraordinarily high growth rate of industrial value-added (including construction) in China over the 27 years between 1978 and 2005 of 11.3 per cent per year (National Bureau of Statistics (2006: 60).

per cent in the 2010s. The proximate causes of this stagnation are that Vietnam has been caught in the 'low value-added trap' with shallow integration into the global value chain and declining productivity (Perkins and Vu Thanh 2011; Dinh et al. 2014).

This paper provides a political economy account of Vietnam's recent industrial growth. It will show that the relationship and, therefore, co-ordination between the public sector and the business sector, on the one hand, has been a key factor contributing to the success of Vietnam's industry for the last 25 years, but on the other hand, they have also created significant structural obstacles for its continued development in the future.

This paper is organized as follows. The next section will analyse the status of the three ownership sectors, namely state-owned enterprises (SOEs), domestic-private enterprises (DPEs), and foreign invested enterprises (FIEs), in the political and economic strategy of the Communist Party of Vietnam (CPV). In a one-party totalitarian regime with communist ideology such as Vietnam, the political status of the business sector in the eyes and minds of the politicians will largely determine the state-business relation (SBR), and therefore the co-ordination between the two sectors. Sections 3, 4 and 5 will analyse the dynamics of state-business relation and co-ordination as reflected through the design and implementation of three generations of the law on private enterprises and their impacts on the country's industrial performance. Section 6 then analyses the changing nature of state-business relationship and co-ordination at the local level in the context of recent decentralization. This section illustrates an important insight of institutional analysis of SBR in East Asia that is a good understanding of the state structure is critical in explaining the nature of SBR (Johnson 1987; Amsden 1989; Evans 1995). The last section will conclude and draw some policy implications.

2 Political ideology, economic legitimacy, and tripartite industrial structure

2.1 Political ideology, economic legitimacy, and industrial policy in Vietnam

Vietnam's independence in 1945 and reunification in 1975 were both achieved under the leadership of the CPV. Until recently, the merits of liberalizing and unifying the country have been the greatest asset underlying the legitimacy of the CPV. However, this political asset has been depreciating over time. Meanwhile, since doi moi in 1986, economic development has increasingly become the most important source of legitimacy for the CPV leadership. One of the biggest challenges facing the CPV is how to maintain a balance between political ideology and economic legitimacy, or how to boost economic development while keeping its absolute power and comprehensive leadership. An understanding of how this dilemma has unfolded is critical for explaining the directions of economic policies of the Vietnamese party-state since doi moi.

Partly due to the communist ideology, partly because of the symbiotic relationship between the Vietnamese party-state and the SOE sector, SOEs—especially the larger ones—has always been regarded as the key sector of the economy, despite the fact that it is extremely inefficient and, therefore, a heavy burden on the economy (Perkins and Vu Thanh 2011). It follows that the private sector is fettered, discriminated and, as we shall see, usually only taken seriously in crisis situations. It should also be added that there exists discrimination even within the private sector: most FIEs and a handful of crony DPEs are treated much more favourably compared to the remaining majority of small- and medium-sized enterprises (SMEs). The official rationale for giving favourable treatment to FIEs is that incentives for foreign direct investment (FDI) have to be more generous in order to compete with neighbouring countries and that on average FIEs are more capable and much larger than DPEs, and thus contribute far more to the economy in terms of capital, technology, industrial production and employment. But the deeper cause is that, unlike the domestic-private businesses, FIEs do not present immediate and internal political threats to the communist regime.[2]

The difference in the status of the three ownership sectors in the political vision and strategy of the CPV has been systematically translated into differentiated economic institutions and policies for each ownership sector. Despite the establishment of the Unified Enterprise Law (2005) and the Common Investment Law (2005) under the pressure of the WTO, the discrimination against domestic-private SMEs still persists (Vu 2008; Malesky et al. 2013).

Vietnam's industrial policy today is a mix of policies. The policies that have had the largest impact on the country's industrial development have been those that have provided an overall framework of incentives for individual enterprises irrespective of ownership. Many industrial policies, however, have been targeted at specific ownership sectors rather than at industry or businesses as a whole. Most notable in this category are the policies that provide special favours to SOEs. In addition to the monopoly or dominant position in many strategic industries,[3] the SOEs are given favoured access to critical resources such as land, credit, natural resources, and lucrative opportunities such as public investment and government procurement. Moreover, the SOEs are also entitled to many other privileges vis-à-vis private enterprises. The SOEs were allowed to use state capital without paying dividends until very recently.[4] They are generally not subject to hard budget constraints and virtually never face bankruptcy.[5] The SOEs were designated to disburse the majority of ODA capital.[6] In many cases, they are also granted state-owned land for free, or if they must lease land then the rent is substantially subsidized. Moreover, they then can use the leased land as collateral for bank loans, while private businesses do not have such an option. SOEs, backed by the state, are also given priority access to scarce foreign exchange for less than the market rates. Since 2005, the formation of large state economic groups (SEGs) with near monopoly control over key industrial sectors is a form of government support that is only provided to SOEs. In summary, the degree to which the government can favour the state-owned sector over the others has been reduced by the 1999 and 2005 enterprise laws and the WTO membership, but it has by no means been eliminated.

The other set of industrial policies that is directed at a single ownership sector are those laws and regulations that deal with FDI. At the outset of the reform period, Vietnam opened up its economy to direct investment by foreign firms, and since the early reform years has steadily refined the rules governing FDI. Throughout the 1990s and into the twenty-first century, foreign private investors have in fact been favoured over domestic-private investors. In this respect, Vietnam's experience is also much like China's. In both countries domestic-private investors have had to struggle to get access to capital, have had to pay higher taxes for similar activities,

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[2] According to a senior politician, in the 1980s and even until the early 2000s, a significant number of politicians still share the view that if private enterprises have economic power, they will become independent and eventually challenge the political power of the Communist Party.

[3] According to the Report on Economic Concentration of the Ministry of Industry and Trade (2012), the state economic groups occupy a dominant position in the most key industries and sectors of the economy. In particular, the state economic groups hold monopoly or dominant position in the oil and gas industry, coal and minerals, infrastructure, transportation, aviation, rail, and electricity.

[4] See Decree 204/NĐ-CP/2013 dated 5 December 2013.

[5] The number of SOEs totally owned by the State declines from about 6,000 in 1994, i.e. when the Law on Bankruptcy was promulgated, to about 3,000 by mid-2000s. In about 3,000 SOEs that were subject to reform measures, only 17 were forced to go bankrupt (Vu Thanh 2014).

[6] According to Vu (2008) the SOEs' share in ODA capital disbursement in 2006 was about 70 per cent.

and have had less help in cutting through government red tape. FIEs, especially in the early years, regularly develop joint ventures with state-owned firms to take advantage of these state firms' easier access to land among other things. Ironically one effect of joining the WTO may be to begin to level the playing field for domestic-private investors vis-à-vis their foreign competitors. Overall, however, the domestic-private industrial sector in Vietnam still labours under some form of discrimination and the WTO rules will not end them all.

2.2 Vietnam's tripartite industrial structure and performance

Vietnam's industry features a tripartite structure. There are the SOEs (both central and local), the FIEs, and the DPEs.[7] In this and the next three sections, we will describe and analyse the current state of each of these three ownership sectors. We will focus first on the economic performance of each of these sectors and then with that as background, we will analyse how state-business relation and co-ordination help explain the pattern of industrial performance that we have observed. We will pay special attention to the regulatory environment, particularly the three generations of the law on private enterprises, and finally to the efforts to create large scale industrial conglomerates, namely the state economic groups.

