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Vietnam must ditch state-sponsored crony capitalism

By David Pilling

For a country in its demographic sweetspot, the economy is not growing fast enough

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The country has just emerged from a scandal that exposed virulent corruption at the heart of the Communist party. There is a pressing need to reform state-owned enterprises – behemoths of inefficiency, patronage and powerful vested interests. The internet is awash with stories about arbitrary land grabs, prisoners of conscience and the antics of the party's privileged offspring.

It sounds like China, but this is Vietnam, another one-party state where the economic and social aspirations of the people are bumping up noisily against a rigid and flawed political system.

Few in Vietnam would relish the comparison with China. Vietnam has a long history of antagonism towards its giant northern neighbour. Yet despite the vastly different scales (Vietnam has 90m people to China's 1.3bn) and levels of development (income of $1,500 per capita against $6,000 in China), the comparisons are too compelling to ignore.

Like China, Vietnam is emerging from a period of tense political infighting that has given its people a rare peek into the inner workings of the party machinery. Last year China's Communist party brought down one of its own when Bo Xilai, Chongqing party secretary and erstwhile rising star, was purged after allegations of venality and murder surrounding him and his family.

Vietnam has had its own political soap opera. In its case, the focus was Nguyen Tan Dung, the prime minister, who had become the country's most powerful figure. As in China, the battle was mostly fought by proxy, starting with the unmasking of Vinashin, a state-owned shipbuilding company that had amassed hulking debts of $4.4bn. Mr Dung had thrown his weight behind the supposed champion of national industry, which proved better at siphoning off state funds for party hacks than at making ships. Vinashin's chairman was the fall guy. He got 20 years.

There were other casualties of the proxy war, including one of the country's best-connected tycoons, the co-founder of Asia Commercial Bank, which was backed by Standard Chartered. Though the raw politicking was sometimes dressed up as an ideological struggle over the country's future, it looked suspiciously like fighting over spoils.

At times, it was touch-and-go for the prime minister. He survived but was forced to eat humble pie when, last October, he apologised to the National Assembly for his mishandling of state coffers.

The government has also made gestures designed to show it has learnt its lesson. Not for the first time, it promised to overhaul the state sector. It has even opened a consultative process on constitutional reform, entertaining ideas from the public on everything from land reform to equal rights for gays and lesbians. Neither democracy nor party supremacy is up for discussion.

The political infighting has taken its toll on the economy. In a country where few things move without a nod from party power brokers, the system seized up. Last week, the central bank lowered its policy rate to 7 per cent, its eighth straight cut, in an attempt to get things going again. Previously it had increased rates to 15 per cent in order to tame runaway inflation and stop the collapse of the dong, a perennial problem in a country where people trust dollars and gold more than their own banknotes.

Growth has fallen from an average of 8 per cent a year in the five years to 2007 when Vietnam was a darling of foreign investors looking for the next China. Today, the economy is limping along at 5 per cent – and that according to official numbers. Even then, much of the growth is thanks to exports. Samsung's factory alone, which employs 30,000 people, will soon be churning out up to one in five of all smartphones sold globally. But the domestic value-added for exports is still low, even in the garment industry.

Inflation and the once-frightening current account deficit (12 per cent of GDP) are both now under control but that is as much thanks to stagnant domestic demand as to skilled macroeconomic management. The banking system is riddled with bad debts left over from excessive consumer lending and a collapse in property values.

Vietnam's population is still young and will only start to age from 2030, in contrast with China, whose workforce began to shrink last year. For a country in its demographic sweet spot, with a highly motivated and entrepreneurial population, Vietnam is not growing fast enough.

One hope of breaking the logjam is the trans-Pacific Partnership, a trade agreement being negotiated between the US and several Asian states, including Vietnam. The TPP aims to create a level playing field among its members, regulating everything from public tenders to state-owned enterprises. Theoretically, at least, it could force Vietnam to clean house.

Still, most of the impetus for any overhaul of its state-dominated economy must come from the Communist party itself. The problem is that Vietnam has gone straight from collectivisation to crony capitalism with not much in between. As recent scandals have shown all too clearly, corruption, vested interests and waste run deep. It is far from clear that those who have benefited so richly from the system have any incentive to dismantle it. If they do not, Vietnam's economic progress is likely to disappoint.

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