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Viet Nam: a transition tiger? Institutional change and business development

Abstract for chapter 9

Viet Nam has surprised many observers by rapidly increasing productivity, accelerating economic output, and expanding its exports to market economies, despite the dominant role of state enterprise in industry and external trade. This chapter examines the process of change through the interplay between formal and informal institutional development.

It focuses on the following: identifying the key actors in the business sector during the reform process; examining the institutions and law in business and economic development; providing an overview of institutional reform processes in Viet Nam and an international perspective on state enterprise reform and business development; providing an overview of state enterprise reform in Viet Nam; looking at state and non-state business development in Viet Nam since *Doi Moi* as well as state and non-state industrial output from 1995 to 2000; and highlighting the implications for private business development and state enterprise reform.

Keywords:

'rules of the game', business sector, Constitution, Doi Moi, foreign direct investment (FDI), formal and informal institutional development, institutions, market economy, mining, policy, reforms, state enterprise, state-owned development banks, state-owned industries, state-owned utilities

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INSTITUTIONAL CHANGE AND BUSINESS DEVELOPMENT

A pivotal ongoing component of the *Doi Moi* process has been the response of key economic actors to market opportunities. Early reforms facilitated increased contributions from households and businesses to economic activity, generating higher income and employment and reduced poverty during a period of profound restructuring of the economy. A strong supply response during the early stages of reform—especially the sharp jump in output resulting from increased household investment in agriculture and retail trade—was vital to macroeconomic stabilisation.

An important part of the ongoing *Doi Moi* process is the creation of new market institutions, including a legal framework for business that defines the accepted forms of business organisation and governs a wide range of business activities. So far, however, the process of creating many of the components of a formal legal and administrative environment for the market economy has been quite slow. In this, as in other areas, the economy has performed well despite the perceived weaknesses in the formal institutional framework. Changes in the behaviour of key economic actors have tended to move ahead of the adjustments to the formal institutional framework. The description of the process of change therefore emphasises the inter-play between formal and informal institutional development.

ACTORS IN VIETNAMESE BUSINESS ACTIVITY

As Viet Nam shifted towards a market economic system, economic performance increasingly depended on the decentralised decisions of economic actors responding to an economic environment influenced by public policy and newly emerging market institutions.

Key actors in the business sector during the reform process were farmers and other household business, cooperatives, state enterprises, domestic private enterprises and business involving foreign investment (in Vietnamese terminology 'foreign-invested businesses'). State enterprises have been important actors in larger scale and more formal economic activity, especially in industry, but the state share of total employment was much smaller than in most centrally planned economies at the beginning of transition and has fallen further during the transition period. Households have been important in rural and informal urban economic business activity and have provided employment for most of the population. Cooperatives played a role in agriculture, light industry, retail trade and other services. Formal private enterprises and foreign investors only became significant economic actors as the transition progressed.

INSTITUTIONS AND LAW IN BUSINESS AND ECONOMIC DEVELOPMENT

North argues that institutions[1] 'form the incentive structure of society, and the economic and political institutions, in consequence, are the underlying determinants of economic performance' (1994:360). In particular, institutions set the 'rules of the game' that accommodate and condition the participation of diverse actors in the economy. Effective institutions provide investors with confidence that contracts and property rights will be enforced. Such confidence is critical to ensuring increased investment. The most obvious institutions affecting business are the formal policies, laws, regulations and administrative arrangements that attempt to control and influence the behaviour of economic actors.

Creating an appropriate legal framework will eventually be part of a successful reform process. In examining the Vietnamese experience, however, it is striking that improvements in enterprise performance have usually preceded changes in the legal framework. It should be recognised when evaluating the urgency and timing of legal reform and the importance of formal legal arrangements during transition that informal institutions may evolve effectively ahead of the endorsement of the arrangements through legislation, while legislation may not be very effective if it is not in accord with established views and practices.

The Vietnamese experience is consistent with the views of those who emphasise that 'law develops over time and in interaction with changes in the socioeconomic environment' influencing the nature and content of laws and legal institutions.[2] In other words, market institutions, including formal legislation, evolve in response to social demand and need. Demand arises because legal institutions are needed to reduce the transaction costs of conducting business as economies develop. Legislation often formalises and reinforces informal arrangements that have emerged in response to need.[3]

While the importance of legal institutions in economic development is widely accepted, many attempts to accelerate economic development by transplanting laws have not produced the expected results (Berkowitz et al. 2000). John Gillespie has argued that the uneven reception of imported law in Viet Nam is consistent with experiences elsewhere in East Asia (Gillespie 2001a).