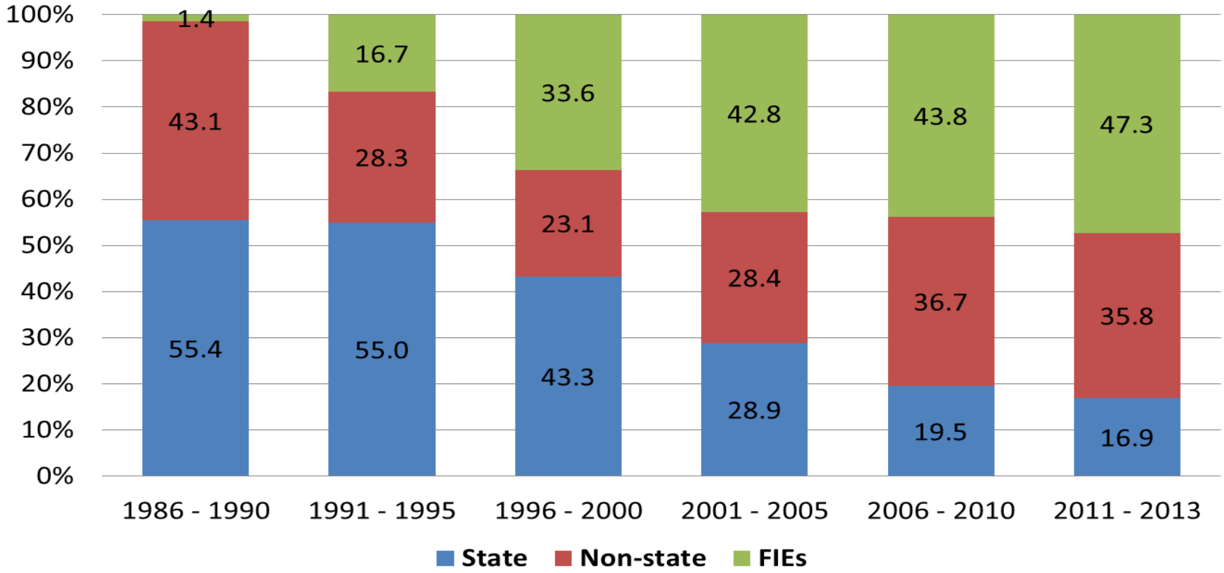
The major theme of what follows is that there are substantial differences in performance between the three ownership sectors and that government policy discriminates in favour of the sector that has performed least well. This conclusion will come as no surprise to most observers of Vietnamese industrial development. I further conclude that elimination of the discriminatory policies that remain is critical to achieving an overall improvement in industrial performance.

The first thing to note about Vietnam's industrial structure is that two significant structural changes occurred in the first decade of reform. The first is that starting from ground zero, the growth of the FIE sector sky rocketed. Since the first FIE came to Vietnam in 1988, it took less than a decade for the FIE sector to account for a third of Vietnam's industrial production (Figure 2). The second important change—which is a result of the first one—is that in 1996, for the first time the private sector (both domestic and foreign) replaced the public sector as the largest contributor in the nation's industrial production. Since then, this trend has continued and as of 2013, SOEs contributed less than 17 per cent of the total industrial production.

The second thing to note is that high industrial output growth rate has been sustained mainly by FIEs, and since the year 2000 by DPEs. The FIE sector was undeniably the industrial champion in the 1990s. By the 1990s—that is, after a decade of presence in Vietnam—with an average growth rate of nearly 23 per cent, twice as high as the other two sectors, the FIE sector had become the biggest contributor to the industrial growth in Vietnam. In the following decade, this honor was handed over to the domestic-private sector. In the 2000s, with an average growth rate of about 20 per cent—significantly higher than the growth rate of the FIE sector (16.7 per cent) and nearly 2.5 times higher than that of the SOE sector (8.8 per cent)—the domestic-private sector had almost caught up with the FIE sector in terms of contribution to industrial growth (Figure 3(A) and 3(B)).

[7] There are also collective firms and household industrial firms but the share of these latter groups is small and generally growing slowly if at all.

Figure 2: Industrial output share by ownership (1986-2013)



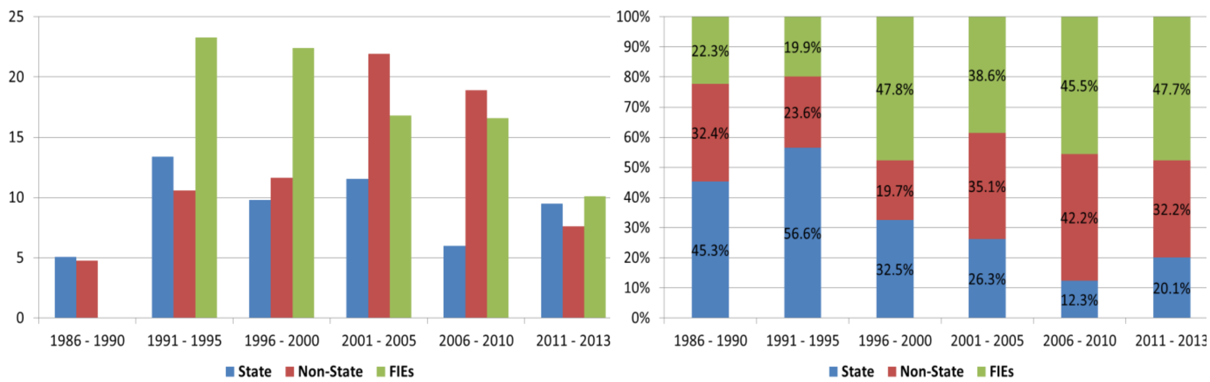
Source: Author's calculation based on Vietnam's Statistical Yearbooks, 1986-2013.

As can be seen from Figure 3(A), in the last three years (2011-13), the rate of industrial growth of both FIE and DPE sectors has declined, partly reflecting the fact that growth in these sectors in recent years has been from a much higher base, but most importantly, due to the impact of serious domestic macroeconomic turbulence since 2007 and global financial crisis since 2008.

Figure 3: Industrial growth by ownership sectors (1986-2013)

(A) Industrial production growth (%) (1986-2013)

(B) Contribution to industrial production growth (1986-2013)



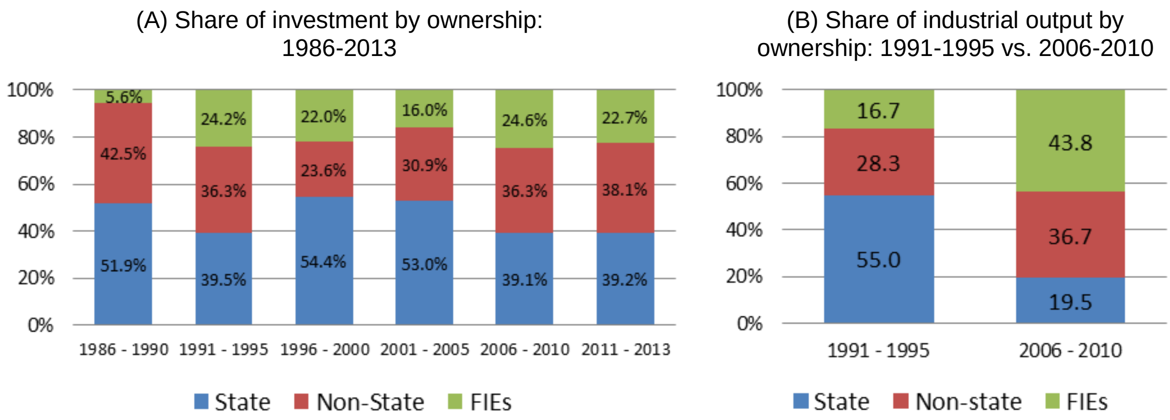
Source: Author's calculation based on Vietnam's Statistical Yearbooks, 1986-2013.

The declining SOE sector's share in Vietnam has occurred despite the fact that this sector received a much larger share of the available investment than the non-state sector (Perkins and Vu Thanh 2011). In Vietnam the state share of investment was consistently at or above 50 per cent of total investment until 2004. Much of this investment was plowed into industry by first the government budget and later through state-owned commercial bank loans. Private SMEs had no access to the first source and little access to the second source for funding their fixed assets.

