Why Doesn’t Vietnam Grow Faster?: State Fragmentation and the Limits of Vent for Surplus Growth

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Why Doesn't Vietnam Grow Faster?

State Fragmentation and the Limits of Vent for Surplus Growth

Jonathan Pincus

Although Vietnam has achieved exceptionally rapid growth of exports, "vent-for-surplus" production of agricultural commodities and labour-intensive manufactures has yet to stimulate the development of large-scale, technologically progressive firms. Foreign-invested and small domestic enterprises still dominate and rely heavily on imports of intermediate and capital goods. The absence of upstream and downstream industries can be explained at least in part by Vietnam's unique transition from central planning. The state has not receded from economic life as much as reconfigure itself to benefit from market opportunities. Commercialization of the state has aggravated the long-standing problem of fragmentation, which has blocked government efforts to impose discipline on state agencies and enforce central government plans and regulations.

Keywords: Vietnam, economic growth, economic transition, productivity, Nicholas Kaldor, Hla Myint.

1. Introduction

Economists should learn to be wary of telling development success stories. Today's economic miracles reappear as tomorrow's underperformers with depressing regularity, not least for those of us who study the economies of Southeast Asia. In the 1950s the Philippines was one of the richest countries in Asia and was widely seen as the region's rising star, an economy with far greater potential than that notorious "bottomless pit" of American aid, South Korea (Woo 1991, p. 46). Indonesia had its turn as the donors' favourite developing country in the latter half of the 1980s, when the Suharto government responded to the fall in global oil prices with market-friendly policies that by 1993 had earned the country inclusion among the East Asian miracle countries of the World Bank's eponymous study (World Bank 1993). Alas, the collapse of 1997 was just around the corner.

Now it appears to be Vietnam's turn. From "one of the most successful cases in economic

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development in recent times", or as one World Bank mission chief put it rather inelegantly, the "poster child" for economic reform, Vietnam is now "A Tiger Tamed" (*The Economist*, 2 February 2013) that "faces a risk of a prolonged period of slow growth" (World Bank 2013*a*, p. 15). The optimism — bordering on euphoria — surrounding Vietnam's accession to the World Trade Organization (WTO) in 2007 has drowned in a sea of bad debt, falling asset prices and corporate collapse.

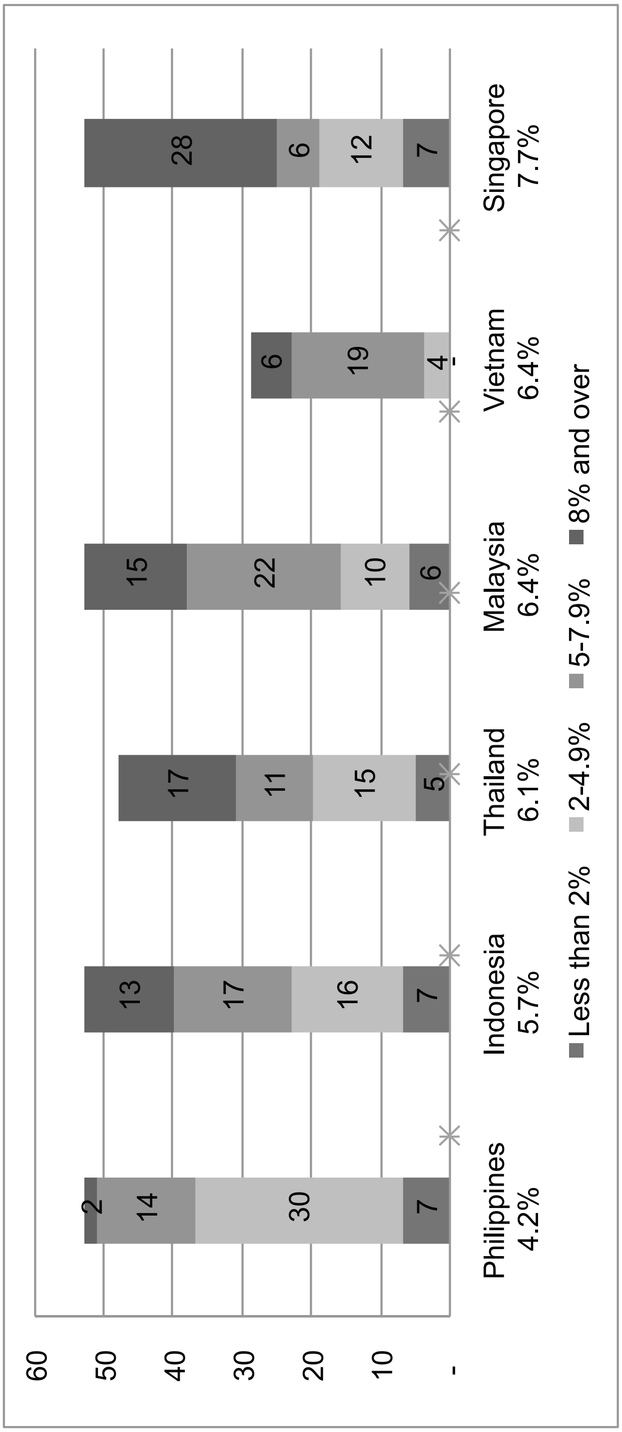
However dramatic these shifting fortunes may appear on the surface, it is important to keep them in perspective. Talk of the "middle-income trap" is all the rage among donor agencies and some academic observers of Vietnam (Ohno 2009) as it is for the region as a whole (OECD 2013). Countries are said to fall into the trap when they have exhausted labour-intensive growth but are unable to move into more technologically and managerially demanding industries (Eichengreen, Park and Shin 2013). As building institutions and education systems can take decades, countries can find themselves priced out of low-tech exports for many years before they can penetrate markets for higher value-added goods. This scenario is not one that has immediate relevance to Southeast Asia. As shown in Figure 1, since 1960 none of the large countries in the region has endured a long period of less than 2 per cent growth of GDP per annum. Even the Philippines, the worst performer among these countries, posted low growth rates in only seven of the last fifty-three years, and only once for three years in succession.