In the history of developed countries, most market institutions, including formal legislation, evolved in response to social demand. As an economy becomes larger, more open and complex, the demand for formal institutions to reduce risk and the transaction costs of conducting business increases. As the role of large private businesses increases, both national and foreign, the need for a more effective legal system—and for administrative practices (including tax administration) that are rule based rather than discretionary—also increases.

While formal business laws in market economies have tended to converge, attitudes to law and the role of key institutions still differ widely. This affects the way laws are implemented, and thus impacts on business decisions and economic behaviour. While formal institutions may remain in place, even if there is no demand,[4] informal institutions will only be sustained if supported by society. The sudden introduction of formal institutions can also undermine the effectiveness of informal arrangements.[5]

Informal understandings and interpretation are particularly important in developing and transition economies, where formal rules may not yet have adjusted to new economic needs and where formal institutions for enforcing formal rules remain weak and unpredictable, resulting in erratic enforcement. Even in relation to government regulations, informal understanding and interpretation of the intentions of government can be as important an influence on business behaviour as the formal 'rules of the game'.

Viet Nam's experience is consistent with a view that the formal legal institutions do not uniquely determine enterprise behaviour.[6] Even in rule-based societies, most contract and property disputes are settled informally (Pistor 1999), and politics can affect the way rules are interpreted.[7] Informal institutions (social practice and behaviour, and pressures to conform) provide alternative mechanisms for protection of property and rights. Informal institutions play an important role in all economies, including the most developed economies, and the relative roles differ from country to country and within countries (Berkowitz et al. 2000). Informal institutions linked to reputations have played an important role in more developed East Asian market economies (Pistor and Wellons 1999),[8] where recognition that a reputation is important to securing future business transaction provided strong incentives for performance. Pistor argues that

> [t]he concept of law as infrastructure fails to realise that formal law is but one set of institutions that govern behaviour. Where formal and informal institutions evolve over time, they tend to complement each other. In the context of a political or economic regime change, however, formal and pre-existing informal institutions compete. Formal law may be rejected or ignored and substituted with informal institutions that operate independently of and frequently in contradiction to the formal legal system (Pistor 1999:2).

While arguing that 'there is empirical evidence showing that the rule of law does contribute to a nation's wealth and its rate of economic growth', Richard Posner (a Chief Judge of the US Court of Appeals) argues that 'even very wide deviations from this capitalist rule-of-law ideal may not seriously compromise economic efficiency' (Posner 1998:2–3).

Even in economies with highly elaborate systems of commercial law, segments of the economy may operate on the basis of informal agreements, where there is a long-established trust between the contracting parties. The limitation is that under informal arrangements transaction costs are lower for those who are members of such informal networks than for outsiders, for whom a legally enforceable contractual system may be seen as a necessity.

In the case of Vietnam, the tendency of informal change to precede legislation and for business and government to engage in *de facto* arrangements to accommodate new norms of business behaviour may well have a differential impact on businesses, between those better able to understand and handle such an environment, with its uncertainties and need to cement informal relationships through discrete (and illegal) financial transfers, and those more at home in a more transparent legal environment.[9]

Viet Nam can draw on differing legal traditions in framing its new laws. Some observers argue that legal heritage impacts on institutional and economic development. Islam and Montenegro cite studies that argue that 'countries with French legal heritage have consistently poorer institutional quality than those with other legal traditions. It is argued that French civil law countries have been characterised by more interventionist and formal government apparatus' (2002:3). While French law had a major impact in the colonial era of Viet Nam, there was a long hiatus when the legal system was influenced more by Soviet thinking. Since the beginning of *Doi Moi*, Viet Nam has sought to learn from the business regulatory environments in neighbouring countries and OECD members, and from the experiences of other transition economies.

The view adopted in this study is that, although a well designed, clearly defined, generally accepted and enforceable system of laws is an optimal goal for the reduction of uncertainty and transaction costs, solutions exist that fall short of being optimal but are nonetheless workable. Differences in performance between systems may therefore depend more on the characteristics of the second-best solutions that emerge, which may involve informal arrangements and behaviour which by-pass inappropriate rules and regulations to establish workable ways of maintaining orderly business arrangements even in the absence of the certainties implied by the term 'rule of law'.

OVERVIEW OF INSTITUTIONAL REFORM PROCESSES IN VIET NAM

During the reform process in Viet Nam changes in formal rules have often responded to a spontaneous process of institutional development, accommodating changes in informal practices. This has critical implications for interpretations of the Vietnamese experience. On the one hand, the development and behaviour of businesses, both private and publicly owned, often moved ahead of reforms in policy, and informal stratagems were often effective in by-passing unhelpful formal constraints (McMillan and Woodruff 1999a, 1999b). Even within the state sector, corporate behaviour was varied and not easily characterised by reference to formal arrangements.

