9

The Political Economy of Industrial Development in Viet Nam

Impact of State–Business Relationships on Industrial Performance, 1986–2013

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9.1 Introduction

Since Doi Moi (economic renovation), Viet Nam has experienced an impressive industrial growth (Figure 9.1). Between 1986 and 2013, in spite of serious economic downturns caused by the collapse of the Soviet Bloc, 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.

However, after nearly three decades of extensive development, Viet Nam's industry now seems to have reached a 'glass ceiling'. The rate at which labour

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

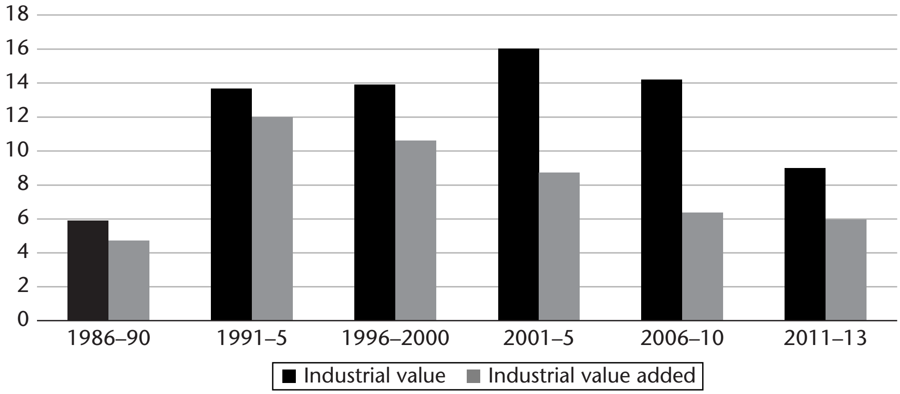

Figure 9.1. Average rate of industrial growth in Viet Nam since Doi Moi (%)

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

moved out of agriculture during the period 2006–12 was less than a third of the rate during 2000–6. 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. In 2012, MVA accounted for only 17.4 per cent in the gross industrial value compared with 36 per cent in the early 2000s. The proximate causes of this stagnation are that Viet Nam 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 chapter provides a political economy account of Viet Nam's industrial growth since Doi Moi. It will show that the improving relationship and coordination between the public and business sectors has been a key factor contributing to the success of Viet Nam's industry for the first two decades since Doi Moi. This chapter will also show that the clientelistic state–business relations (SBRs) emerged in the last decade have created significant structural obstacles for Viet Nam's continued development in the future.

This chapter is organized as follows. Section 9.2 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). In a one-party authoritarian regime with communist ideology like Viet Nam, the political status of the business sector in the eyes and minds of the politicians largely determines the SBR, and therefore the coordination between the two sectors. Sections 9.3, 9.4, and 9.5 will analyse the dynamics of SBRs and coordination 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 9.6 will conclude and draw some policy implications.

9.2 Political Ideology, Economic Legitimacy, and Tripartite Industrial Structure

9.2.1 *Political Ideology, Economic Legitimacy, and Industrial Policy in Viet Nam*

Viet Nam's independence from the French in 1945 and reunification in 1975 after the Viet Nam War were both achieved under the leadership of the VCP. Until recently, the merits of liberating and unifying the country have been the greatest assets underlying the legitimacy of the VCP. However, this source of legitimacy has been depreciating and, over time, replaced by economic performance. One of the biggest challenges facing the VCP 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—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 that the private sector is fettered, discriminated, and, as we shall see in Sections 9.3 and 9.4, usually only taken seriously in crisis situations.

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 VCP 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 World Trade Organization

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

(WTO), the discrimination against domestic-private SMEs still persists (Vu 2008; Malesky 2014).