What sets the Philippines apart is *not* the time that it has spent in a slow growth trap but instead the comparatively few years in which the economy grew at *extremely rapid rates* of 8 per cent or more. Singapore, at the other end of the spectrum, has had its share of bad years, but it has also posted growth rates of more than 10 per cent in seventeen of the last fifty years. At its most basic level the transformative power of double-digit growth is reflected in the arithmetic fact that an economy growing at 10 per cent per annum will double in size every seven years. Nicholas Kaldor's second law of growth, generally known as Verdoorn's Law, provides a deeper explanation. Kaldor finds at least three reasons for the positive relationship between the rate of growth of manufacturing output and labour productivity growth. First, the presence of surplus labour in the rural sector means that labour can be redeployed from agriculture to higher productivity industrial jobs without decreasing agricultural output. Second, manufacturing is uniquely capable of delivering economies of scale through specialization and technological learning. Finally, rapid growth of output stimulates the development of downstream industries that process manufactured goods (for example, sewing cloth into garments) and upstream industries that produce capital goods (the production of textile machinery).[1] Concentrating on the demand side, he sees rapid output growth as a stimulus to large-scale investment and technological learning.

Hla Myint uses the term "vent for surplus" to describe the mobilization of underutilized land and labour for export production, a process that he views as pivotal to Southeast Asian development (Hla Myint 1972). Myint credits Adam Smith with the insight that the demand contributed by exports promotes specialization, the division of labour and the realization of scale economies. As in Verdoorn's Law, vent for surplus jettisons the neoclassical assumption of full employment and emphasizes the relationship between the aggregate demand and productivity growth. Southeast Asian economies have specialized in the export of agricultural commodities like rubber and palm oil, adopting and developing new technologies, rationalizing management and reaping economies of scale. Foreign demand for manufactured goods such as garments and shoes, and later electronic components and automobile parts, has stimulated the development of these industries.

Vietnam is an even a less likely candidate for the middle-income trap than the Philippines: the economy has expanded at an average of nearly 7 per cent since 1988, and the growth rate dropped below 5 per cent in only one year during this period. Still predominantly rural, Vietnam's transition from an agrarian to an industrial economy has only just begun. However, like the Philippines, Vietnam has not achieved many years of very high

FIGURE 1
Economic Growth in Southeast Asia



NOTE: Figure below country names are average growth rates 1961 to 2013 (for Thailand 1966–2013 and Vietnam 1985–2013).
SOURCE: World Development Indicators.

rates of growth, and growth has not exceeded 8 per cent since 1997. Economic growth has not returned to the highs recorded in the 1990s despite average growth of non-oil exports of 16 per cent per year. Even as non-oil exports accelerated after 2004, labour productivity growth has yet to regain the highs recorded during the early years of reform (Table 1).

