Title: The Political Economy of Private Sector Development in Vietnam since Doi Moi

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The Political Economy of Private Sector Development in Vietnam since Doi Moi

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Abstract: Vietnam's private sector development since Doi Moi is a success, but only a partial one. This paper provides a political economy account of Vietnam's private sector development since *Doi Moi*, illustrated through its contribution to the country's GDP and industrial performance. The paper shows that for political reasons, meaningful improvement in the status of the private sector usually only possible when the economy faces economic crisis, and that the improved status of the private sector has been a key factor contributing to the growth of Vietnam's industry for the first two decades since *Doi Moi*. This paper also shows that the clientelistic state-business relations emerged in the mid-2000s have created significant political economic obstacles for Vietnam's future reforms.

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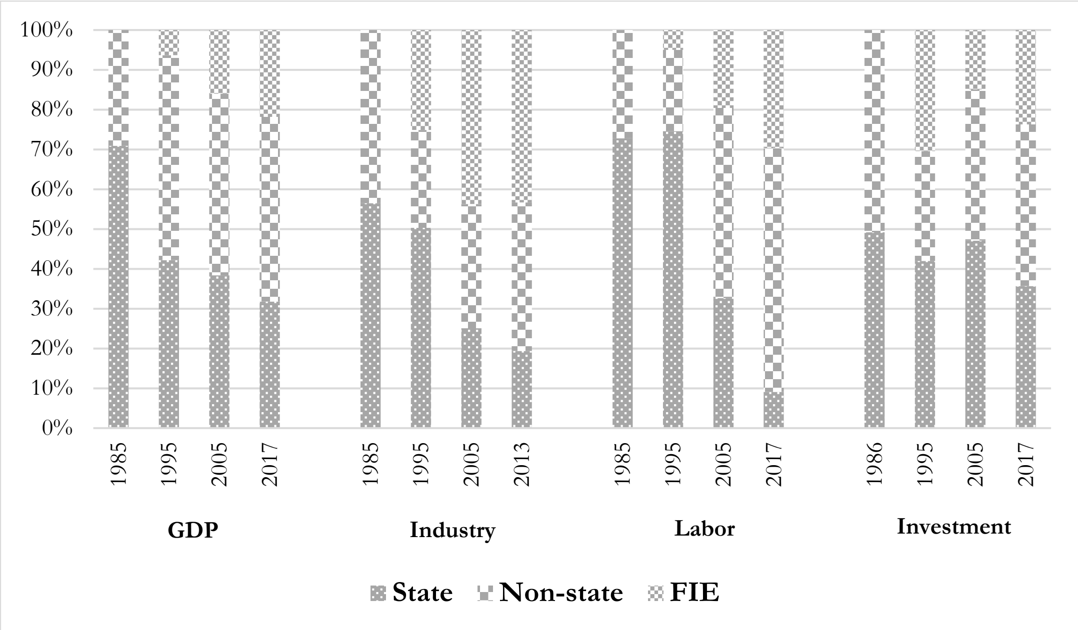
1 Introduction

Since *Doi Moi* (economic renovation), the private sector in Vietnam has experienced exponential growth. From marginal position, the private sector has now become the main growth engine of the economy. At the beginning of *Doi Moi*, the private sector contributes only 30 per cent of GDP, 44 per cent of industrial output, 27 per cent of non-agricultural workers, and 51 per cent of total investment, then after three decades, these shares are 68 per cent, 81 per cent, 91 per cent, and 64 per cent, respectively (Figure 1). The essence of Vietnam's *Doi Moi*, therefore, is a process of gradual withdrawal of the public sector (and the accompanied central planning), replaced by the growth of the private sector (and decentralized markets).

Figure 1: Relative Importance of the Three Ownership Sectors since Doi Moi (%)



Source: Author's calculation based on Vietnam's Statistical Yearbooks (1985 to 2017).

Note: GSO stops publishing data on industrial production by ownership since 2014.

The formal private sector in Vietnam is composed with three virtually separate sub-sectors, in which the most successful is foreign invested enterprises (FIEs). From absolute non-existence in 1986, this sector now contributes 22 per cent of GDP, 30 per cent of employment in the formal business sector, and 24 per cent of total investment in Vietnam. In some important areas, FIEs even rose to the top position, far ahead of both the state sector and the domestic private sector. For instance, in 2018, the FIE sector accounts for over 43% of the industrial production and contributes more than 70% of Vietnam's total export.

The second sub-sector, emerged from the mid-2000s, is domestic private conglomerates, thriving mostly in lucrative or rent-seeking industries such as banking and real estate, mainly thanks to their strong links in one way or another with the public sector (World Bank Vietnam and Ministry of Planning and Investment 2016, Nguyen 2019). These conglomerates started to emerge in the mid-2000s, but by 2018 they account for one third of the top 100 biggest companies in Vietnam in terms of sales.