But first, it will be useful to highlight the most important formal legal changes. The 1992 Constitution was a milestone in laying the foundations for a private sector to compete with the state sector (Government of Vietnam 1992:18–19). The Constitution provided guarantees against nationalisation

(Article 23), stated that foreign investment and trade were to be encouraged (Articles 24 and 25), and specified that state enterprises should be run autonomously and be accountable for their performance (Article 19). Moreover, the Constitution stated that

> [t]he aim of the state's economic policy is to make the people rich and the country strong, to satisfy to an ever greater extent the people's material and spiritual needs by releasing all productive potential, developing all latent possibilities of all components of the economy—the state sector, the collective sector, the private capitalist sector, and the state capitalist sector in various forms—pushing on with the construction of material and technical bases, broadening economic, scientific, technical cooperation and expanding intercourse with world markets (Article 16).

It also noted that

> [i]n the private individual and private capitalist sectors, people can adopt their own way of organising production and trading; they can set up enterprises of unrestricted scope in fields of activity which are beneficial to the country and the people (Article 21).

There are areas where legal development has been important. The most important formal laws governing business introduced under *Doi Moi* are presented in Table 9.1. Legal developments have been very important in attracting foreign investment and have provided a strong signal to domestic investors that the government is serious in pursuing its stated intention to move towards a market-based allocation of resources, and a rules-based system of state management. The business community was receptive to some key pieces of legislation, most notably in the response to the Enterprise Law, which exceeded most expectations in terms of new business registrations.

STATE ENTERPRISE REFORM AND BUSINESS DEVELOPMENT: AN INTERNATIONAL PERSPECTIVE

Up until a couple of decades ago, the mainstream development profession tended to identify a potentially important role for state enterprises as development (even entrepreneurial) institutions. Megginson and Netter recently argued that '25 years ago proponents of state ownership could have just as easily surveyed the postwar rise of state owned enterprises and concluded that their model of economic organisation was winning the intellectual battle with free-market capitalism' (Megginson and Netter 2001:321). Multilateral financial institutions actively encouraged the development of state-owned development banks, financed state-owned industries, and supported the development of state-owned utilities. This support was not based on a

Table 9.1 **Formal laws governing business entities**

Law	Dates law approved and amended or repealed	Categories of business entities or arrangements addressed
Companies	Enacted December 1990 Amended June 1994 Replaced January 2000	Joint-stock companies Private limited liability companies
Private Enterprises	Enacted December 1990 Amended June 1994 Replaced January 2000	Private unlimited liability enterprises
Enterprise Law	Approved April 1999 Enacted January 2000	All private enterprises Allows state enterprises to be incorporated
State Enterprises	Approved April 1995	Entities with state invested capital (state corporations, public service enterprises, and business enterprises)
Cooperatives	Approved March 1996	Cooperatives
Financial Institutions	Approved November 1997	Banks and other financial institutions
Insurance services	Approved May 2000	Entities providing insurance
Bankruptcy Law	Approved December 1993	All business entities
Commercial Code	Approved May 1997	All business entities
Environmental Protection	December 1993	All business entities
Land Law	Approved December 1987 Amended November 1993 Amended December 2001	Applies differently to different entities
Labour Code	Approved June 1994	Applies (but not equally) to all entities
Mining	March 1996	All relevant business entities
Promotion of Domestic Investment	June 1994 Amended April 1998	All domestically owned business entities
Foreign Investment	Approved December 1987 Amended June 1990 Amended December 1992 Amended April 1997 Amended May 2000	Joint-venture entities Foreign-owned entities Business cooperation contracts Build-operate-transfer projects

Source: Central Institute for Economic Management/United Nations Development Programme (UNDP), 2001. Improving the Regulatory Environment for Business, Project Document VIE/01/025, United Nations Development Programme, Hanoi (unpublished).

particularly pro-state ideological view, but reflected a widely held pragmatic view that this would accelerate development investment levels above those that were likely to be achieved by relying solely on the private sector.[10]

The balance of conventional wisdom changed in the 1980s partly because of sharp ideological shifts, particularly in the United States and the United Kingdom, and partly because of pressures to improve fiscal balances and to increase economic efficiency. There was increasing support for the view that state ownership was only justified where there was a clear case of market failure that could not be addressed by less drastic interventions. Megginson and Netter argued that 'privatisation now appears to be accepted as a legitimate—often a core—tool of statecraft of more than 100 countries' (2001:321).