Viet Nam's industrial policy today is a mix of policies. The policies that have had the largest impact on the country's industrial development are 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. According to the Report on Economic Concentration of the Ministry of Industry and Trade (MITI) (2012), the state economic groups (SEGs) occupy a dominant position in most key industries and sectors, namely oil and gas, coal and minerals, infrastructure, transportation, aviation, rail, and electricity. In addition, 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. Until very recently, SOEs were allowed to use state capital without paying dividends.[3] They are generally not subject to hard budget constraints and virtually never face bankruptcy.[4] The SOEs were designated to disburse the majority of official development assistance (ODA) capital.[5] 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, used to be given priority access to scarce foreign exchange for less than the market rates. Since 2005, the formation of large SEGs with near monopoly control over key industrial sectors is a form of government support that is only provided to SOEs. Although 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 FIEs. At the outset of the reform period, Viet Nam opened up its economy to direct investment by foreign firms, and since the early reform years has steadily refined the rules governing FIEs. Ever since, foreign investors have in fact been favoured over domestic-private investors. In this respect, Viet Nam's experience is much like

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

[4] The number of SOEs totally owned by the state declined from about 6,000 in 1994, that is, 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 2014a).

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

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 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 (Vu-Thanh 2014b). Overall, however, the domestic-private industrial sector in Viet Nam still labours under some form of discrimination and the WTO rules will not end them all.

Although receiving many preferential treatments and playing an important role in improving economic legitimacy for the VCP, there has been so far no discernible evidence that FIEs, as a sector, receive special access to decision makers. The main reasons are that FIEs are quite diverse in terms of country of origin and that they share the need of improving the overall business environment, but compete otherwise. It is worth emphasizing that some particular groups of FIEs, most notably the American Chamber of Commerce (AmCham), European Chamber of Commerce (EuroCham), and Japanese Business Association (JBA), have better access to decision makers and are more active in policy lobbying efforts thanks to their relative significance. However, even some of these groups with particular access to policy-making face difficulty in their business operations in Viet Nam. In a recent report presented at the Viet Nam Business Forum (VBF) 2014, the chairman of AmCham asserts that 'doing business in accordance with the law is very hard to succeed in Viet Nam'.[6] In his view, the business environment in Viet Nam is not competitive, administrative procedures are complicated, laws are not implemented fairly, and, in many cases, businesses do not compete based on their own capabilities in the access to capital, space, and opportunities.

9.2.2 *Viet Nam's Tripartite Industrial Structure and Performance*

Viet Nam'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 (Sections 9.3 to 9.5), we will analyse performance of each of these sectors and, with that as background, show how SBRs and coordination 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.

[6] Source: <http://vneconomy.vn/doanh-nhan/amcham-lam-an-dung-luat-tai-viet-nam-kho-thanh-cong-2014120111574856.htm?mobile=true>, accessed 20 December 2014.

[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.

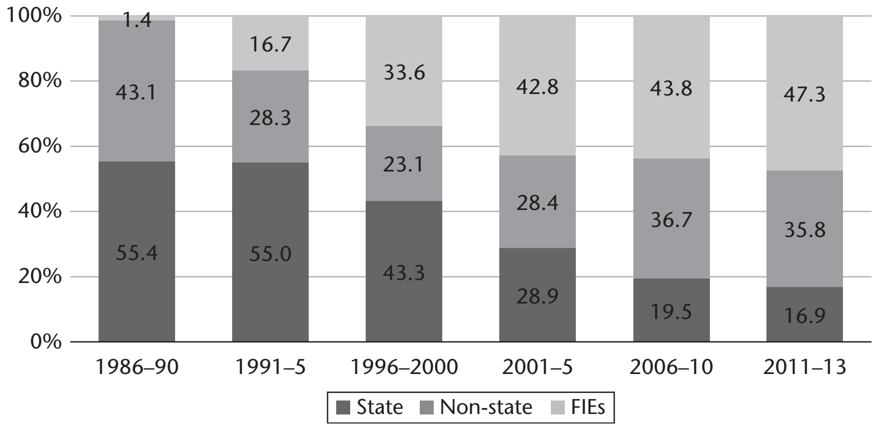

Figure 9.2. Industrial output share by ownership, 1986–2013

Source: Author's calculation based on Viet Nam's Statistical Yearbooks (1986 to 2013) and data published by World Bank's WDI.

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. It follows that elimination of the discriminatory policies that remain is critical to achieving an overall improvement in industrial performance.

Two significant structural changes occurred in the first decade of reform. Firstly, starting from a base line of almost zero, the growth of the FIE sector sky-rocketed. Since the first FIE came to Viet Nam in 1988, it took less than a decade for the FIE sector to account for a third of Viet Nam's industrial production (Figure 9.2). As a result, since 1996 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.