The third sub-sector, domestic private small and medium-sized enterprises (SMEs), has experienced the fastest growth in terms of quantity, but its contribution to GDP has been stable around 10% and its average size (in terms of both capital and labor) has been declining in the last two decades. Results from the General Statistical Office's Enterprise Survey show that the average number of workers in Vietnam's domestic private sector has been reduced from 30 in 2000 to only 16.7 in 2016.

This paper provides a political economy account of Vietnam's private sector development since *Doi Moi*, illustrated through its contribution to the country's GDP and industrial performance. It will show that for political reasons, significant improvement in the status of the private sector, especially the domestic private sector, usually only possible when the economy faces economic crisis, and that the improved status of the private sector has been a key factor contributing to the growth of Vietnam's industry for the first two decades since *Doi Moi*. This paper will also show that the clientelistic state-business relations (SBRs) emerged since the mid-2000s have created significant political economic obstacles for Vietnam's 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 Vietnamese Communist Party (VCP).[1] In an one-party authoritarian regime with communist ideology like Vietnam, the political status of each business sector in the eyes and mind of the politicians largely determines its economic role in the country's overall strategy. Sections 3, 4 and 5 will analyse the dynamics of private sector development as reflected through the design and implementation of four generations of the law on private enterprises, as well as their impacts on the country's GDP and industrial performance. Section 6 will show that the undisciplined decentralization has contributed to the rise of clientelism between large domestic private enterprises and the government. The last section will conclude and draw some implications for Vietnam's future reform.

2 Vietnam's fundamental political economic dilemma and tripartite ownership structure

[1] From now on, we will refer to the state-owned enterprise sector as the state or SOE sector, domestic private enterprise sector as non-state or PDE sector, and foreign invested enterprise sector as FIE sector.

2.1 Vietnam's fundamental political economic dilemma

Until recently, the leadership in unifying the country has been the greatest assets underlying the legitimacy of the VCP. However, this source of legitimacy has been eroding over time, while the economic legitimacy has become more important. The Vietnamese party-state's overarching goal is to achieve high rates of economic growth in order to maintain its performance legitimacy, while keeping intact its absolute political power. This fundamental political economic dilemma explains why Vietnam has adopted market-oriented reforms, compromised private ownership and allowed the functioning of markets to a certain extent, and actively integrated into the world economy. But, at the same time, the Vietnamese party-state has tried very hard to maintain a large SOE sector despite its indisputable inefficiency, and even found various ways to subsidize and shield this sector from international competition even after Vietnam had become a member of the WTO and joined CP-TPP.

This political economic dilemma explains why domestic private sector, while being promoted rhetorically but has faced formidable barriers in reality. First and foremost, these barriers stem from the dualistic nature of Vietnam's socialist-oriented market economy. Partly due to the communist ideology, partly because of the symbiotic economic relationship between the Vietnamese party-state and the SOE sector, SOEs—especially the larger ones—have always been regarded as the backbone of the economy, despite the fact that it is inefficient and, therefore, a heavy burden on the economy (Perkins and Vu-Thanh 2011). It follows from this logic that the domestic private enterprises are facing many challenges, namely the enforcement of private property rights is weak, private enterprises suffer from unequal treatments in terms of access to resources such as land and credit, market-supporting institutions are either lacking or ineffective.[2]

Institutional weaknesses explain the limited significance of the private enterprise sector in Vietnam. These weaknesses are also responsible for the clear differentiation within the private sector between cronies (who have close relationship with government officials) and regular SMEs with little opportunity to gain access to important resources such as land and credit. It follows, as North (1990) predicted, that the majority of large private enterprises concentrate in commercial or speculative activities, most in the real estate sector. SMEs, on the other hand, being crowded out by the SOE and FIE sectors, find it very difficult to get access to credit and make long-term investment to scale up and become large enterprises. This explains why Vietnam has very few large-scale manufacturing private enterprises. Thirty years of reform have certainly helped many entrepreneurs accumulate wealth, but failed to create internationally recognized manufacturing enterprises.

[2] For detailed discussion, see Pham Chi Lan (2008) , Vu Quoc Tuan (2008) , Pham Duy Nghia et al. (2013).

While the domestic private sector, with the exception of a few large cronies, has been fettered and discriminated, the FIE sector – thanks to its political neutrality – has thrived. Since the very beginning of Doi Moi, Vietnam has opened up its economy to foreign direct investment and steadily refined the rules governing FIEs. Ever since, foreign private investors have in fact been favored over domestic-private investors. In this respect, Vietnam's experience is 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, and have had less help in cutting through government red tape. FIEs, especially in the early years, regularly develop joint ventures with SOEs to take advantage of these state firms' easier access to land and other preferential treatments. 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 (Vu-Thanh 2017). Overall, however, the domestic-private industrial sector in Vietnam still labors under some form of discrimination and the WTO rules will not end them all.