Another thing to note about Vietnam's industrial development is that a large and rising share of exports is coming from FDI firms. In 2013, the FDI sector contributed two-thirds of Vietnam's total exports.[8] In effect, the FDI firms are able to meet international competition whereas the state sector and substantial parts of the domestic-private sector are less able to do so.

An empirical puzzle that emerged from the above discussion is that: given the CPV's bias toward the private sector and a top priority it has attached to SOEs' industrial performance, how have the private sectors—the FIE sector in the 1990s and then the domestic-private sector in the 2000s—has sidelined the SOE sector to become the main industrial player in Vietnam?

Figure 4: Share of investment and industrial output by ownership



Sources: Author's calculation based on Vietnam's Statistical Yearbooks, 1986-2013.

At first glance, Figure 4(A) may make one think that the changing order in terms of investment share of the SOE vis-à-vis the private sector is the main reason behind the decline of the former and the rise of the latter. As a matter of fact, during the 1996-2005 period, the public sector still contributed approximately 53-54 per cent to total investment, but from 2006 onwards, this figure has only been around 39 per cent.

However, an additional look at Figure 4(B) reveals that it is not investment but productivity that is the key determinant of private sector's rapid industrial growth. While the investment structure of the three sectors over the period 1991-95 and 2006-10 is almost identical (Figure 4(A)), the industrial structure was fully reversed (Figure 4(B)), implying that the efficiency of the public sector has been much lower than that of the private sector. This conclusion is consistent with Bui's (2011) finding that during the period of 2000-07; the ICOR (incremental capital output ratio), calculated based on implemented investment, of the state sector is 7.8, while that ratio for the DPE and FIE sectors are 3.2 and 5.2, respectively. The empirical puzzle then now becomes: which political and policy changes between 1990 and 2010 help explain improvement in the rates of investment and the efficiency in the Vietnamese private sector vis-à-vis the state sector? We now turn to this puzzle in the next three sections.

[8] It is also estimated that the state sector contributed only 10-15 per cent to total non-oil exports, and the remaining is contributed by the domestic-private sector.

3 Economic crisis in the 1980s and the emergence of private sector in the 1990s

In the first half of the 1980s, Vietnam experienced what even the CPV has to admit as a 'comprehensive social and economic crisis'.[9] A series of policies intended to eradicate private property and put an end to free market such as commercial and industrial 'socialist rehabilitation' (*cải tạo công – thương nghiệp*), agricultural collectivization, and prohibition of inter-provincial circulation of goods (*ngăn sông, cấm chợ*)—pushed the economy to the brink of crisis. Serious failures of the 'price-wage-money' (*giá – lương – tiền*) stabilization package in 1985 was the final blow to the near collapse economy. Not only exhausted internally, Vietnam in the mid-1980s found itself completely isolated, both economically and politically, from the world. Aid from the COMECON was cut completely due to the political crisis within the socialist block. Vietnam's involvement in Cambodia was not only extremely costly, but also shuts down any window of opportunity for economic normalization with the USA and, therefore, trade with the West. In sum, the economy was pushed to the wall.

Truong Chinh—the then acting General Secretary of the CPV, a highly indoctrinated communist—bravely left behind his old dogma to adopt market-oriented reforms, which is a completely uncharted water. He led a group of reformers within the CPV, in just five months (from July to December 1986), to rewrite the Political Report of the Central Communist Party in the direction of market-oriented reform with the hope to restore economic growth and, thereby, the legitimacy for the Party's leadership. Under his leadership, the party-state conducted doi moi or economic renovation in 1986, accepting the co-existence of different economic (or more precisely, ownership) sectors in the so-called 'commodity economy' and began to open up international trade and economic relations.

It must be emphasized that although sharing the goal of restoring legitimacy with the reformers, for the orthodox communists, doi moi were only viewed as a 'temporary setback'. Deep in their mind, to accept the existence of both the non-state sector and market relations in the economy would be deemed 'strategic one-step backward' in the transitional path to socialism.[10] Similarly, the opening up of economic and trade relations with non-socialist countries was considered by many as the 'lesser of two evils' because traditional relationships with the COMECON had declined sharply in the late 1970s, almost collapsed in the mid-1980s, and were in danger of being terminated entirely at any time.

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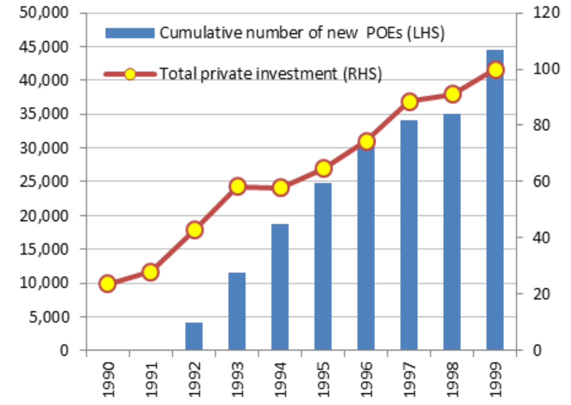
[9] See, for example the Strategy for Socio-economic Stabilization and Development to 2000 (Chiến lược ổn định và phát triển kinh tế - xã hội đến năm 2000) adopted at the 7th Party Congress in June 1991.

[10] The term 'private economy' (*kinh tế tư nhân*) (which includes individual and smallholder businesses and private capitalists) is only officially used for the first time since the 6th Meeting of the 6th Party Congress (March 1989). Documents of the 6th Party Congress (Communist Party of Vietnam 1987: 59-61) asserted that 'the socialist economy with the state sector as the core must regain a decisive role in the national economy.' This document, on the one hand, acknowledges the need of private capitalist economy but, on the other hand, maintains steadfast direction of completely eliminating the private commercial business, and only accepting the existence of small productive capitalists in industries and commodities that are closely regulated by the state. Moreover, these capitalists are still deemed to be subjects of 'socialist rehabilitation'.

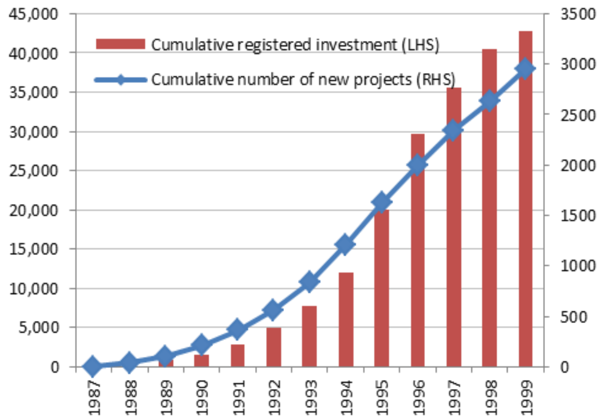
Figure 5: Newly registered FIEs and DPEs in Vietnam (1987-1999)

(A) Cumulative newly registered FIEs and foreign direct investment (1987-1999)



Note: Investment is in VND trillion, 1994 constant price

(B) Cumulative newly established DPEs and private investment (1990-1999)



Note: Investment is in US$ million

Source: Author's calculation based on data published by Ministry of Planning and Investment, GSO (various years).

With the acceptance of a temporary setback, the Law on Encouraging Foreign Investment—the first market-oriented law in Vietnam—was enacted in 1987. Then the Law on Private Enterprise and the Company Law—the first two laws on the DPEs—were issued in 1990. Results of this state–private business 'normalization' were immediate and astonishing. Since the arrival of the first FIE in 1988, both the number of FDI projects and their registered capital on average increased about 36 per cent per year over the next decade (Figure 5(A)). Similarly, since their first appearance in 1990, the number of private enterprises increased at exponential speed, average 112 per cent per year over the period 1991-99 (Figure 5(B)).[11] The private sector's investment growth increased more slowly, averaging only 17.2 per cent in the same period, reflecting its much smaller size as well as limited capacity to mobilize capital compared with the FIE sector.