Secondly, since early 1990s, high industrial output growth rate has been sustained mainly by FIEs, and since the 2000s by DPEs. The FIE sector was undeniably the industrial champion in the 1990s. By the end of 1990s—that is, after a decade of presence in Viet Nam—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 industrial growth in Viet Nam. In the following decade, with an average growth rate of about 20 per cent, compared to 16.7 per cent of the FIE sector and 8.8 per cent of the SOE sector, the DPEs had almost caught up with the FIE sector in terms of contribution to industrial growth.

During the period 2011 to 2013, 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.

The declining SOE sector's share in Viet Nam 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 2011). The state share of investment was consistently at or above 50 per cent of total investment until mid-2000s. Much of this investment was ploughed into industry, first through 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.

A large and rising share of exports is coming from FIEs. In 2013, the FIEs sector contributed two-thirds of Viet Nam's total exports. 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.

An empirical puzzle that emerged from this discussion is that given the top priority the VCP has attached to SOEs' industrial performance and bias against the private sector, how has the private sector—the FIE sector in the 1990s and then the domestic-private sector in the 2000s—side-lined the SOE sector to become the main industrial player in Viet Nam?

At first glance, Figure 9.3(A) seems to suggest 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. However, an additional look 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 1991–5 and 2006–10 is almost identical (Figure 9.3(A)), the industrial structure was fully reversed (Figure 9.3(B)), implying a much higher efficiency of the private sector. The empirical question 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 (Sections 9.3 to 9.5).

9.3 Economic Crisis in the 1980s and the Emergence of Private Sector in the 1990s

In the first half of the 1980s, Viet Nam experienced what even the VCP has to admit as a 'comprehensive social and economic crisis'.[8] A series of policies

[8] See the Strategy for Socio-Economic Stabilization and Development to 2000 (the 7th Party Congress, 1991).

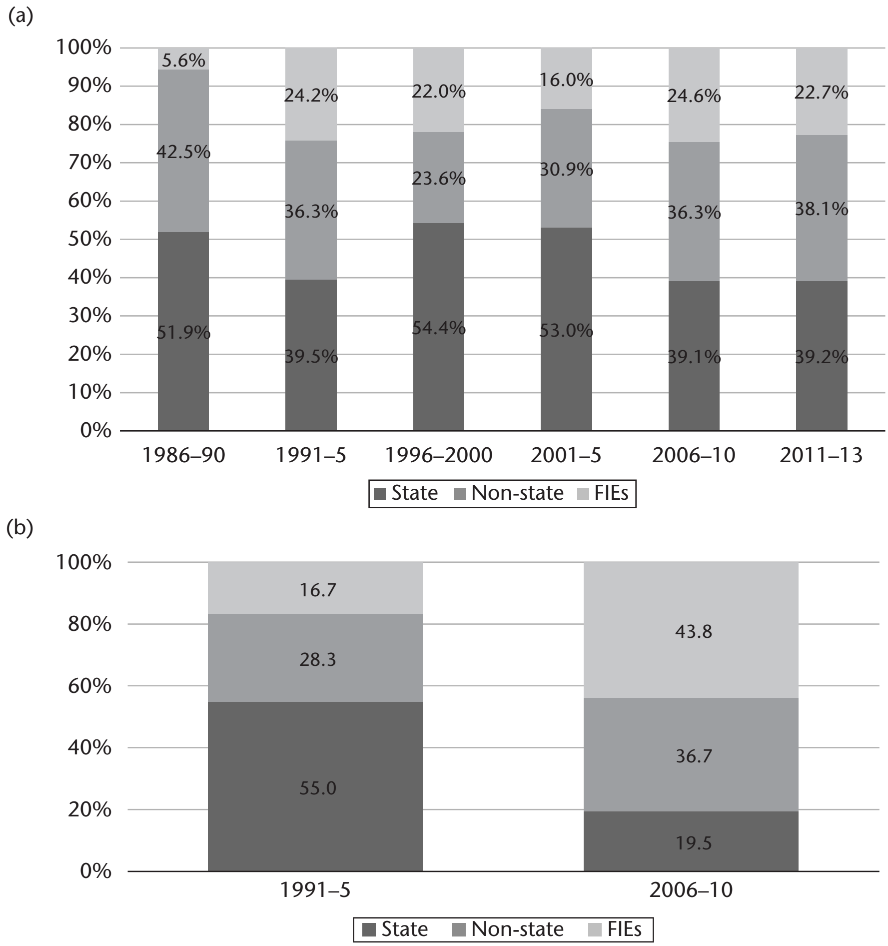

Figure 9.3. Share of investment and industrial output by ownership
Sources: Author's calculation based on Viet Nam's Statistical Yearbooks, 1986–2013.