The influences at work that redefined views about the proper relationship between the state and the market included

- the obvious failures in the former CMEA economies
- a record of inefficiency and mismanagement of state enterprises in many developing countries
- a growing perception that government involvement in business distracted the attention of governments from their core responsibility
- ideological shifts in many OECD economies
- technological developments that allowed competition in markets that were traditionally seen as natural monopolies (for example, telecommunications).

The most persuasive case against state enterprises is that they are unlikely to face pressures to perform because, unlike private business, they are not faced with a 'hard budget constraint' (Kornai 1992). The market forces private businesses to perform by the ultimate sanction of failure if they are persistently unable to cover costs. In contrast, access to state subsidies, either directly from the state budget, or indirectly from state banks, means that state enterprises are not subject to the discipline of market forces.

The sceptical view on state enterprises argued that not only are they insulated from market pressures to perform efficiently, but they may also be subject to pressures to pursue goals other than efficient business operations. They may be instructed to pursue multiple (sometimes conflicting) objectives. In particular, state business enterprises can be subject to pressure from politicians, governments and interest groups to pursue unprofitable activities. While the case for subsidy is typically argued by reference to some legitimate social objective, the reality is that state enterprises can be used to further sectional interests, or to provide ‘rents’ to interested parties, often in a non-transparent fashion. In effect, state enterprises are often neither accountable to the market, nor to an efficient system of public supervision.[11]

Fashions change. With the increasing emphasis among development agencies in targeting poverty reduction directly, and growing recognition of the need for state intervention to support more equitable economic development, there appears to be a shift back towards a more sympathetic middle-ground vision of the important complementary role the state plays in a market economy. Rodrik suggests that there has been a major change in thinking from the ‘Washington consensus’ of the 1980s, where the priority was on ‘rolling back the state, not making it more effective’ (2000:1–2), and argues that the poor response to price reform and privatisation in Russia, and dissatisfaction with the impact of market reforms in much of Latin America, has contributed to this re-think. He argues that there is an emerging consensus on the need to improve the efficiency of the state as an essential complement to the market economy.

Others, arguing for a cautious path to reform, point to the social upheaval and lawlessness following rapid privatisation in Eastern Europe. Stiglitz argues ‘that the destruction of social and organisational capital in the process of transition…may have played an important role in the failures in Russia and some of the other countries of the former Soviet Union’ (1999b:7).

A recent World Bank study on ten years of transition experience in the former USSR and Eastern Europe also recognised the need for caution, concluding that policymakers ‘face a difficult choice between (i) privatisation to ineffective owners in a context of weak corporate governance, with the risk of expropriation of assets and income of minority shareholders, and (ii) continued state ownership in the face of inadequate political commitment to transparent privatisation outcomes and limited institutional capacity to prevent asset stripping by incumbent enterprise managers’ (World Bank 2002:xxviii).

The same report emphasises the importance of the business environment as much as the form of ownership, noting that

> [c]reating an environment that disciplines old enterprises into releasing assets and labour and encourages new enterprises to absorb those resources and undertake new investments without tilting the playing field in favour of any particular enterprises, is central to economic growth (World Bank 2002:xix).

OVERVIEW OF STATE ENTERPRISE REFORM IN VIET NAM

Whatever the international debate, there are certainly examples in Viet Nam that lend strong support to the case for state enterprise reform, and for state enterprise divestiture. Overall, state enterprises have absorbed a large share of capital, but generated less output and less employment per unit of investment than other sectors. Despite strong output growth, state enterprise employment fell during the late 1980s and early 1990s, and only recorded very modest growth subsequently. Moreover, there are regular reports in the domestic press of cases of inefficiency, mismanagement, and corruption associated with state enterprises.

This, however, is not the whole story. Experience with individual state enterprises is variable. Some state firms adjusted remarkably quickly to the requirements of the market economy, in contrast to others that continue to operate inefficiently, surviving through state protection and (often hidden) subsidies, and others that largely ceased operations. With state enterprises dominating exports and industrial output, Viet Nam's impressive economic performance during the early transition period would not have been possible without strong performance by a significant segment of the state enterprise sector. State enterprises made an important contribution to recent economic growth and remain an important source of government revenue.