While the advent of the Law on Private Enterprise and the Company Law in 1990 plays an important role in shaping the formal domestic-private sector, it is worth noting that these two laws are not sufficient to strengthen the position of the domestic-private sector vis-à-vis the other two sectors. In fact, the share of this sector in total investment decreased continuously from 42.5 per cent in the period 1986-90 to 36.3 per cent in the period 1991-95 and 23.6 per cent in the period 1996-2000 (Figure 4(A)).

Thus, in the 1990s, industrial growth rate of the domestic-private sector was only 9.9 per cent, lower than that of the SOE sector and only about a third of the FIE sector. As a result, the share in industrial production of this sector fell sharply from 43.1 per cent in the period 1986-90 to 28.3 per cent in the period 1991-96 and to only 23.1 per cent in the period 1996-2000. As will be shown in the next section, this declining trend was dramatically reversed only in the 2000s, after the passage of the 1999 Law on Enterprise.

[11] In addition to private enterprises officially registered, the family business households also increased rapidly from 0.84 million households in 1990 to 2.2 million households in 1996 (Pham 2008: 191).

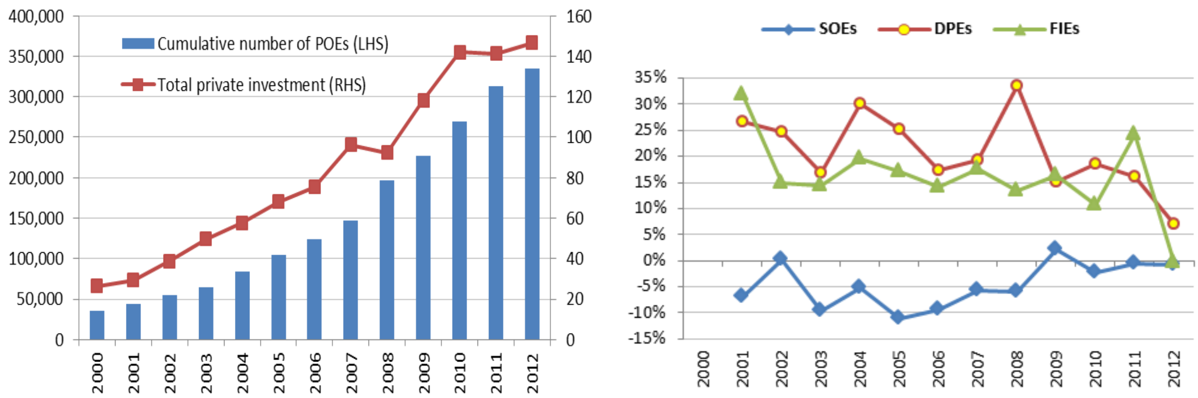
4 Economic slowdown in the late 1990s and the revival of the domestic-private sector

Due to heavy reliance on FDI and exports, the Vietnam economy was significantly affected by the Asian Financial Crisis in 1997. From a peak of US$9.6 billion in 1996, registered FDI plummeted to US$6.0 billion in 1997 and to US$2.3 billion in 1999. Moreover, many investors stopped investment or even withdrew licensed projects. Export growth, which was about 30 per cent per year, dropped to less than 2 per cent in 1998. GDP growth fell from more than 9 per cent in the mid-1990s to a nadir of only 4.8 per cent in 1999. Against this backdrop, the party-state decided to adjust the path of economic development, in which the internal forces were considered the backbone of the economy and, therefore, brought to the fore. It is in this context that the 1999 Law on Enterprise was invented. Just like the Law on Private Enterprise and the Company Law in 1990, once again, only the intertwine of serious internal difficulties and external crisis was sufficient to force the party-state conservatives to accept the 'lesser evil', thereby paving the way for private sector development.

Figure 6: Growth of the domestic-private sector (2000-12)

(A) Cumulative newly established DPEs and private investment

(B) Growth rate of newly established enterprises by ownership



Note: Investment is in VND trillion, 1994 constant price.

Source: Author's compilation based on data published by Ministry of Planning and Investment, GSO (various years).

If the 1990 Law on Private Enterprise and the Company Law establishes the DPEs as a sector in the national economy, then the 1999 Law on Enterprises has a crucial role in helping this sector flourish. Within two years of its implementation, more than 35,000 DPEs was established, not far off the number of enterprises established in the previous ten years combined. During the period 2000-05, a total of approximately 160,000 DPEs were established with the total investment of VND 323 trillion (or about 1.5 times the total investment of the FIE sector), creating three million new jobs (Pham 2008). In term of industrial performance, during the period 2001-10, the private sector's average growth rate surged to 20.5 per cent, significantly higher than that of the FIE sector (16.7 per cent) and 2.5 times higher than that of the SOE sector (8.8 per cent). With this remarkable growth, private sector's contribution to industrial growth in the period 2006-10 amounted to 42.2 per cent, far exceeding the contribution of the SOE sector (12.3 per cent) and quite close to the contribution of the FIE sector (45.5 per cent) (see Figure 3(B)).

What really caused the huge difference between the two generations of law on private enterprises? There are of course many factors involved, but the most crucial one is a fundamental shift in the status of the domestic-private sector as regarded by the Vietnamese party-state.[12] The remainder of this section will briefly present the arduous journey to reach this fundamental change, and thereby demonstrate the critical importance of state-business relation and co-ordination for the success of the 1999 Law on Enterprise.

4.1 Designing and lobbying for the new Law on Enterprise (1999)

Although doi moi was officially launched in 1986, and although the first two laws on domestic-private enterprises were enacted in 1990, not until the enactment of the 1992 Constitution were the ownership rights and the freedom to do business officially recognized for the very first time. However, private enterprises in Vietnam had to wait for another seven years to see these 'abstract' rights to be institutionalized in the 1999 Law on Enterprise, and then implemented in reality.[13] Two years later, the Ninth Party Congress (April 2001) confirmed the new direction of 'widely encouraging the development of the private capitalist sector in the production and business areas which are not prohibited by law.'[14] Then, in the 5th Meeting of the Central Committee of the 9th Party Congress (March 2002), the status of the private sector was firmly established as 'an important component of the national economy. Developing the private sector is a matter of long-term strategy in the socialist-oriented multi-sectoral economic development,' and this strategy demanded that 'favourable institutional and social environment for the development of the private sector should be created'.[15]

It is important to remember that during the process of designing and implementing the Law on Private Enterprise and Company Law in 1990, private enterprises were still considered the subject of 'socialist rehabilitation' and only allowed to do business in areas stipulated by law. With the advent of 1999 Law on Enterprise, they have become an important part of the national economy and could do business in any areas *not* prohibited by law.[16] As will be discussed below, designing a Law on Enterprise that truly respects the people's freedom to do business and can be effectively implemented requires co-ordination within the state system as well as between the state and businesses.[17]

The Prime Minister's Research Commission (hereafter PMRC) and a very small group of highly dedicated technocrats in the Central Institute of Economic Management (CIEM) are the brain of the whole process, from initial idea to drafting and implementation of the 1999 Law on Enterprise. In 1996, realizing serious inadequacies in the 1990 Law on Private Enterprise and the Company Law, the PMRC proposed to Prime Minister Phan Van Khai that these two laws should be modified in line with the spirit of the 1992 Constitution. Shortly thereafter, a steering committee charged with drafting the new law (hereafter Steering Committee) was established, headed by the then MPI's minister Tran Xuan Gia, with members include representatives of

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[12] Another, very important factor is the bilateral trade agreement between Vietnam and the USA (2001), which almost coincides with the time of the Law on Enterprise, and therefore strongly complements it.

[13] For further discussion, see Pham (2008), Tran (2008), and Vu (2008).

[14] Vietnam Communist Party (2001: 98).

[15] Vietnam Communist Party (2002: 58-59).

[16] The 10th Party Congress advocated that '[a]ll economic sectors operating under the law are important components of the market-oriented socialist economy. They are all equal before the law, co-develop in the long run, co-operate and compete in a healthy manner.' (Vietnam Communist Party 2006: 83).