2.2 Vietnam's tripartite ownership structure and performance

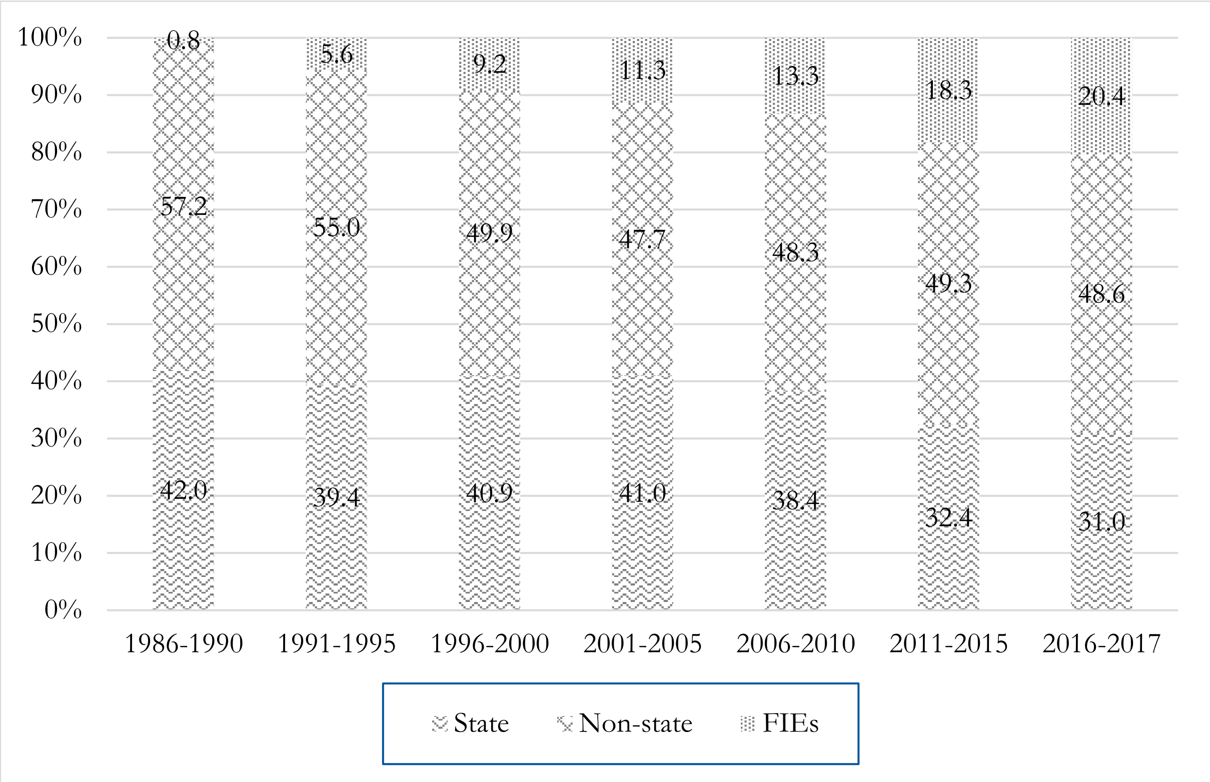
Vietnam's economy features a tripartite structure: the SOEs (both central and local), the FIEs, and the DPEs.[3] In this and the next three sections, we will analyse performance of each of these sectors and, with that as background, show how the policy toward private sector helps explain the performance pattern that we have observed. We will pay special attention to the political economy associated with the four generations of the law on private enterprises.

Vietnam's GDP and industrial structure has gone through significant changes in the last three decades. Starting from nothing in early years of Doi Moi, the FIE sector has grown quickly, currently account for more than 20% of Vietnam's GDP. During the same period, the state and non-state sector's share has declined from 42% to 31%, and from 57.2% to 48.6%, respectively (Figure 2).

The structural change has been even more significant with respect to Vietnam's industrial output. 1990s. By 1996—that is, after a decade of presence in Vietnam—with an average growth rate of nearly 23%, twice as high as the other two sectors, the FIE sector accounted for a third of Vietnam's industrial production. As the result, in that same year, for the first time the private sector (including both domestic and foreign) replaced the public sector as the largest contributor in Vietnam's industrial production.

[3] 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.