Why has robust demand for Vietnam's exports not generated more rapid growth of labour productivity? This paper offers an explanation for the failure of Vietnamese firms to capitalize on export growth to develop backward and forward linkages in agriculture and manufacturing. Despite successful vent for surplus growth, Vietnam has run large and persistent trade deficits, and in particular widening deficits with China, and depends heavily on China for inputs into its export industries. Vietnam's domestic firms — largely contained within or closely linked to the state sector — have remained small, uncompetitive and dependent upon state support. Production is dominated by family farms in agriculture and small workshops in manufacturing, with relatively few examples of large-scale, technologically progressive firms outside of foreign-invested sector.

In order to understand why this remains the case we need to situate recent developments within the broader context of Vietnam's unique experience of transition from central planning to the market. It is often noted that during the transition the Vietnamese state did not withdraw from the market but rather commercialized itself to take advantage of opportunities for arbitrage as markets expanded and internationalized. As the state commercialized it also fragmented, as vertical authority relations broke down and horizontal coordination — which was never a great strength of the system — become even more difficult. Commercialization and fragmentation of the state discouraged investment in large-scale, technologically and managerially demanding investment projects. State and state-linked companies have instead favoured activities in property development and finance that generate short-term rents on the basis of preferential access to state-controlled land, capital or licences. An important policy implication of state commercialization is that privatization of state companies may have the unintended consequence of increasing rather than reducing the role of the state in the Vietnamese economy.

2. Vent for Surplus

Vietnam enjoyed two decades of rapid growth following the adoption of *Doi Moi* or "economic renovation" announced in December 1986 and implemented in stages over the next ten to fifteen years. *Doi Moi* marked a deliberate shift in policy away from central planning and toward a mixed economy — what the government terms a "socialist market economy." Agriculture was decollectivized; domestic prices, foreign trade and investment were liberalized; and greater space was allowed for private sector activity. Two decades of classic vent for surplus growth followed, led by the domestic agricultural sector and foreign investment in oil and light manufactures. Millions of jobs were created and domestic markets expanded in turn. Per capita income increased more than threefold and the official poverty rate fell from 60 per cent of the population to 12 per cent.

Vietnam came from nowhere to rank among the largest agricultural exporters in the world. A

TABLE 1
Growth of Non-oil Exports and Labour Productivity

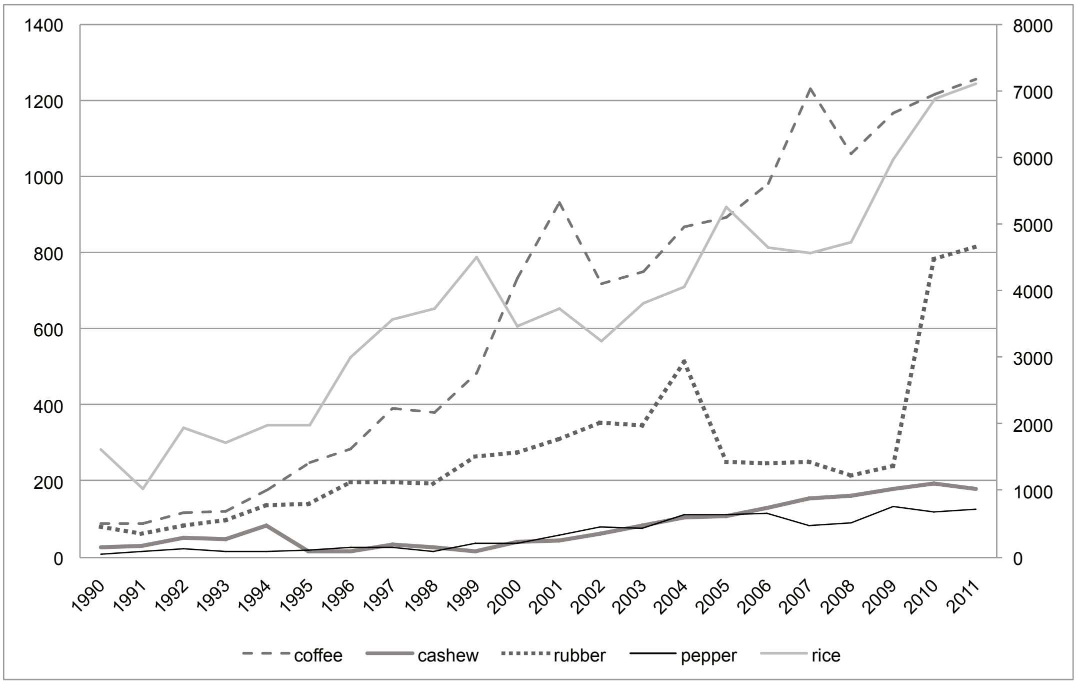
	1991–97	*1998–2004*	*2005–12*
Non-oil exports	25%	9.3%	21.2%
Labour productivity	6%	3.8%	4.3%