[17] This section is based on Pham (2008) and interviews by the author with several key members of the PMRC, the Steering Committee for drafting the Law on Enterprise, the Central Institute of Economic Management, and the Vietnam's Chamber of Commerce and Industry.

CIEM (the principal drafter of the law), deputy minister-level representatives from the National Assembly and relevant ministries. For the *very first time*, a representative of the business community—the Vietnam's Chamber of Commerce and Industry (VCCI)—was invited to participate in the drafting process (Box 1).

Box 1: The Prime Minister's Research Commission[18]

The predecessor of the PMRC is the Advisory Group on Economic and Public Administration Reforms (hereafter Reform Advisory Group), established in 1993 by the late Prime Minister Vo Van Kiet. By 1996, the Reform Advisory Group was reorganized into the Research Group for Socio-economic and Public Administration Renovation (hereafter Renovation Research Group), which finally was upgraded by the Prime Minister Phan Van Khai to the Prime Minister's Research Commission (PMRC)—which was essentially the advisory commission of the Prime Minister—with greater autonomy in personnel, funding, and collaboration with domestic and international research organizations and experts.

PMRC was a very small and simple organization, never having more than 15 members, including supporting staffs. At the heart of the PMRC is a core group of a dozen advisors, all sharing strong aspirations for change, under the direct supervision of the Prime Minister. Before joining PMRC, most advisors had served as senior experts or researchers in the party-state system. Nevertheless, they did not hold any executive posts in the administration, and many had already retired.[19] Since PMRC members neither had official power nor sought it, and moreover, since they refrained from any business activities and vested interests themselves, they were able to maintain a very high level of autonomy, both in relation with the government and businesses. Members of the PMRC, if they wished, could report and sent recommendations directly to the Prime Minister. In addition, they had the rights to reserve their opinions if these opinions were different from those of the chairman and other members.

The Prime Minister worked regularly with the PMRC chairman and maintained regular meetings with the whole PMRC to listen to their comments and suggestions about the work of the Government. Until Prime Minister Nguyen Tan Dung's dissolving PMRC in July 2006 (i.e. right after taking his office), the PMRC was assigned the task of being the lead editor of the Prime Minister or Deputy Prime Ministers' reports presented to the National Assembly, the Prime Minister's reports submitted to the Party Central Committee, the Politburo, and the National Assembly such as the Socio-economic Development Strategy 2001-10, the Five-year Plans, as well as other documents of the Central Committee's meetings on economic, administrative, and local political system reforms.

A top priority of the PMRC was to observe the economy and society closely through daily interactions with various institutions, businesses, and practitioners, as well as through field trips at the local level. At the same time, the PMRC also built an information and documentation centre for research, and tried to learn from international experience by conducting well-designed surveys overseas.

For three years, after countless heated debates within as well as between the Steering Committee with relevant state agencies, particularly those agencies whose authority was narrowed down by the Law on Enterprise, the 23rd and also the final version of the Law on Enterprise was passed by the National Assembly in May 1999. During this process, under the initiative proposed by CIEM and VCCI, the 5th, the 9th, and the 14th draft were discussed with the business community around the country, particularly where the private business community is strongest such as Ho Chi Minh, Ha Noi, Da Nang, and Can Tho. These consultations attracted very large and enthusiastic participation of the private business community, as this is the first time they are invited to comment directly and formally to a legislation draft which is of most immediate concern to them. With the initiative of the PMRC and the dedication of the Steering Committee, backed by the support of the business community, the 1999 Law on Enterprise was more successful in institutionalizing several fundamental reforms (Box 2) compared with the 1990 Law on Private Enterprise and the Company Law.

[18] This box is based on Tran (2008) and interviews by the author with Tran Duc Nguyen and Tran Viet Phuong during 2011 and 2012.

[19] In addition to retirement pension, the retired members of PMRC received a modest allowance of VND500,000 (equivalent to about US$32), which was in 2005 increased to VND1,000,000 (equivalent to about US$63).

Box 2: Important reforms initiated by the 1999 Law on Enterprise

(1) Merge the Law on Private Enterprises and the Company Law into a unified Law on Enterprise;
(2) Introduce the principle of 'enterprises can do anything that is not prohibited by law', and stipulate clearly the kinds of business which are prohibited or subject to specific conditions;
(3) Replace licensing system with business registration;
(4) Apply post-audit instead of pre-audit;
(5) Institutionalize the autonomy of enterprises in selecting business areas, locations, forms of business and organization;
(6) Clarify internal decision-making mechanisms within private enterprises, protect the rights of investors, particularly minority shareholders and creditors.

4.2 The task force for the implementation of the 1999 Law on Enterprises

Anticipating the risk that the Enterprise Law would be distorted during the implementation process, the PMRC proposed to Prime Minister Phan Van Khai to establish a 'special task force' to help various government organizations implement the Law on Enterprise. In December 1999—right before the Law on Enterprise came into effect—the Prime Minister established the Law on Enterprise Implementation Task Force (hereafter Task Force), again led by Tran Xuan Gia, who previously chaired the Steering Committee. The Task Force also includes some of the most dedicated reformers who previously served in the Steering Committee and the Drafting Committee. The Task Force was entrusted with the task to draft decrees guiding the implementation of the Law on Enterprise and check the current business licensing system. Equally important, the Task Force enjoyed autonomy vis-à-vis the government, i.e., it reported directly and was accountable only to the Prime Minister.

In February 2000—which was only two months after the Task Force was founded—Decree 02/2000/NĐ-CP drafted by the Task Force was enacted, thereby significantly reducing administrative procedures for business and administrative burden for the state apparatus. Also in the beginning of February 2000, following the recommendation of the Task Force, the Prime Minister issued Decision 19/2000/QĐ-TTg revoking 84 licenses deemed contrary to the Law on Enterprise. In August 2000, Decree 30/2000/NĐ-CP abolished 27 additional licenses and moved 34 licenses to business conditions. In total, under recommendation of the Task Force, 286 licenses had been revoked.

4.3 Direct dialogue between the Prime Minister and the business community

Unlike his predecessors, Prime Minister Phan Van Khai neither had substantial revolutionary credential nor was he particularly politically adept. Being a dedicated technocrat, Phan Van Khai soon realized the vital importance of adopting a market economy and fostering private businesses. In 1989, when he was made Chairman of the State Planning Committee (which then became MPI) and assigned to lead the team in charge of drafting the Strategy for Socio-economic Stabilization and Development to the Year 2000 (hereafter Strategy 1991-2000), he managed to put together a group of the most ardent reformers in his drafting team. A number of people in this team later became core members of the PMRC. He and the drafting team advanced the idea that '[o]n the road to doi moi, the central character for revitalizing the country's economy is the businessmen of various calibers, from household business owners intrinsically linked to the market to investors and managers of large enterprises' (Tran 2008: 94-5).[20]

In 1997, just several months after taking office, Prime Minister Phan Van Khai—again on the advice of the PMRC—held the first meeting with the business community, marking a fundamental shift in the state–business relationship.[21] This is also for the very first time, private enterprise owners in the country were officially recognized by the state not as 'rehabilitation subjects' or more slightly as 'management objects' but as 'policy interlocutors'. Since then, meetings like this have been held every year and officially become the policy dialogue between the Prime Minister and the business community. These meetings appealed mostly to domestic-private SMEs, who are virtually voiceless and never have the opportunity to dialogue directly with the top leaders of the government.

Following this precedent, many ministries, agencies, and local governments also held regular meetings with the business community. In these policy dialogues, the hottest topics always concerned the laws and regulations on taxation, customs, import and export, land, credit, investment, and administrative procedures, and from 2000 onwards there is an additional thread on the implementation of the Law on Enterprise. It is through direct dialogue with the business community that the head of the government, ministries and agencies better understand the obstacles to the operation and development of the business, thereby adjusting the laws and legislation to create a better business environment for businesses. Equally importantly, this sincere action from the part of the government helped build trust in the government among the private businesses, who are traditionally underrepresented. The business community started to have a sense of government's sympathy, which encourages them to invest, start up and expand their business (Figure 6(A) and 6(B)). This is a key factor contributing to the very high rate of industrial growth of 25 per cent in the mid-2000s.