A crucial aspect of growth performance in Vietnam in the 1990s was that, although the state enterprises expanded rapidly, they did not 'crowd out' the growth of the non-state sector in most sub-sectors. The share of state enterprises in official national output estimates actually increased in the period up to 1997, even though this was a period of such dynamic growth in private activities that visitors returning to Viet Nam in the late 1990s after a decade away could readily assume that there had been a decisive shift in the balance of the economy towards the non-state sector. In the late 1980s, the visitor would have stayed in a state-run hotel, eaten at state-run restaurants, been entertained at a state-run night club, hired a car from a state-run company, and bought basic consumer requirements from a state store or cooperative. By 1997, a typical visitor would have obtained such services from domestic private and foreign-invested enterprises (the latter enterprise often a joint-venture in which the state retained a minority interest).

STATE AND NON-STATE BUSINESS DEVELOPMENT IN VIET NAM SINCE *DOI MOI*

Data inconsistencies and inadequacies make it impossible to present a precise statistical picture of the changes in the economy from official sources, but there have been a number of clear trends. During the early stages of *Doi Moi*, there was an acceleration in growth of output from farm households and household business (mostly trade and simple processing), and this growth has been sustained over much of the *Doi Moi* period.

The state sector recorded modest growth in the first years of *Doi Moi*, but output (and state employment) declined sharply in 1989 and 1990. There was a rapid build-up of foreign investment, and a recovery in growth in state enterprise output, in the early 1990s. With the fast growth in larger-scale production, domestic private businesses' (including households) share of total output declined during the early 1990s, but continued to be the major source of employment growth. The role of cooperatives in agriculture, retail and other service industries dropped sharply during the early stages of reform as many cooperative activities and resources were transferred to the private sector.

A cyclical turning point was reached in 1997. Even before the onset of the Asian financial crisis, approvals of foreign direct investment (FDI) were declining, and FDI inflows dropped sharply following the onset of the East Asian financial crisis, although output resulting from FDI continued to increase at faster rate than other sectors. As the formal barriers to domestic private sector activity were lifted in the late 1990s, there was a sharp jump in the number of formal domestic private enterprises, and initial estimates indicate that the domestic private sector recorded higher growth than the state sector in 2001. Official data on state and non-state sector growth rates are presented later in Figure 12.1.

Interpreting the data is tricky, given the incentives and opportunities to under-report private sector output, but according to official series state sector output growth equalled or exceeded private sector growth in most years in the decade to 1997, except for 1989 and 1990 when state output suffered from the collapse of economic cooperation arrangements with the former USSR. The surprising conclusion from these data is that the state's share of official GDP increased over much of the reform period,[12] despite reductions in barriers

Figure 9.1 **GDP growth, 1986–2000**

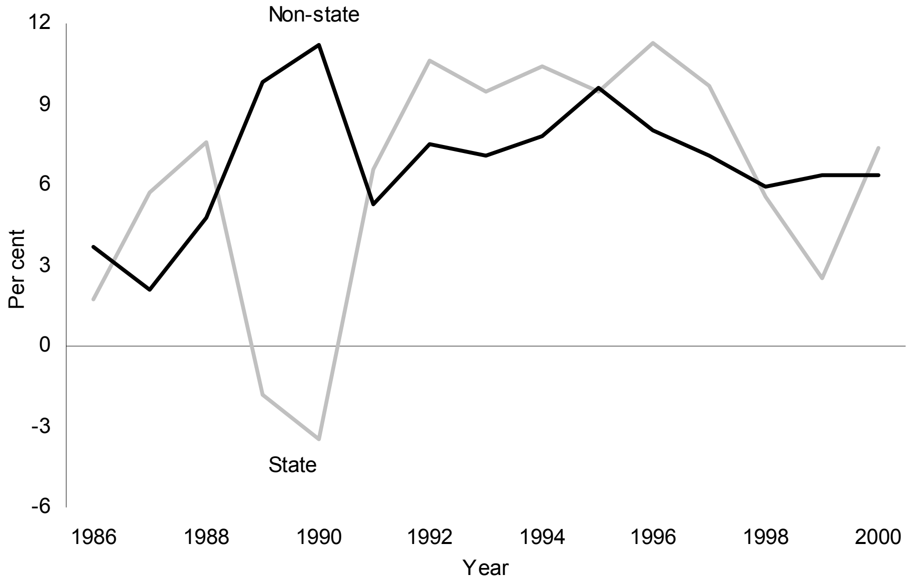
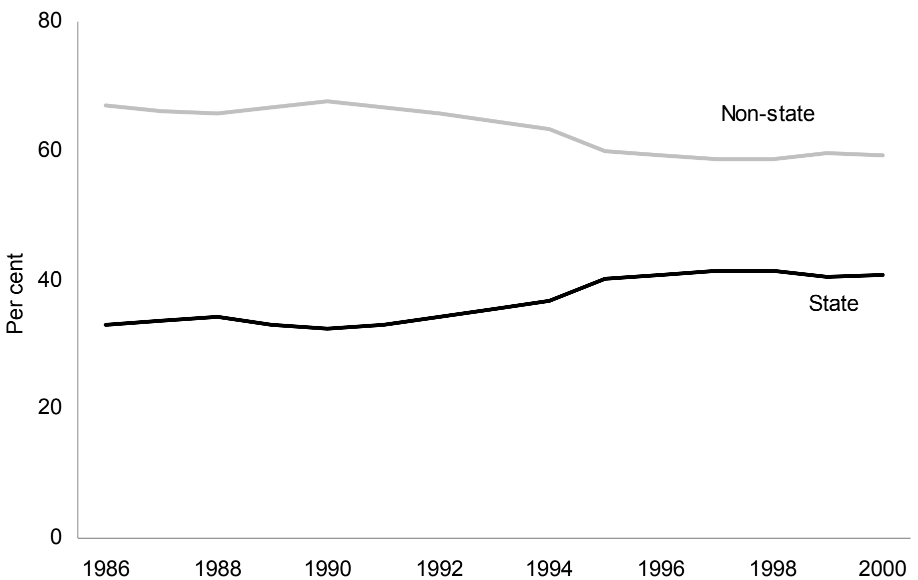