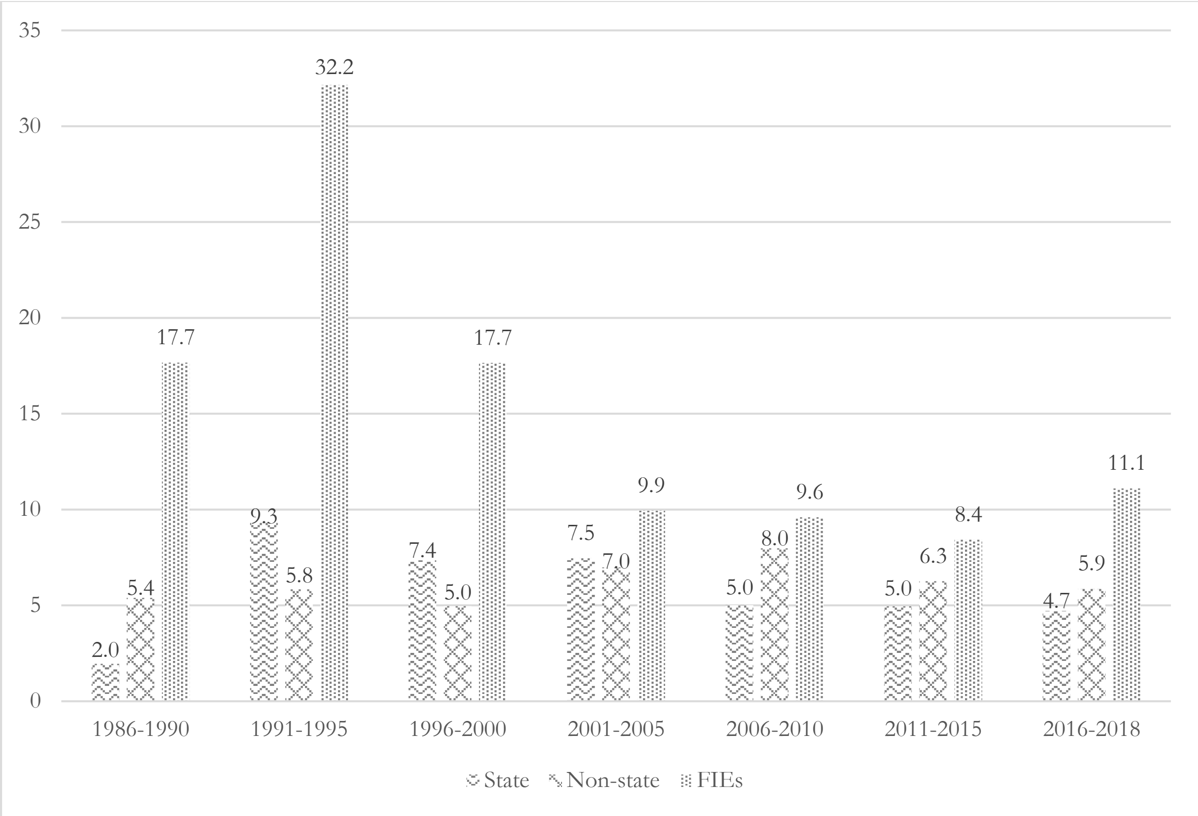
Figure 2: GDP share by ownership (1986-2017)



Source: Author's calculation based on Vietnam's Statistical Yearbooks, 1986-2017

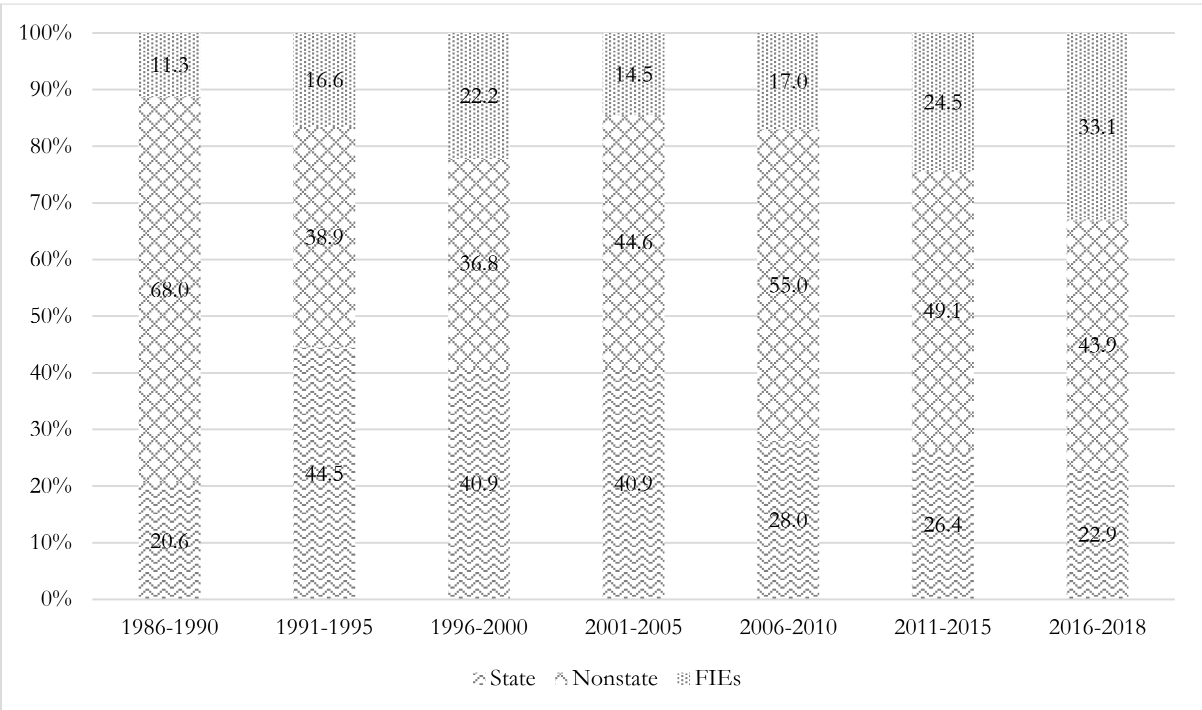
Since the first FIE came to Vietnam, the FIE sector has always registered the highest rate of GDP growth (Figure 3). As the result, even though starting from a much lower base, by the mid of 2010s, the FIE sector contributed more to Vietnam's GDP growth compared to the state sector (Figure 4). It is important to note that after reaching the peak in the mid-1990s, the growth rate of all three sector has generally declined (except for the FIE sector during 2016-2018). This explains why the country's GDP growth rate has declined from the peak of 9.5% in 1995 to just around 6.5 in the 2010s.