5 The (relative) failure of the 2005 unified Enterprise Law

After several years of implementing the Law on Enterprise, the earlier advantages were eaten away, partly because the lack of internal pressures for reform, and partly because the initial 'low hanging fruits'. The later implementation of the Law on Enterprise increasingly clashed with even more powerful vested interests groups.

Understandably, the strongest opposition came from government agencies whose licenses risked being revoked by the Implementation Task Force. According to Pham (2008), '[m]any times, the Implementation Task Force had to work directly with the most senior leaders of the licensing agencies to *explain* and *persuade* (*italics* added), nevertheless there are cases in which the agency insisted not to revoke their licenses, and their main rationale was the need to keep the 'state

[20] It is worth mentioning that parallel with the Strategy 1991-2000 chaired by the government, the Party also prepared the Platform for Nation Building in the Transitional Period to Socialism (Platform 1991 for short). Interestingly, there are quite a few differences between the Strategy 1991-2000 and the Platform 1991, in which the most notable difference is that the Strategy 1991-2000 consciously tone down the distinction with respects to both class and ownership sectors. The fact that the two most important documents of the Party and the State have different views on key issues, but both were passed in the 6th Party Congress on the one hand reflects uncertainty about the way forward among the participants, and on the other hand, reveals the uneasy compromise between reformers and conservatives.

[21] Also in 1997, the Vietnam Business Forum (VBF) was established as one of the first public-private dialogue mechanisms that provides regular channels of communications between foreign and domestic companies with the Vietnamese government. The VBF has been widely recognized for contributing to reforms that have improved the business environment in Vietnam.

management' with regards to these business activities, and in order to manage them, it was necessary to keep the licensing mechanism. When the Implementation Task Force submitted the *proposal* (*italics* added) to revoke licenses to the government, these agencies also found ways to prove and lobby for the opposite, leading to the government's hesitance and indetermination'.

With no executive power in the context of declining political will for reform and opposed by increasingly powerful interest groups, the Task Force ceased to be effective. Moreover, some ministries and agencies also lobbied to recover many previously revoked licenses. Worse still, these organizations found ways to add new licenses by building them right into the new laws or amendments of existing ones. As a result, the number of licenses gradually increased, and the mentality of 'if it's not manageable, then prohibit it' (*không quản được thì cấm*) started to spread out among state agencies. The conflicting views about the government's role and its relationship with business sectors resurfaced. In these debates, the real motives of economic power and benefits were often disguised under the umbrella of political and ideological correctness.

Meanwhile, the discrimination among ownership sectors is still very strong, with the same pecking order as before: the SOEs come first, followed by the FIEs, and the DPEs come last. This discrimination exists both *de facto* and *de jure*. Until 2005, in the Vietnamese legal system, the Law on [Private] Enterprise co-existed with the Law on State-owned Enterprise; and the Law on Domestic Investment Promotion existed alongside the Law on Foreign Investment. The reformers realized an increasingly urgent need to create a level playing field for all types of businesses regardless of their ownership, which was also a critical requirement of WTO accession. With this motivation in mind, the PMRC and the Task Force recommended to the Prime Minister Phan Van Khai to merge the two existing enterprise laws into the unified Law on Enterprise and the two investment laws into the common Investment Law, both were enacted in late 2005 and became effective in mid-2006.

While the first two generations of law on private enterprise in 1990 and 1999 were drafted and enacted during crisis and therefore considered an 'emergency exit' for the economy, on the contrary, the 2005 Law on Enterprise came out when the economy was at its peak and vested interest groups began to take root and spread. Moreover, for some senior party-state leaders, the two new laws were just a necessary means to achieve the end of joining the WTO. Altogether, these are the main reasons that prevent the 2005 Law on Enterprise from creating necessary breakthroughs compared with the 1990 and 1999 enterprise laws. Moreover, the 'breakthroughs' that made their way through legislation have generally been disabled during the implementation process. For instance, lawmakers have succeeded in forcing the SOEs to 'sit on the same table' with the other economic players in the unified Law on Enterprise, and this opened the hope for ensuring equal footing for all types of businesses, especially for private SMEs. But in reality, the discrimination has still been persistent and serious, and is even becoming more sophisticated (Pham 2008).

It is worth mentioning that favourable treatment given to the SOE sector and discrimination against the domestic-private sector persisted despite the fact, proven in the last two decades, that in almost every measure of performance, from GDP growth to industrial performance, from job creation to export, the SOE sector has been increasingly lagging behind the domestic-private sector (Vu Thanh 2014). Similarly, generous incentives for FIEs, in many cases, effectively created the shield for inefficient and foot loose foreign enterprises, running from one place to another to take advantage of government protection, fiscal incentives, cheap land, as well as lower environmental cost in Vietnam. Clear examples of this phenomenon can be found in steel, ship repairing, and automobile industries (Perkins and Vu Thanh 2011).

In summary, the 2006 Law on Enterprise has not brought about the significant changes as expected. It follows that the limited success in terms of domestic-private sector development and industrial growth during the 2006-10 period has more to do with the lingering effects of the 1999 Law on Enterprise and other factors rather than with the 2006 Law on Enterprise itself. In terms of state—business relations, from the mid-2000s onwards, the co-operative relationship and trust between the state and business sectors built during Phan Van Khai's terms (i.e., 1997-2006) have been degrading. After a period of macroeconomic instability and economic slowdown, domestic-private enterprises confidence in the state has seriously declined. Meanwhile, quid pro quo relationship between the state and big businesses—mostly SEGs and a very small group of big DPEs—in search of political support or privileged benefits has become increasingly widespread. It is no surprise that the annual meetings between the Prime Minister and the business community have ended since 2007.[22] The acceleration of this situation, as will be seen in the next section, resulted from major changes in the party-state leadership and in the internal structure of the state system.

6 Leadership change, fiscal decentralization, and collusive state-business relation

6.1 Leadership change and the emergence of state business groups

In the mid-2000s, the Vietnamese political economy experienced two important events. The first is the launching of the model of state economic groups—the 'commanding heights' of the socialist market economy—in November 2005 and the second is that Nguyen Tan Dung became the Prime Minister in June 2006. These two seemingly unrelated events turn out to be intrinsically woven together.

The aspiration to develop large SOEs dated back to the time of the late Prime Minister Vo Van Kiet. In 1994, 18 largest SOEs (referred to as state general corporation 91—hereafter SGCs 91) were established, inspired by the role of the *keiretsu* and *chaebols* in the industrialization success of Japan and South Korea (Perkins and Vu Thanh 2011). The stated goal is to create large corporations that can become internationally competitive with well-known brands such as Sony or Samsung.[23] Despite this effort, by early 2000s, the SOE reform in general and the experiment with the SEGs in particular came to a standstill. Despite obvious advantages and the government's preferential treatments, the performance of the SOE sector was not improved and even lagging behind the private sector. In this context, the Resolution of the Third Plenum of the 9th Party Central Committee on SOE reform (2001) laid the way for the experimentation of the state economic group (SEG) model by taking existing SGCs 91 as the core, adding to them other SOEs in the same industry, and then injecting capital to these new SEGs. Compared with the SGCs 91, the SEGs have several new roles, in which the most notable are that they become government's key instrument to ensure major macroeconomic balances and a main force in international economic integration. In order to perform these macroeconomic and strategic roles, SEGs are built up in terms of both scale and scope.

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[22] In fact, not only the new Prime Minister no longer holds the annual policy dialogue with the business community in general, but his first meetings with the business sector are with the SOEs, then commercial banks, and the FIEs.