Figure 9.2 **Share of GDP by sector, 1986–2000**



to private sector investment, and increased competition, including strong competition resulting from a much more open external trade regime.

Changes in the balance of ownership have not been uniform across sector and industries. At the sectoral level, state and cooperative involvement in the agricultural sector and most retail businesses is now negligible. Cooperatives no longer play a pervasive role in the economy, but play more limited roles in marketing activities in some areas such as handicrafts. The state sector share of retail activity has declined. Although the state share of industrial output has declined in recent years, it remains higher than it was at the beginning of *Doi Moi*. The household and cooperative share of industrial output has declined over the transition period. The formal domestic private sector is just beginning to emerge, but plays a significant role in some industry and service groups, as discussed later in this chapter.

The strong growth in state enterprise output distinguishes Viet Nam's reform experience from the experiences of most transition economies, and the experiences of most East and Southeast Asian economies. Moreover, growth was initially accompanied by declining state enterprise employment, and later by only modest growth in state employment, indicating significant improvements in output per worker in state enterprises.[13] Official figures indicate that output per state enterprise worker increased 3 times from 1995 to 1995, and by about another 25 per cent from 1995 to 2000. In interpreting these data, it should be noted that a substantial part of the early productivity increases resulted from formally laying off workers who were already not working. There may also have been an increase in sub-contracting work to the emerging private sector. Nevertheless, it is also clear that there have been significant improvements in state enterprise productivity since the *Doi Moi* process started.

STATE AND NON-STATE INDUSTRIAL OUTPUT, 1995–2000

In the second half of the 1990s, the relative output performance of the ownership groups grew more in line with expectations regarding the results of reform (Table 9.2). The state share of industrial output declined from just over 50 per cent to 42 per cent (in constant 1994 prices), the share of the domestic private sector declined from almost 25 per cent to just over 22 per cent, and the share of foreign invested enterprises increased from 25 per cent to 35 per cent. State

Table 9.2 **Share of industry group output by ownership, 1995 and 2000**

Industry group	1995 Total	1995 State	1995 Domestic non-state	1995 Foreign investor	2000 Total	2000 State	2000 Domestic non-state	2000 Foreign investor
TOTAL	100.00	50.29	24.62	25.09	100.00	42.03	22.43	35.54
1. Mining	13.47	2.34	0.65	10.48	13.56	1.78	0.55	11.23
Coal	1.62	1.60	0.02	-	1.15	1.12	0.02	0.01
Oil and gas	10.49	0.03	-	10.46	11.22	0.02	-	11.20
Metal ores	0.23	0.18	0.04	-	0.11	0.09	0.02	-
Stone and others	1.12	0.52	0.58	0.02	1.08	0.55	0.51	0.02
2. Manufacturing	80.54	41.98	23.97	14.59	80.47	34.31	21.87	24.29
Food and beverages	26.13	12.46	8.68	4.99	20.18	9.32	6.63	4.23
Tobacco products	3.85	3.83	0.01	0.01	2.87	2.85	0.01	0.01
Textile products	5.97	3.39	1.54	1.04	4.81	2.59	1.25	0.97
Garments	2.85	0.99	1.34	0.52	3.06	1.03	1.36	0.67
Leather tanning and processing	3.45	1.32	0.90	1.23	4.57	1.38	1.24	1.95
Wood and wood products	3.22	0.69	2.24	0.29	1.89	0.40	1.33	0.15
Paper and paper products	1.88	1.14	0.45	0.29	2.10	1.08	0.77	0.24
Publish, print, copy recorded materials	1.46	1.35	0.08	0.04	1.12	1.00	0.10	0.02
Coke and refined petroleum products	0.33	-	0.04	0.29	0.05	-	0.05	-
Chemicals	4.92	3.73	0.47	0.72	6.09	3.79	0.68	1.61
Rubber and plastics	2.20	0.97	0.92	0.30	3.50	1.13	1.59	0.77
Non-ferrous metals	8.90	5.96	2.50	0.44	8.89	5.22	1.99	1.68
Metal production	3.32	2.01	0.32	0.98	2.95	1.25	0.36	1.34
Metals products	2.26	0.40	1.59	0.26	3.15	0.46	1.77	0.92
Machinery and equipment	1.30	0.89	0.26	0.14	1.23	0.71	0.22	0.29
Computer and office equipment	0.03	0.03	-	-	2.62	-	0.03	2.59
Electrical machinery and apparatus	1.05	0.77	0.14	0.15	1.88	0.89	0.33	0.66