intended to eradicate private property and put an end to the 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' package in 1985 was the final blow to the fragile economy. Not only exhausted internally, Viet Nam in the mid-1980s found itself completely isolated, both economically and politically, from the world. Aid from the Council for Mutual Economic Assistance (COMECON) was cut completely due to the political crisis within the socialist bloc. Viet Nam'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—adopted market-oriented reforms; which were completely uncharted waters. 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 of restoring economic growth and, thereby, the legitimacy for the VCP's leadership. Under his leadership, the party-state conducted Doi Moi 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'. 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. 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 Foreign Investment—the first market-oriented law in Viet Nam—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 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 9.4(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 1991–9 (Figure 9.4(B)).[9] 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 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 1991–5 and 23.6 per cent 1996–2000 (Figure 9.3(A)).

[9] Family businesses also increased rapidly from 0.84 million households in 1990 to 2.2 million households in 1996 (Pham 2008: 191).

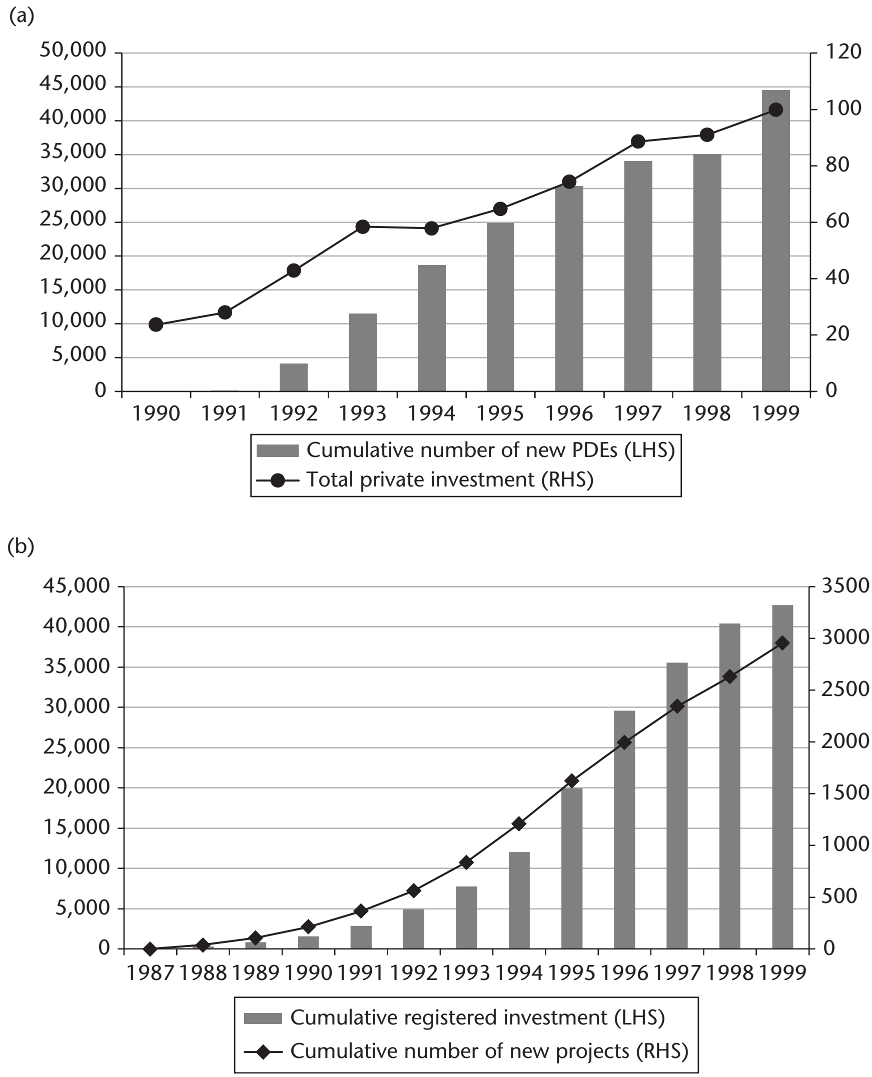

Figure 9.4. Newly registered FIEs and DPEs in Viet Nam, 1987–99
Source: Author's calculation based on data published by the MPI.