[23] But there are at least two fundamental differences between Vietnam's and Korea's efforts to create large well-known competitive firms. In Korea most of these firms were private whereas all of the conglomerates in Vietnam are state-owned with their boards of directors and top management selected by the government. Second, in Korea all of these large *chaebols*, in exchange for temporary government support lasting in most cases for only a few years, were expected to become internationally competitive exporters. Vietnam's conglomerates are still largely oriented toward import substitution.

Being a relatively young and very ambitious prime minister who wants to quickly assert his economic leadership by means of SOEs, Nguyen Tan Dung has replaced the gradual approach of experimenting with the SEG model under Phan Van Khai with a bold plan to accelerate the expansion of this model. Being the person in charge of establishing the first SEGs, as soon as taking office, Nguyen Tan Dung rushed to establish more SEGs despite the warning of many economists and of the former prime minister Vo Van Kiet himself. By 2011, thirteen SEGs have been established.[24] Instead of being traditionally supervised by the line ministries, all SEGs are now put under direct supervision of the Prime Minister Nguyen Tan Dung. Moreover, all decisions to establish new SOEs are now assigned either to the Prime Minister or the local governments, implying that the line ministry's authority over SOEs has dramatically curtailed. All these moves converge to one direction: fragmented authority in SOE supervision, particularly the SEGs, has become more concentrated on the hand of the Prime Minister. Large SOEs increasingly move closer to the Prime Minister and further away from the line ministries.

With massive support from the government, SEGs quickly expanded, not only in terms of size, but also in terms of their activities. In the name of increased autonomy, SEGs now can expand into all kinds of businesses such as banking, real estate, financial investment, and securities trading. Now that SEGs can own commercial banks, they become less dependent on government funding mechanisms. In addition, with inherent advantage in access to land—which under the Constitution is owned by the people but managed by the state—SEGs quickly occupied land in prime locations to build new urban complexes or commercial residential housing, thereby inflating the already inflated real estate market. Similar trends were also observed in finance and security markets.

The degradation in institutional and business environments has serious implications for the development of the private sector. Many businesses succeeded in the reform era by developing capacity now become eager to invest in the relationship with politicians, government officials and state-owned enterprises. In the past, businesses were trying to explore new markets to maximize their profit. Nowadays, much of their energy is driven toward rent-seeking activities. If these kinds of negative behaviour previously appeared idiosyncratic, they now became quite common. In the most recent Provincial Competitiveness Index (PCI) survey conducted by VCCI and Vietnam Competitiveness Initiative (VNCI) in 2013, 8,093 domestic-private firms in all 63 provinces were asked to comment on the following statement: 'Contracts, land and other economic resources mostly fall in the hands of enterprises that have strong connections to local authorities.' The result is not very surprising: the ratio of respondents who agree with this statement in the median province is 96.6 per cent.

6.2 Decentralization and its implications for state–business relationship at the local level

Although Vietnam is a unitary party-state, decentralization—in the sense of the transfer of power from the central to local governments—is built into its internal structure. Two of the most important collective decision making institutions—namely the Central Committee of the Communist Party and the National Assembly—are both heavily local-based as evidence in the overwhelming local representation, and therefore voting power. It follows that even when the central is strong (e.g., under a paramount leader as in the 1960s to mid-1980s), a certain degree of local consensus is called for when it comes to the most important decisions.

[24] It should be added that the plan to promote SEGs is in line both with the official view that the state sector must play the leading role in the economy, and with the dogmatic conservatism of the new CPV's Secretary General, who also came into power in 2006.

Pressures for further decentralization have been growing since doi moi. Economic successes in the 1990s and early 2000s generated stronger pressures for decentralization, simply because the old 'operating system' under central planning proves incompatible with the new economy, which is increasingly market-oriented and internationalized. To remedy this situation, the Government enacted the new Budget Law 2002 (which became effective in 1 January 2004) to accelerate fiscal decentralization and issued Resolution 08 in June 2004 to further decentralize state management, according to which, the central government will accelerate decentralization in important dimensions, including the management of development investment, budget, land and natural resources, and SOE autonomy. These two policies have led to important changes in relationships within the state system itself as well as between the state and business at the local level.

The immediate implication of fiscal decentralization is that provincial governments now have to increase their budget to meet a much higher spending responsibility while the revenue sharing structure with the central government remains largely unchanged and the transfers from the central government is significantly curtailed.[25] For local governments in Vietnam, most of their revenue comes from three sources. The first is land-related revenue (mainly tax on land use and on the transfer of land use rights) and natural resources tax which, according to the budget law, local governments can retain entirely. The two other sources of revenue are corporate income tax and value-added tax, which local governments can retain a certain proportion, depending on their negotiations with the Ministry of Finance. All three sources of revenue have one thing in common: they all depend on the existence of businesses, especially the large ones. This is relatively easy to understand for the latter two sources of revenue, but even for the first source, revenue from land and natural resources usually correlates with the degree of vibrancy of local economy.

The effects of fiscal decentralization on local budget has had different consequences for the 63 provinces in Vietnam. For the dozen provinces that are capable of balancing their budgets (thanks to strong business base or abundant natural resources), decentralization helps expand their fiscal space considerably, and they thus become more independent from the central government. In contrast, fiscal decentralization tends to increase the dependence on the centre for the remaining 50-plus provinces which currently receive transfers from the central government.

This situation has several important consequences for the state-business relationship. First, at the national level, the Prime Minister—who has already consolidated the control over the SEGs—now can use these 'weapons' to serve his interests. For instance, to obtain the local support in the Party Central Committee, the Prime Minister may suggest SEGs to invest simultaneously in many provinces.[26] During the boom time, this suggestion is often welcome by both SEGs and local governments because SEGs can seize the opportunity to extract rents, and local governments can benefit from big investments. Of course, the state budget cannot accommodate every investment projects.[27] And when the economy slows down—as it does

[25] Indeed, between 2000 and 2010, the ratio of local revenue to total national revenue increased from 25 per cent to 38 per cent while the ratio of local spending to total national expenditure increased from 45 per cent to 53 per cent. During the same period, subsidy from central government as a percentage of total local expenditure significantly reduced from about 50 per cent to 30 per cent (Vu Thanh 2012: 16).

[26] For a detailed discussion of this phenomenon, see Pincus et al. (2012).

[27] The total investment estimate for an incomplete list of public investment projects is about US$150 billion for the 2011-20 period, or approximately US$15 billion each year, which is equivalent to about one third of the total annual budget expenditure.

currently—these political-driven projects become a huge burden for all parties involved, especially for the state expenditure, which ultimately falls onto shoulders of tax payers.

Decentralization has both positive and negative impacts at the local level. Probably the most important positive impact is that many local governments become more pro-active in improving business environment for economic development. Some of the most successful examples include Ha Tay (before being merged into Ha Noi) and Vinh Phuc in the north, Da Nang in the central, Binh Duong and Dong Thap in the south. These provinces have been either consistently at the top or greatly improving their ranking in the Provincial Competitiveness Index (PCI) compiled by VCCI and Vietnam Competitiveness Initiative since 2005.[28]

In addition to the clientelism described above, two of the most serious negative impacts are the emergence of rent-seeking and state-business collusive activities. In the short-run, the largest, and also fast and simple, source of revenue comes from land and natural resources. For example, to increase tax revenue, the provincial people committee can now simply issue an administrative decision to convert hundreds of hectares of land from agricultural to industrial or urban uses, then transfer the land use rights to investors at much higher value. The enormous rent generated from land and natural resources is the greatest source of corruption at the local level. *Nhân Dân* (The People)—the mouthpiece of the CPV—quoted a report by the Government Inspectorate acknowledging that between 2003 and 2010, the state administrative organs at all levels have received more than 1.2 million complaints and denunciations in which 70 per cent is related to land.[29] Similarly, according to the Ministry of Natural Resources and Environment, land-related complaints have always accounted for about 70-90 per cent of total complaints received by this ministry. This number was tripled between 2004 and 2007, right after the revised Land Law came into effect in 1 July 2004 (World Bank 2009).