Radio, TV and communications equipment	2.00	0.96	0.12	0.92	2.36	0.36	0.03	1.97
Medical and precision instruments	0.20	0.04	0.11	0.04	0.23	0.04	0.02	0.16
Assembly and repair of motor vehicles	1.41	0.20	0.21	1.00	1.09	0.15	0.15	0.79
Produce/repair other transport equipment	1.83	0.66	0.35	0.82	3.63	0.50	0.42	2.70
Furniture	1.91	0.18	1.58	0.14	2.13	0.14	1.46	0.53
Recycling	0.09	-	0.09	0.00	0.07	0.00	0.07	-
3. Electricity, gas and water supply	5.99	5.97	0.01	0.01	5.97	5.95	0.01	0.02
Production, distribution of electricity and gas	5.27	5.25	0.01	0.01	5.44	5.43	-	0.01
Supply, purification and distribution of water	0.73	0.72	-	-	0.53	0.51	0.01	0.01

Source: Derived from GSO, 1997 and 2001, Statistical Yearbooks.

and private sector industrial output both recorded solid growth over this period (58 per cent and 72 per cent respectively), but output from foreign invested projects grew much more rapidly, increasing by 168 per cent.

Mining accounted for about 13.5 per cent of the value of total industrial output. Foreign investors dominated mining. Foreign capital in oil and gas alone accounted for 11.2 per cent of industrial output in 2000. Coal (mostly state) and precious stones are the only other significant mining activities, each accounting for about 1 per cent of total industrial output.

Manufacturing accounted for about 80.5 per cent of industry in both 1995 and 2000, but there was a drop in the share of state manufacturing, from 42 per cent to 34 per cent. The share of domestic private manufacturing declined from about 24 per cent to 22 per cent, while the share of foreign invested manufacturing increased from nearly 15 per cent to just over 24 per cent. There were marked declines in the share of food processing, tobacco, textiles and wood products, and increases in garments, leather goods, rubber, plastics, electrical machinery, computer and office equipment, and transport equipment. State enterprises continued to account for virtually all of the nearly 6 per cent of industrial valued added from electricity, gas and water supply.

IMPLICATIONS FOR PRIVATE BUSINESS DEVELOPMENT AND STATE ENTERPRISE REFORM

Viet Nam has surprised many observers (the authors included) by rapidly increasing productivity, accelerating economic output, and rapidly expanding its exports to market economies, despite the dominant role of state enterprise in industry and external trade. Most donors had been advising the government that an increased private sector role was essential for sustaining economic growth and reducing poverty.[14] The strong state enterprise performance therefore needs to be analysed.

The strong state enterprise performance was undoubtedly due in part to preferential treatment and access to resources, the low starting base, restrictions on competition (especially in the earlier periods of reform), and the weak governance and accountability mechanisms which have meant that many state enterprises managers face strong personal incentives to expand output and turnover. Under-reporting of private sector activity also affects the picture of relative sectoral growth.

Some of the larger scale industries dominated by state firms increased their share in total production (for example, power, building materials, and telecommunications) as a secular phenomenon at this stage of Vietnamese development. The rapid build-up in official development assistance and FDI has also boosted state enterprises in the power, water supply, construction, and construction material sectors. In addition, during the early 1990s, the output of state-owned heavy industry expanded as a result of earlier investments (most notably Soviet investments in oil and power development).