SOURCE: General Statistics Office (GSO), Vietnam.

net food importer as recently as the 1980s, by the 2000s Vietnam was the second largest rice exporter in the world, as well as the second largest exporter of coffee, the top exporter of pepper and cashew, and an important supplier of fish, shellfish and fresh fruit. Once institutional constraints on small farmers were removed, export markets provided incentives for farmers to bring more land into production and to shift from low to higher value commodities. Coffee and fish export growth was particularly impressive, increasing at average annual rates of 15 and 23 per cent, respectively over the twenty year period from 1992. With the exception of rubber, most of these commodities are produced on small, often family-run farms and then marketed through state and private trading companies. Vietnam's small farmers have proven more adept at increasing volumes than improving quality; the country is still the leading exporter of cheap, green coffee and low-grade rice, although Vietnam has also had some success breaking into higher value-added commodities like cut flowers and shrimp. The dominance of state trading companies has discouraged the formation of linkages between producers, processors and consumers, which has reduced incentives to specialization and has limited the flow of information and technology to farmers and farmer associations. State trading companies have also used their domestic market power to extract profits from producers.[2] The sustainability of production is also open to question, especially fish and shellfish production in the Mekong Delta (see Figures 2 and 3).

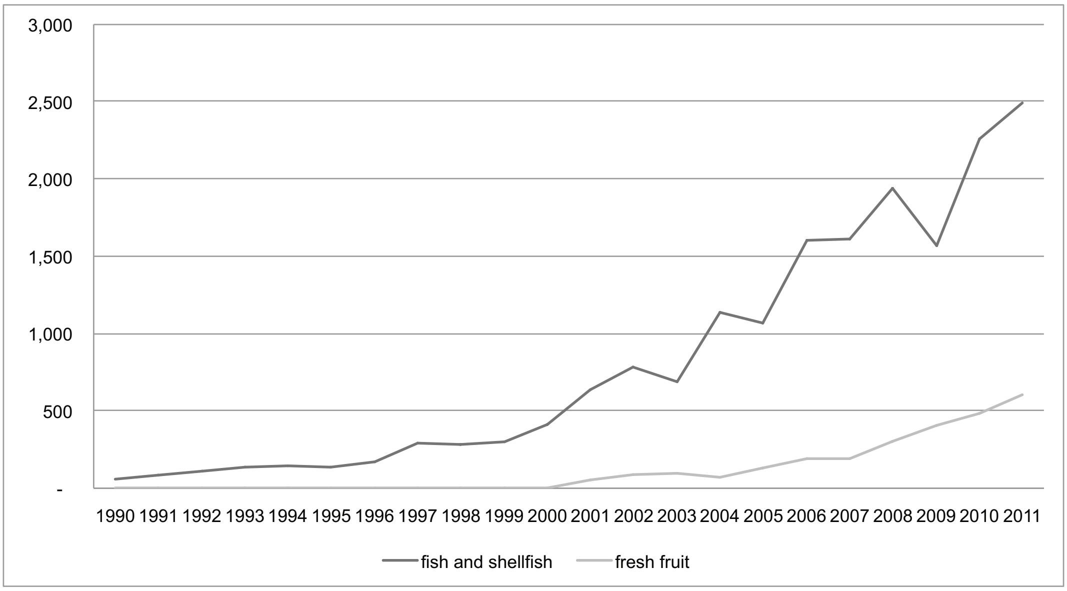
In manufacturing, garment, footwear, and more recently, electronics assembly have grown at extremely rapid rates, especially since the completion of the U.S. Bilateral Trade Agreement

FIGURE 2
Vietnam's Commodity Exports, tonnes (thousands)



SOURCE: FAOSTAT.