Figure 3: GDP growth by ownership sectors (%, 1986-2017)



Source: Author's calculation based on Vietnam's Statistical Yearbooks, 1986-2017

Figure 4: Contribution to GDP growth (1986-2017)



Source: Author's calculation based on Vietnam's Statistical Yearbooks, 1986-2017

The decline of SOE sector's share in Vietnam's GDP has occurred despite the fact that this sector received a unproportional share of investment vis-à-vis the non-state sector (Perkins and Vu-Thanh 2020). In Vietnam the state share of investment was consistently at or above 50 per cent of total investment in the forms of government budget and state-owned commercial bank loans until mid-2000s. In contrast, the private SMEs had no access to the first source and little access to the second source to finance their fixed assets.

It is in export performance where the FIE sector demonstrates its dominance over both the state and non-state sectors as evidence by the fact that a large and rising share of exports is coming from FIEs. Indeed, the FIE sector contributed about 72% of Vietnam's total exports in 2018.[4] In effect, the FIEs are able to meet international competition whereas the state sector and substantial parts of the domestic-private sector are less able to do so.

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 VCP has to admit as a 'comprehensive social and economic crisis'.[5] A series of policies intended to eradicate private property and put an end to free market such as commercial and industrial 'socialist rehabilitation', agricultural collectivization, and prohibition of inter-provincial circulation of goods—pushed the economy to the brink of crisis. Serious failures of the 'price-wage-money' stabilization package in 1985 was the final blow to the already fragile 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 shut down any window of opportunity for economic normalization with the USA and, therefore, trade with the West. In sum, the economy was pushed against a wall.

Truong Chinh - the then acting General Secretary of the VCP - renounced his old dogma in order to adopt market-oriented reforms, which was a completely uncharted water. He led a group of reformers within the VCP, 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* in 1986, accepting the co-existence of

[4] It is 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.

[5] See, for example the Strategy for Socio-economic Stabilization and Development to 2000 adopted at the 7th Party Congress in June 1991.

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' by many political leaders. To accept the existence of both the non-state sector and market relations in the economy was considered a 'strategic step backward' in the transitional path to socialism.[6] 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.

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 'normalization' between state and private businesses were immediate and astonishing. 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(A)).[7] Similarly, 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(B)). The domestic 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.

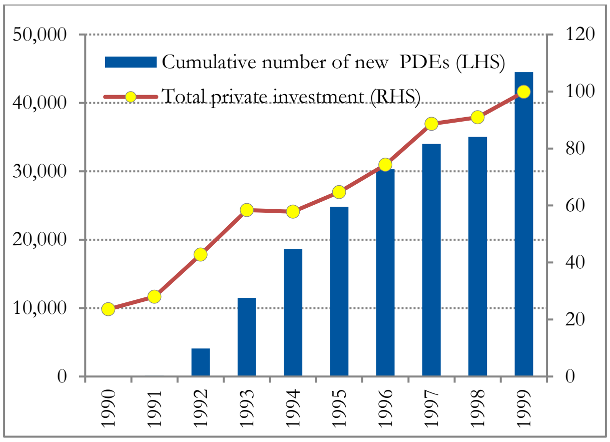
Figure 5: Newly registered FIEs and DPEs in Vietnam (1987-1999)

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

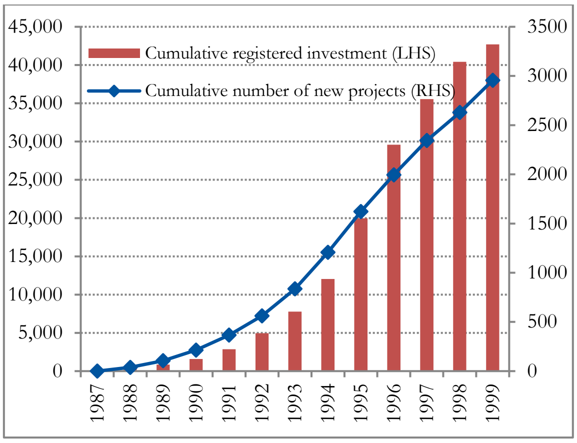
(B) Cumulative newly registered FIEs and foreign direct investment (1987-1999)

[6] The term 'private economy' is only officially used for the first time since the 6th Meeting of the 6th Party Congress (March 1989). Before that, 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 acknowledges the need of private capitalist economy but, at the same time, 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'.