In the lighter industrial and processing sectors, state enterprises continued to benefit from protection provided by the state (for example, in garments and in key agricultural commodities, through preferential access to export quotas). Some state firms achieved genuine competitive successes in export markets, including in joint ventures with private foreign investors.

By contrast, agriculture, the sector with the highest proportion of private (household) activity, grew more slowly than the overall average. Although buoyant growth was achieved in historical and international comparative terms, the expected secular trend is for the proportion of agriculture in total output to decline as the economy grows.

Despite the above points, the relatively effective performance of state enterprises in Viet Nam needs further explanation, particularly in light of conventional wisdom regarding the ineffectiveness of state enterprises and the failure of state enterprises with similar preferential treatment in other developing countries. This raises a number of important questions.

- What special factors, if any, contributed to strong state enterprise performance in Viet Nam?
- Can this strong performance be sustained in the future?
- Why has the private sector taken so long to develop, especially in the industrial sector?
- Are there lessons to be learned that can be replicated elsewhere?

Much of the material in the following chapters in this section is an attempt to answer these questions.

NOTES

[1] Institutions as defined by North 'Institutions are the humanly defined constraints that structure human interaction. They are made up of formal constraints (e.g. rules, laws, constitutions) and informal constraints (e.g. norms of behaviour, conventions, self-imposed codes of conduct) and their enforcement characteristics' (1994:360).

[2] Pistor and Wellons (1999) identify this approach with the work of the eighteenth century economist Adam Smith and the nineteenth century German sociologist Max Weber.

[3] For example, in the development of land law in many countries, legislation has included formalising and accommodating customary tenure arrangements that have developed historically.

[4] Pistor notes that informal institutional arrangements in East Asia, which had been seen as a source of stability, became 'increasingly regarded as an impediment for future economic development. While many formal rules had long been on the books, a demand for them was created only with the economic regime change, which in some cases (Korea, Taiwan) was accompanied by a political regime change' (Pistor 1999:6).

[5] Messick argues that attempts to impose formal institutions can even be counterproductive noting that 'a variety of studies, in settings as diverse as medieval Europe and contemporary Asia, show that informal mechanisms based on incentives provided by repeat dealings can ensure the performance of contracts that no court has the power to enforce. One early, and surprising, finding of this research is that in some instances the sudden introduction of a formal mechanism to resolve legal disputes can disrupt informal mechanisms without providing offsetting gains' (Messick 1999:118).

[6] Pistor argues that Asian experiences show that economic development is possible even when rational legal systems play a subordinate role: 'For much of the period of high speed economic growth in East Asia since the late 1950s, the law that had much earlier been transplanted from the West played only a marginal role…It was supplemented by negotiated bargains between governments and business elites, as well as by rulings and decrees issued by the executive which had extensive discretionary powers. Large parts of the society remained outside the realm of formal law. Private transactions were governed by customary rules and disputes settled out of court' (Pistor 1999:5).

[7] Upham (2001:19) notes that while both George W. Bush and Al Gore promised in the 2000 US elections to maintain the rule of law 'they also each promised to appoint judges who would support certain positions on abortion, affirmative action, and other highly politicized issues'.

[8] See also Van Arkadie (1990) for a more general discussion of the interplay between formal and informal institutions.

[9] One may speculate that the disproportionate weight of foreign investors from the region may not only reflect geographical proximity but also the greater ease with which firms from the region adapted to the Vietnamese environment.

[10] There were counter views—for example the case against state enterprises was put vigorously by Peter Bauer (for example, see Bauer and Yamey 1957:155–61), but in the 1960s and 1970s such views were in the minority and tended to be viewed as away from the mainstream.

[11] The fact that this line of argument is so universally popular among the staff of multilateral funding institutions may be that the description fits so well the lack of accountability and 'hard budget constraints' in their own organisations (which are enterprises owned by many states, and which are themselves asked to achieve multiple objectives).

[12] The jump in the state share in 1995 is partly due to a shift in constant prices from 1989 prices to 1994 prices, but even allowing for this the trend remains the same.

[13] As with all data on Viet Nam, this table should be seen as indicative. Estimates of state enterprise employee numbers were reported separately prior to 1995. From 1995, state enterprises employees are estimated as total state employees, minus state employees working in science and technology, state management and national defence and public security, education and training, health and social relief, culture and sport, activities of the Party and mass organisations, and community and personal services. Moreover, different official statistics give quite different estimates of output levels and growth prior to 1995.

[14] World Bank (1995a:xii) warned that '[o]verwhelming international evidence indicates that there are limits to what reform without divestiture of non-strategic enterprises can accomplish and sustain. Divestiture of non-strategic state enterprises will be critical to encourage entry by private business in productive sectors'