FIGURE 3
Vietnam's Seafood and Fresh Fruit Exports, tonnes (thousands)



SOURCE: FAO.

signed in 2000. Garment export growth has averaged 20 per cent per annum since 2002; footwear exports, 13 per cent (Figure 4). Since 2003, the growth of electronic equipment — largely mobile phones — has been exponential; global companies like Samsung and Nokia have commenced assembly operations (Figure 5). The wages earned by these workers — like the profits going to small farmers — have helped to stimulate domestic demand, which has accounted for more than half of Vietnam's output growth over the past two decades.

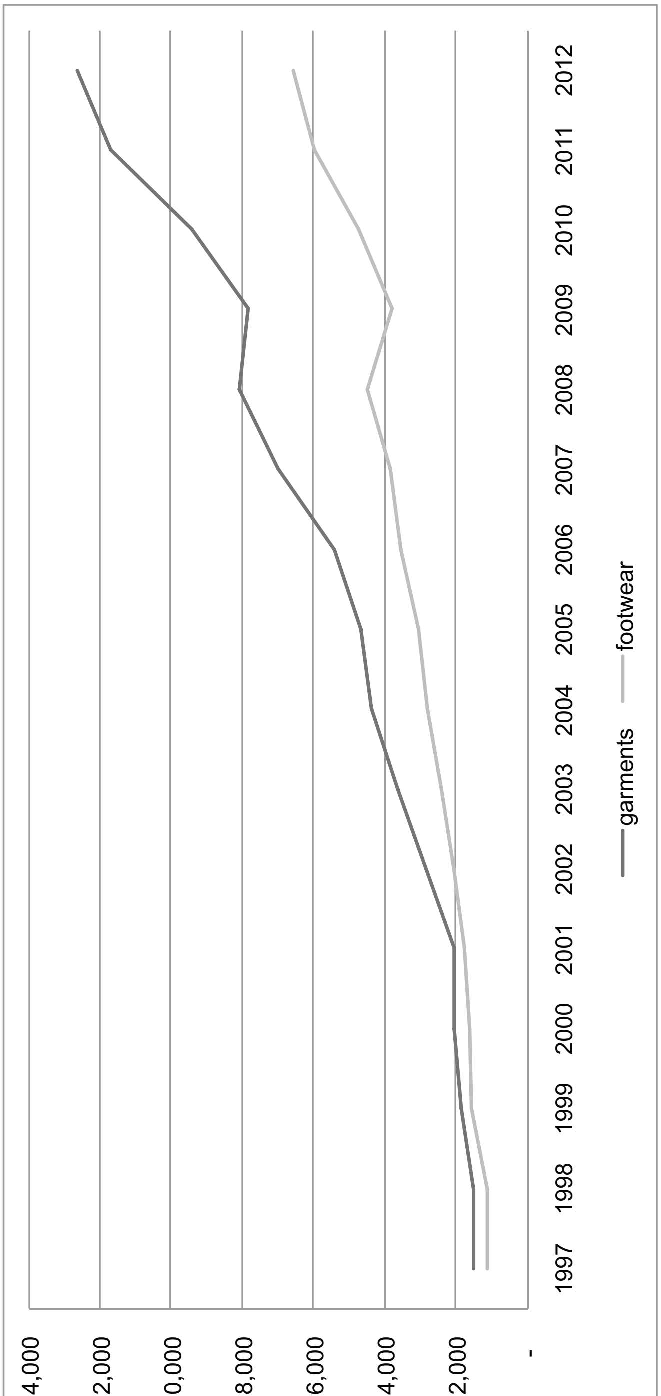
With its young and still largely rural labour force, Vietnam is well positioned to enjoy many more years of vent for surplus growth. New commodities have come on stream, including higher value-added exports such as fresh and processed vegetables, cut flowers and fresh and processed meat. As costs rise in China, Vietnam has emerged as an attractive destination for inward investment in labour-intensive manufactures, with wages for unskilled workers in Ho Chi Minh City considerably lower than in Jakarta and Manila.

2.1 Vent for Surplus and Upstream Demand

In addition to generating jobs and export earnings, vent for surplus growth also creates a sizeable and reliable domestic market for capital goods, and inputs into the production of commodities and labour-intensive manufactures. It also produces raw commodities that can be used as inputs in processing industries. Vietnam ranked eighteenth among garment exporters with revenues of less than US$2 billion as recently as 2000. But by 2011, the country was the eighth largest garment exporter in the world with earnings in excess of US$13 billion.[3] In the same year, Vietnam was the third ranked exporter of footwear behind China and Hong Kong (Portuguese Footwear, Leather Goods and Components Manufacturing Association 2012, p. 4). And yet Vietnam has run large and persistent trade deficits largely as a result of continued dependence on China for inputs into its main export industries.