[7] 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).



Note: Investment is in VND trillion, 1994 constant price



Note: Investment is in US$ million

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

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 were not sufficient to strengthen the position of the domestic-private sector. 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.

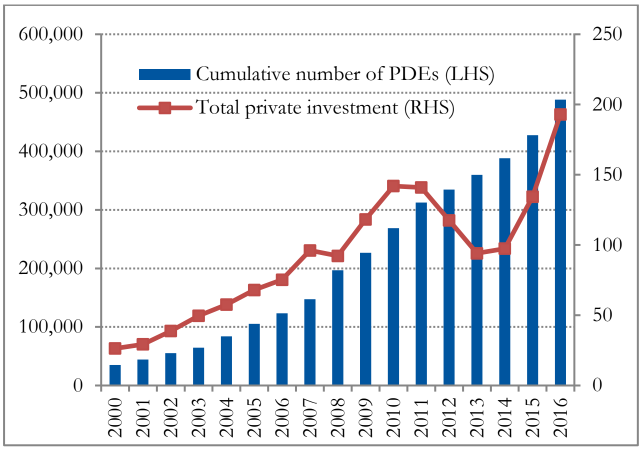
Similarly, in the 1990s, GDP growth rate of the domestic-private sector was only 5.4 per cent, much lower than that of the SOE sector and only about a quarter of the FIE sector. As a result, the share in GDP of this sector fell sharply from 57.2 per cent in the period 1986-90 to 49.9 per cent in the period 1996-2000. As will be shown in the next section, this declining trend in GDP growth was dramatically reversed only in the 2000s, after the passage of the 1999 Law on Enterprise.

4 Asian Financial Crisis and the thrive of private sector in the 2000s

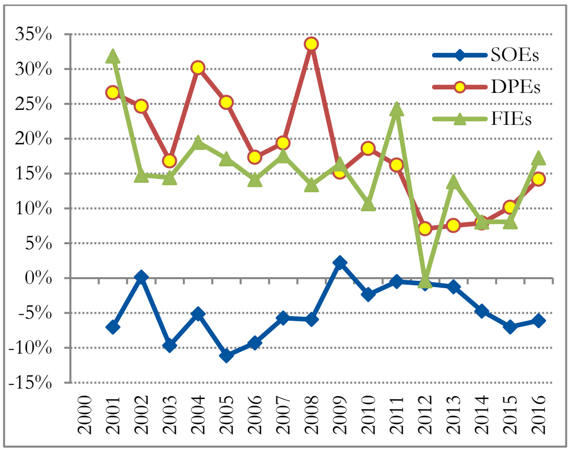
The Vietnamese economy was significantly affected by the Asian Financial Crisis in 1997 due to its heavy reliance on FDI and exports. From a peak of US$9.6 billion in 1996, annual registered FDI plummeted to US$6.0 billion in 1997 and to US$2.3 billion in 1999. Moreover, many investors stopped investment or even withdrew licensed projects. Export growth, which was about 30 per cent in previous years, dropped to less than 2 per cent in 1998. GDP growth experienced a free fall from 8.0 per cent in 1997 to 4.8 per cent in 1999. Against this backdrop, the party-state decided to adjust the path of economic development, in which emphasis was put on promoting the so-called "internal forces", including both SOE and DPE sectors. It is in this context that the 1999 Law on Enterprise was introduced. Just like the Law on Private Enterprise and the Company Law in 1990, once again, only the combination 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 (2000-2016)

(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 (various years).

If the 1990 Law on Private Enterprise and the Company Law established the DPEs as a formal economic sector in the Vietnamese economy, then the 1999 Law on Enterprises has a crucial role in helping this sector flourish by (i) introducing 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; (ii) replacing the licensing system with business registration; (iii) applying post-audit instead of pre-audit; (iv) institutionalizing the autonomy of enterprises in selecting business areas, locations, forms of business and organization; and (v) clarifying internal decision-making mechanisms within private enterprises, protect the rights of investors, particularly minority shareholders and creditors.

Within two years of its implementation, more than 35,000 DPEs were established, nearly as many as the number of enterprises established in the previous ten years combined. During the period 2000-2005, 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 (Figure 6 and Pham 2008). In terms of industrial production, during the period 2001-2005, the private sector's average growth rate surged to 21.9 per cent, significantly higher than that of the FIE sector (16.8 per cent) and nearly double the growth rate of the SOE sector (11.5 per cent). With this remarkable growth, the private sector's contribution to industrial growth in the period 2001-2005 amounted to 35.1 per cent, far exceeding the contribution of the SOE sector (26.3 per cent) and quite close to the contribution of the FIE sector (38.6 per cent).