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 1991–6 and to only 23.1 per cent in the period 1996–2000. As will be shown in Section 9.4, this declining trend was dramatically reversed only in the 2000s, after the passage of the 1999 Law on Enterprise.

9.4 Economic Slowdown in the Late 1990s and the Revival of the Domestic-Private Sector

Due to heavy reliance on FDI and exports, the Vietnamese economy was significantly affected by the Asian financial crisis in 1997. 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 per year, dropped to less than 2 per cent in 1998. Gross domestic product (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 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.

If the 1990 Law on Private Enterprise and the 1990 Company Law established the DPEs as a sector in the economy, then the 1999 Law on Enterprises (together with the US–Viet Nam Bilateral Trade Agreement (BTA)) has a crucial role in helping this sector flourish. 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 2000–5, 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 3 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, the 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).

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.[10] The remainder of this section will briefly present the difficult journey to reach this decisive change,

[10] Another, very important factor was the BTA between Viet Nam and the USA (2001), which almost coincided with the time of the Law on Enterprise, and therefore strongly complemented it.

and thereby demonstrate the critical importance of SBRs and coordination for the success of the 1999 Law on Enterprise.

9.4.1 *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 DPEs were enacted in 1990, not until the enactment of the 1992 Constitution were ownership rights and the freedom to do business officially recognized for the very first time. However, private enterprises in Viet Nam 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.[11] 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.'[12] Then, in the 5th Meeting of the Central Committee of the Ninth 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'.[13]

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. As will be discussed in Sections 9.4.2 and 9.4.3 designing a Law on Enterprise that truly respects the people's freedom to do business and can be effectively implemented requires coordination within the state system as well as between the state and businesses.[14]

The PMRC and a very small group of highly dedicated technocrats in the CIEM were 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

[11] For further discussion, see Pham (2008), Tran (2008), and Vu (2008).
[12] VCP (2001: 98). [13] VCP (2002: 58–9).
[14] This section is based on Pham (2008) and interviews by the author with several key members of the Prime Minister's Research Commission (PMRC), the Steering Committee, the Central Institute of Economic Management (CIEM), and Viet Nam's Chamber of Commerce and Industry (VCCI).

Box 9.1. THE PMRC

The predecessor of the PMRC was the Advisory Group on Economic and Public Administration Reforms, established in 1993 by the late Prime Minister Vo Van Kiet. By 1996, this group was reorganized into the Research Group for Socio-Economic and Public Administration Renovation, which was finally upgraded by Prime Minister Phan Van Khai to the PMRC, with greater autonomy in personnel, funding, and collaboration with domestic and international research organizations and experts.

PMRC was a very small organization, never having more than fifteen members, including supporting staff. At the heart of the PMRC was 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.[15] 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 to 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 right to reserve their opinions if these differed from those of the chairman and other members.

The prime minister worked regularly with the PMRC chairman and attended 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 dissolved the PMRC in July 2006 (i.e., immediately after taking office), the organization 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 documents in included the Socio-Economic Development Strategy 2001–10 and 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.

Source: Based on Tran (2008) and interviews by the author with Tran Duc Nguyen and Tran Viet Phuong during 2011 and 2012.

Steering Committee) was established, headed by Mr. Tran Xuan Gia, by then the minister of Ministry of Planning and Investment (MPI), with members including representatives of 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 VCCI—was invited to participate in the drafting process.

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

Box 9.2. 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.

Source: Author's compilation.

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 was the first time they were invited to comment directly and formally on a legislation draft which was 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 9.2) compared with the 1990 Law on Private Enterprise and the Company Law.