In many provinces, decentralization pressures make the local government feel the need to build up a number of key local SOEs to become its right arm in raising funds as well as implementing infrastructure projects.[30] These companies can be either rent-seeking or welfare-improving or both, depending critically on the degree of commitment to economic development of the local government. Very little is known, however, why some local governments are more benevolent than others.

Some provinces even nurture crony private companies to help them mobilize resources from the central government. Nominally, these firms are delegated by local governments to raise funds for local development projects. With this delegation, not necessarily in official forms, these companies start their lobbying efforts, possibly first by lobbying the centre—e.g., the planning agencies and line ministries—to insert their projects into the master plan. They then take this master plan to the Ministry of Finance to apply for disbursement. Another channel is that, under the name of raising funds for local economic development, the crony companies can directly 'lobby' the Vietnam Development Bank, state-owned commercial banks, and the Economic Stimulus Funds for outright subsidies or loans with preferential interest rates. For example,

[28] For the description of PCI, see http://eng.pcivietnam.org

[29] Source: http://www.nhandan.com.vn/mobile/_mobile_chinhtri/_mobile_tintucsukien/item/788102.html, accessed on 12 October 2014.

[30] Many examples can be found, for instance Ho Chi Minh City Finance and Investment State-Owned Company (HFIC), Hanoi Housing Development and Investment Corporation (Handico), Investment and Industrial Development Corporation (Becamex IDC) in Bình Dương province, and Tín Nghĩa Corporation in Dong Nai province.

during the period of economic stagnation, subsidies from central government to Ninh Binh province in 2009 increased by 1.8 times compared to 2008 (while on average, the subsidy increased only 1.4 times), thanks in significant part to the 'efforts' of a couple of key private domestic firms in the province.

7 Conclusion and policy implications

Vietnam's industrial development since doi moi is a success, but only a partial one. There are obviously many factors behind this performance, but the key determinant is the relationship between the party-state and the private sector. Adhering to the Communist ideology, the party-state's distrust of, and therefore, discrimination against the private sector is inescapable. However, the level of distrust and discrimination depends on the degree of the tradeoff between the political ideology and economic legitimacy, on the internal structure of the state, and on the quality of leadership.

In the early 1980s, the Soviet-style centrally planned economy fell into a serious crisis which challenged the legitimacy of the Communist Party's leadership. Under the leadership of then the acting Secretary General Truong Chinh—a highly indoctrinated communist turned economic reformer—Vietnam launched doi moi or market-oriented reform in 1986. Private enterprises, both domestic and foreign, were still marginalized, however for the very first time, they were officially accepted as an economic sector of the so-called 'multi-sectoral commodity economy'. Thanks to its economic capacity and political neutrality, FIEs were welcome to form joint-ventures with SOEs. Within a decade, the FIE sector has surpassed the SOE sector to become the largest contributor to industrial growth in Vietnam.

In the late 1990s, Vietnam's economy once again faced serious difficulties, not to the extent of a crisis, but were sufficiently pressing for the Communist Party to be concerned about its performance legitimacy. At the time, Prime Minister Phan Van Khai—a dedicated technocrat—together with his group of reformers, with the PMRC and CIEM at the nucleus, successfully designed and implemented the 1999 Law on Enterprise. This outstanding success was the direct impetus for the blossoming of the domestic-private sector. Within several years and throughout the 2000s, this sector surpassed the FIE sector in terms of industrial growth rate. Meanwhile, despite all advantages and privileges, the designated 'leading sector'—i.e., the SOE sector—continued falling far behind the private sector in almost every measures of industrial performance.

Unlike the first two generations of enterprise laws, the 2005 Law on Enterprise was enacted during the peak of economic growth. In addition, the internal structure of the state had been altered by decentralization, and the status of the SEGs had been adjusted by the leadership change. In terms of supervision, the SEGs have increasingly moved away from the line ministries towards the Prime Minister, and have even become his economic means for building political support. Decentralization has intensified competition among provinces in Vietnam. On the one hand, this competition increases the leverage of the Prime Minister—who now can use SEGs as his 'investment vehicles' in provinces. On the other hand, it encourages local governments to stay closer to businesses, especially the larger ones. Consequently, while the local business climates have generally been improved across provinces, clientelism and collusive behaviour in the relationship between the state and business at both the central and local levels becomes widespread.

This case study of Vietnam offers several implications. First, Vietnam's experience has been consistent with the statist literature in suggesting that a prerequisite for rapid industrial growth in the late-late-late industrializers is that the leaders single-mindedly commit to economic growth and put national interests above political, ideological and personal interests. These are preconditions for the ruling elites to form a close alliance with the most productive forces, build strong reform coalitions, and create a meritocratic bureaucracy—all of which are the 'usual suspects' behind the success of Japan, South Korea, and Taiwan.

In the Vietnamese case, because the alliance with the most dynamic and efficient sectors was viewed by many as a temporary concession rather than a coherent strategy, the success was only partial. More fundamentally, because of the orthodox ideology at the beginning of reforms and later on due to a symbiotic economic relationship with the SOEs, the Vietnamese party-state has chosen to rely on the SOEs, which are persistently the least efficient sector in the economy. Additionally, the fragmentation of power and inherent lack of effectiveness render the state incapable of imposing hard budget constraints on the SOEs or sanctions them for underperformance. Without effective 'sticks', and an over reliance on 'carrots' for political support rather than development goals—the state-business relationships run the risk of being degraded into clientelism and corruption.

Second, the relationship between the state and business will influence the institutions and the quality of co-ordination between them. In Vietnam before 1986, when private businesses were deemed to be subjects of 'socialist rehabilitation', there could hardly be any possibility of co-ordination between the state and the private sector. True co-ordination first requires a certain degree of equality between the parties involved, and therefore never exists when the state assumes the dominant role and the private sector is merely subservient. This implies that, for non-capitalist countries, before discussions about the optimal institutions for effective state-business co-ordination (see, for instance Schneider 2013), it is necessary to analyse the role of the business sector in the vision and strategy of the ruling elites.

Third, it has long been asserted that industrial development requires effective co-ordination between the public sector and businesses (Amsden 1989, Johnson 1987, Evans 1995, Kohli 2004, Schneider 2013). This co-ordination, in turn, requires effective co-ordination in the state system itself as well as in the business sector. In Vietnam, the co-ordination within the business sector is inefficient, partly because of the clear hierarchical structure dominated by SOEs, and partly because business associations are often designed as extended arms of the party-state rather than representatives of business community. In addition, as analysed in Ketels et al (2010), 'inter-ministerial coordination on policy substance as well as implementation details is poor primarily because mechanisms are lacking to encourage different ministries to work together.' Under these conditions, the consolidation of state-business co-ordination authority can be necessary. Although Vietnam has never had any institutions even close to the Economic Planning Board in South Korea or the Council for Economic Planning and Development in Taiwan, the co-ordination by the PMRC and the Implementation Task Force led to the impressive success of the 1999 Law on Enterprise. In contrast, with the concentration of controlling power over SEGs and the disbandment of the PMRC right after taking office, the new Prime Minister has, on the one hand, created 'socialist cronyism' and, on the other hand, destroyed the very little 'corporate coherence' and 'embedded autonomy' existed in the bureaucracy.

Fourth, the greatest effect on industrial development does not necessarily come from narrowly-defined industrial policy per se, or even from purely economic policy. As evidence in the case of Vietnam, political compromises about the role of the private sector are the foundation in which economic and industrial policies are shaped. This also implies that industrial development runs the risk of being reversed because of changes in leadership or political coalition.

Finally, a qualification should be added to our discussion on the impact of decentralization on the state-business relationship. Our analysis of the serious negative implications of decentralization in Vietnam by no means implies that decentralization is necessarily ineffective and should not be implemented. Quite contrarily, decentralization is necessary because it provides incentives for local governments to stay closer to local people and businesses. What this paper does suggests is that the effects of decentralization—both positive and negative—with respect to the state-business relationship should be seriously taken into account for an effective decentralization programme.

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