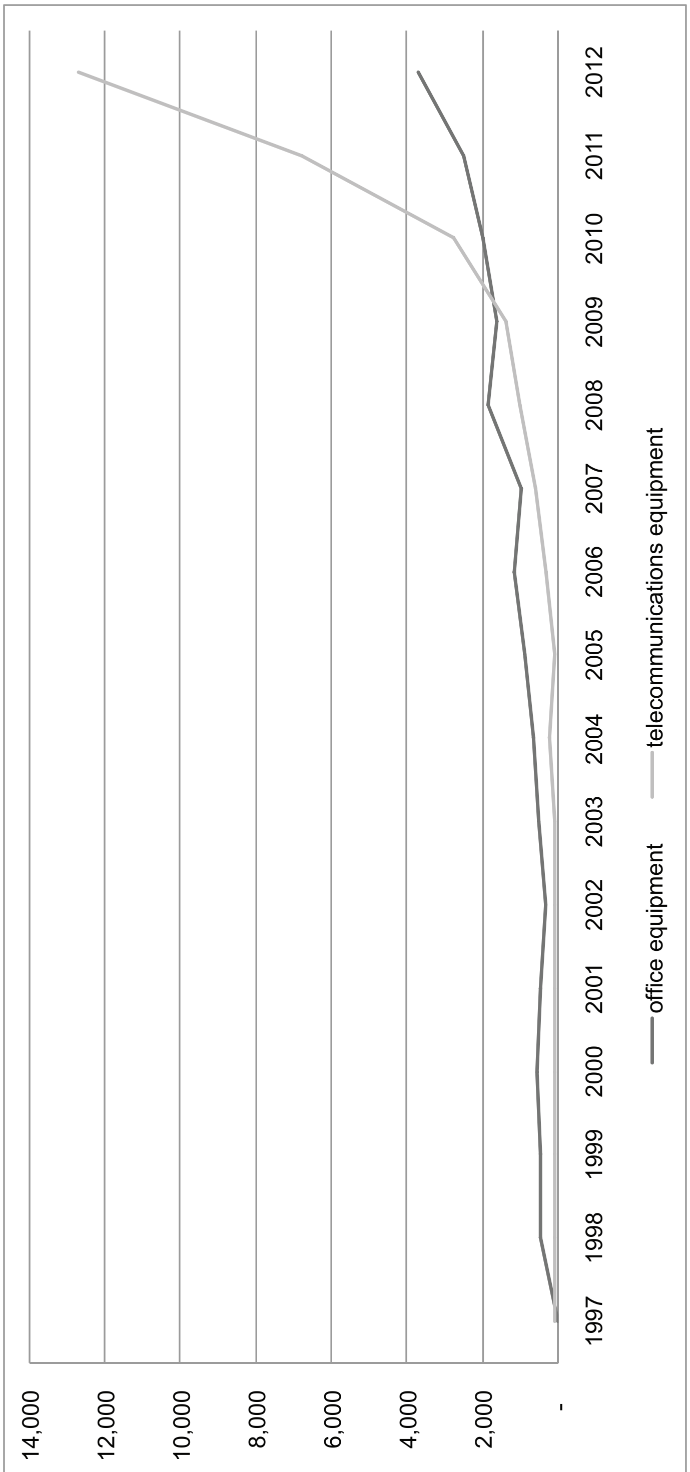
Vietnam and the Philippines are the two countries in the region that have tended to record large trade deficits as a share of GDP in

FIGURE 4
Garment and Shoe Exports, US$ constant 2005, millions



SOURCE: UN Comtrade database.

FIGURE 5
Exports of Telecommunications and Office Equipment, constant 2005
US$, millions



SOURCE: UN Comtrade database.

the period after the Asian Financial Crisis (AFC) (Figure 6). Trade deficits are partly a product of net capital inflows from investment, borrowing or transfers such as remittances of foreign workers. The steep rise in Vietnam's trade deficit in 2007 and 2008 was driven by an investment boom that increased demand for imported machinery, construction material and other capital goods and intermediates. This reflects an established pattern in which current account deficits widen with the acceleration of economic growth.