The contribution of the DPE sector was even more impressive when it comes to GDP. Robust growth of the DPE sector helped the non-state sector increased its contribution to GDP from 36.8 per cent during 1996-2000 to 44.6 percent during 2000-2005. During the same period, the contribution of the state sector stayed unchanged (40.9 percent), while that of the FIE sector fell from 22.2 percent to 14.5 percent. It is important to emphasize that during 2000-2005, the domestic private sector in Vietnam, for the very first time since Doi Moi, surpassed the state sector in terms of both contribution to GDP and industrial production.

What really caused the huge difference between the two generations of law on private enterprises? There are of course many factors involved, but two stand out.[8] First and foremost, there was a fundamental shift in the status of the domestic-private sector as regarded by the Vietnamese party-state. When the first two laws on domestic-private enterprises were enacted in 1990, private enterprises in Vietnam were still considered as 'subject of socialist rehabilitation'. In contrast, the 1999 Law on Enterprise was able to institutionalized the rights of doing business for private firms established in 1992 Constitution.[9] In 2001, the Ninth Party Congress 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.'[10] 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 since then has become a matter of long-term strategy in the socialist-oriented multi-sectoral economic development, and this strategy demanded that 'favorable institutional and social environment for the development of the private sector should be created'.[11]

Second, the establishment of the Law on Enterprise's Implementation Task Force (hereafter Task Force) played an instrumental role in enforcing the Law on Enterprise and thereby reinforcing the 'new status' of the private sector. This Task Force, including some of the most dedicated reformers, was led by Tran Xuan Gia, who previously chaired the Law on Enterprise's Steering Committee. The main job of the Task Force was to draft guiding decrees for the implementation of the Law on Enterprise and keep the business licensing system in check. It is important to note that the Task Force enjoyed autonomy vis-à-vis the government since it reported directly to the Prime Minister. In February 2000 (i.e., only two months after the Task Force was founded), Decree 02/2000/NĐ-CP drafted by the Task Force was enacted,

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[8] Another, very important factor was the bilateral trade agreement between Vietnam and the USA (2001), which almost coincided with the time of the Law on Enterprise, and therefore strongly complemented it.

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

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

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

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.

5 The Law on Enterprise in 2005 and 2014 to meet requirements of WTO and TPP

After several years of implementing the 1999 Law on Enterprise, the earlier advantages faded away, partly because the lack of internal pressures for reform, and partly because the initial 'low hanging fruit' had already been exhausted. The implementation of 1999 Law on Enterprise increasingly clashed with even more powerful vested interest groups.

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. The conflicting views about the government's role and its relationship with private sector resurfaced. In these debates, the real motives of the conservatives and interest groups (especially state conglomerates) were often disguised under the umbrella of maintaining political and social stability.

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 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. The later factor also applies for the 2014 Law on Enterprise. Moreover, for some senior party-state leaders, the 2005 and 2014 Law on Enterprise were merely a necessary means to achieve the objective of joining the WTO and Trans-Pacific Partnership (TPP) respectively. Together, these are the main reasons that prevented these Laws on Enterprise from creating the kind of breakthroughs brought about by the 1990 and 1999 Law on Enterprise. 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 at 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), especially given the emergence of powerful state economic groups since 2005 (Nguyen 2014, Vu-Thanh 2017).

In summary, the 2005 and 2014 Laws on Enterprise have not brought about the significant changes to Vietnam's private sector development. 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 government's stimulus package after the Global Financial Crisis rather than with the 2005 Law on Enterprise itself. Similarly, the recovery of the private sector (Figure 6 (B)) since 2014 came from the recovery of both international and Vietnamese economy rather than thanks to 2014 Law on Enterprise. Even worse, from the mid-2000s onwards, the co-operative relationship and trust between the state and private business sectors built during Phan Van Khai's terms (i.e., 1997-2006) have been degrading. Meanwhile, quid pro quo relationship between the state and big businesses—mostly SEGs and a very small group of big private conglomerates—in search of political support or privileged benefits has become increasingly widespread.

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

6.1 Leadership change and the emergence of state economic 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.[12] 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.

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.[13] Instead of being traditionally supervised by the line ministries, all SEGs are now put under direct supervision of the Prime Minister. 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

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[12] 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.

[13] 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 VCP's Secretary General, who also came into power in 2006.

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 behavior previously appeared idiosyncratic, they now became quite common. In the most recent Provincial Competitiveness Index (PCI) survey conducted by VCCI 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.

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 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.[14] 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. Thus, decentralization changes not only the status of the business sector in general, but also the relative role of the three business sectors in the calculation of the local government.

Fiscal decentralization has different consequences for the 63 provinces in Vietnam in terms of their budget. 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 central government 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

[14] 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).