9.4.2 *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, that is, 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 eighty-four licences deemed contrary to the Law on Enterprise. In August 2000, Decree 30/2000/NĐ-CP abolished twenty-seven additional licences and moved thirty-four licences to business conditions. In total, under recommendation of the Task Force, 286 licences have been revoked.

9.4.3 *Direct Dialogue between the Prime Minister and the Business Community*

Unlike his predecessors, Prime Minister Phan Van Khai neither had substantial revolutionary credentials 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).

In 1997, just several months after taking office, Prime Minister Phan Van Khai—again following the advice of the PMRC—held the first meeting with the business community, marking a fundamental shift in the SBR.[16] This is also the very first time that private enterprise owners in the country were officially recognized by the state not as 'rehabilitation subjects' or

[16] Also in 1997, the VBF was established as one of the first public–private dialogue (PPD) mechanisms that provides regular channels of communications between foreign and domestic companies with the Vietnamese government.

'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 otherwise 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 most-discussed topics always concerned the laws and regulations on taxation, customs, import and export, land, credit, investment, and administrative procedures, and from 2000 onwards an additional thread on the implementation of the Law on Enterprise. Through direct dialogue with the business community that the head of the government, ministries, and agencies better understood the obstacles to the operation and development of the business, thereby adjusting the laws and legislation to create a better environment for businesses. Equally important, this sincere action on 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 towards them, which encourages them to invest, start up and expand their business (see Vu-Thanh 2014a: figure 6). This is a key factor contributing to the very high rate of industrial growth of 25 per cent in the mid-2000s.

9.5 The Relative Failure of the 2005 Unified Enterprise Law

After several years of implementing the 1999 Law on Enterprise, the earlier advantages were eaten away, partly because of the lack of internal pressures for reform, and partly because the initial 'low-hanging fruit' had already been exhausted. 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 licences risked being revoked by the Implementation Task Force. According to Pham (2008: 213, emphasis added),

> [m]any times, the Implementation Task Force had to work directly with the most senior leaders of the licensing agencies to *explain* and *persuade*, 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 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* 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 licences. Worse still, these organizations found ways to add new licences by building them right into the new laws or amendments of existing ones. As a result, the number of licences gradually increased, and the mentality of 'if it's not manageable, then prohibit it' 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 self-interested economic power and interests 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 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 merely a necessary means to achieve the objective of joining the WTO. Together, these are the main reasons that prevented 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 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 SEGs since 2005 (Vu-Thanh 2014b).

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 2005 Law on Enterprise itself. In terms of SBR, from the mid-2000s onwards, the cooperative 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, DPE 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.[17] The acceleration of this situation, as will be seen in Section 9.6, resulted from major changes in the party-state leadership and in the internal structure of the state system.

9.6 Conclusion and Policy Implications

Viet Nam'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 has depended on the degree of the trade-off between the political ideology and economic legitimacy, on the internal structure of the state, and on the quality of leadership.

This study offers several implications. First, Viet Nam's experience has been consistent with the statist literature (e.g., Johnson 1987; Amsden 1989; Evans 1995; Kohli 2004) in suggesting that a prerequisite for rapid industrial growth in the late-late-late industrializers is that the leaders 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

[17] The prime minister's first meetings with the business sector were with the SOEs, then commercial banks, and the FIEs.

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 overreliance on 'carrots' for political support rather than development goals—the SBRs 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 coordination between them. In Viet Nam before 1986, when private businesses were deemed to be subjects of 'socialist rehabilitation', there could hardly be any possibility of coordination between the state and the private sector. True coordination 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 coordination (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, the statist literature has emphasized that industrial development requires effective coordination between the public sector and businesses. This coordination, in turn, requires effective coordination within the state system itself as well as within the business sector. In Viet Nam, the coordination 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 and colleagues (2010: 68), '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 coordination authority can be necessary. Although Viet Nam has never had any institutions even close to the Economic Planning Board (EPB) in South Korea or the Council for Economic Planning and Development in Taiwan, the 'embedded autonomy' of and the coordination 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, Prime Minister Nguyen Tan Dung has, on the one hand, created 'socialist cronyism' and, on the other hand, destroyed the very little 'corporate coherence' and 'embedded autonomy' that 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 evidenced in the case of Viet Nam, 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.

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