Minister may suggest SEGs to invest simultaneously in many provinces.[15] 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.[16] And when the economy slows down—as it does 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 on the relationship between local governments and businesses. 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.[17]

The improvement in the relationship between businesses and provincial governments, and thus the quality of the business environment, generally help provinces attract additional foreign direct investment. In turn, these FIEs – acting as "agents of change" – contribute to better business environment (Vu 2008), especially where FIEs are significant contributors to the province's GDP and industrial production.

However, although provincial governments can support the business expansion, they often fail to facilitate cluster development as in the case of local governments in China (see Dinh 2014). One of the main reasons is due to the fact that provinces –

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

[16] 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.

[17] PCI is a non-government initiative, jointly developed by the VCCI and USAID, designed to assess the ease of doing business, quality of economic governance, and progress of administrative reform in all 63 provinces in Vietnam. PCI is constructed using opinion data provided by domestic private businesses as well as published data regarding ten dimensions of provincial economic governance, namely (1) entry costs for business start-up; (2) access to land and security of business premises; (3) information transparency and equitability; (4) time requirements for bureaucratic procedures and inspections; (5) informal charges; (6) policy biases toward state, foreign, or connected firms; (7) proactivity of provincial leadership in solving problems for enterprises; (8) business support services; (9) labour and training policies; and (10) fair and effective legal procedures for business dispute resolution. Since the PCI was first introduced in 2005, it has been actively used by provincial governments to monitor and benchmark the competitiveness of their business environment. The PCI is, however, rarely used by the central government as an input to its policy formulation. For more information on the PCI, see http://eng.pcivietnam.org

which are the decentralized units in Vietnam – are quite small.[18] As a result, industrial clusters often spread across several provinces, while unfortunately these provinces have little incentives to coordinate but compete with each other. For instance, industrial clusters such as catfish, shrimp, and rice – those agricultural processing industries that Vietnam has outstanding comparative advantage – spread over provinces in the Mekong Delta. But so far, despite commitments made by leadership of these provinces, "public good" activities such as export market database and regulations as well as trade promotion activities of the thirteen provinces in the Mekong Delta remained isolated (Vu-Thanh et al. 2011). Similarly, the southern textile clusters – one of Vietnamese leading exports – located in Ho Chi Minh, Binh Duong and Dong Nai, but these provincial governments hardly have any cooperation or coordination efforts for improving or upgrading the cluster.

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 VCP—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.[19] 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.[20] These companies can be either rent-seeking or welfare-improving or both, depending critically on the degree of

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[18] By ways of comparison, in 2010 an average province in China (Vietnam) has an area of 282,264 (5,257) km^2, a population of 38.6 (1.4) million, and a GDP of US$ 175 (1.6) billion.

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

[20] 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.

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 center—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, 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

The private sector in Vietnam has experienced impressive growth since Doi Moi. From marginal position – being considered as subject of 'socialist rehabilitation' and only allowed to do business in areas stipulated by law until early 1990s – this sector has played the central role for economic growth, industrial development, and job creation for the economy. Indeed, the development of the private sector is one of the most significant achievements of Doi Moi in Vietnam.

But the success of the private sector in Vietnam is only a partial one. The FIE sector has grown very strongly and now dominates both export and industrial production in Vietnam, however without being integrated to the domestic economy. Domestic private sector has also grown very fast in terms of quantity, but its average scale is very small and its competitiveness is still limited. As analyzed in this paper, the root cause of this situation stems from the nature of the Vietnamese political economic system, in which one of the biggest challenges facing the VCP – or its fundamental political economic dilemma – 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.

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 has depended 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. Consequently, in a long time, the private sector, especially the domestic private sector, has been discriminated, despite the fact that this sector is the largest contribution to the growth and integration Vietnam's economy. Only very recently (i.e., the 12th Party Congress in 2016), after many heated debates, the private sector is now considered to be "an important driving force" of the economy, while the "leading role" of the state sector has been reaffirmed. It is also because of the fundamental political economic dilemma that status of the private sector had only been fundamentally improved when the economy plunged into crisis. And then, as evidenced in this paper, the private sector (together with the household agricultural sector) has always become the "life saver" of the economy.

This paper also points out an important distinction in Vietnam's domestic private sector, which is the difference in nature between small- and medium-sized private enterprises and large private conglomerates. While the former have to struggle in unfair competition and institution environment, and therefore it is very hard for them to grow up, the majority of the latter are rent-seeking, overcoming their "original sin" primarily through colluding with the state and state enterprises. As argued in this paper, the rapid emergence of these enterprises since the mid-2000s stems from the Vietnamese political economic system itself as well as from the leadership, institutional fragmentation, and decentralization in Vietnam.

In retrospect, Doi Moi success in Vietnam depends on three decisive factors: existential urgency of the situation, quality of reform leadership, and the lack of powerful vested interest groups, which emerged due to the collusion between business conglomerates (both public and private) and the state. Looking forward, if the first factor does not emerge while the other two factors remain unchanged, any reform breakthrough, or the so-called "*Doi Moi II*", seems implausible.

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