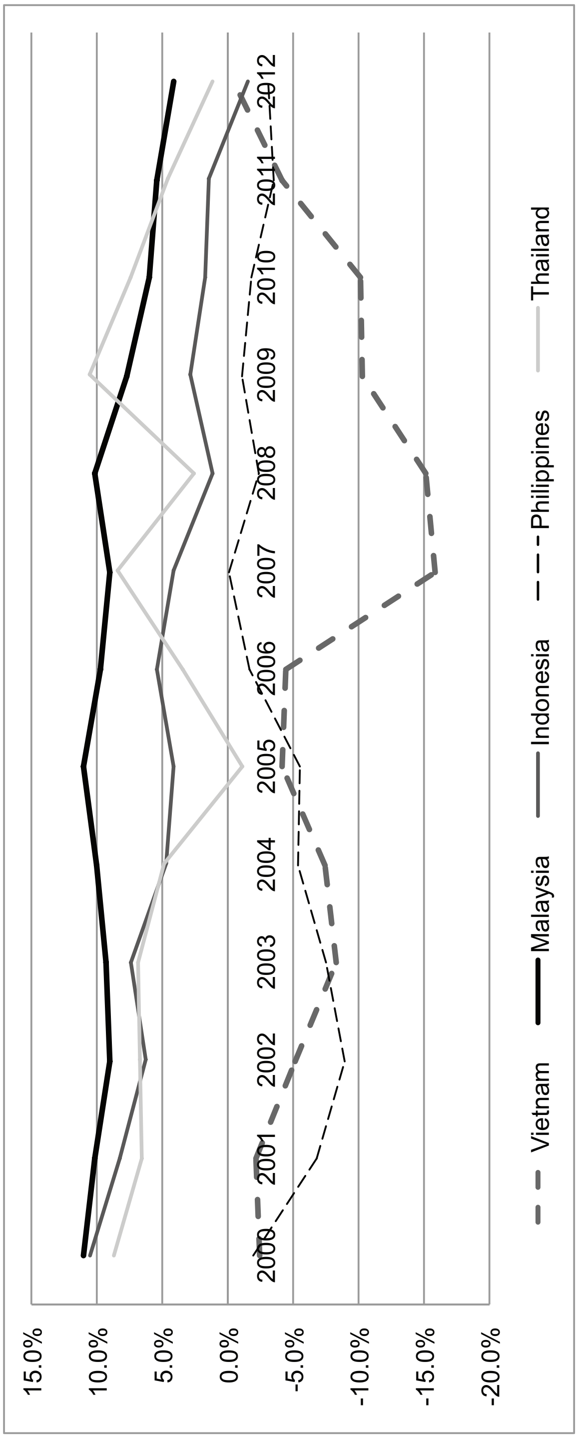
One of the main causes of Vietnam's persistent current account deficits is a large and growing trade deficit with China, which peaked in 2010 at the equivalent of 15 per cent of GDP (Figure 7). In this, Vietnam is an outlier in the region as the other large economies run trade surpluses with China in most years (the exception being Indonesia, for which trade with China is typically in balance). Vietnam's pattern of recording trade surpluses with the United States and the European Union (EU), and trade deficits with China, broadly reflects the direction of trade of finished manufactured products and inputs: Vietnam imports capital and intermediate goods from China and sells finished products to the United States, EU and Japan.

This pattern emerges most clearly in Figure 8, which shows net exports of fibres, cloth and garments as a share of GDP.[4] Unlike the other countries of the region, Vietnam's deficit with China is large and expanding directly in tandem with domestic exports of garments. The figure presents a vivid illustration of Vietnam's dependence on China for intermediate inputs in this important domestic industry. Vietnam's trade deficit with China in iron and steel is also sizeable, with a massive spike during the investment boom resulting from a surge in imports of construction materials (Figure 9). Similarly striking results are obtained for inputs into the footwear industry, pharmaceuticals, electronics assembly, motor vehicles and a range of other sub-sectors of domestic manufacturing (for reasons of space and tedium these are not included here).

There is some good news on the trade front with China. Net exports of transistors, semiconductors and integrated circuits to China have turned sharply positive as Intel's assembly and test facility in Ho Chi Minh City has come on stream (Figure 10). When completed, this factory will be the largest of its kind in the world, and if successful, Vietnam will attract interest from other producers of electronic components. Exports of components from Vietnam to Chinese assemblers would help reduce the size of the bilateral trade deficit and would create thousands of stable, relatively highly paid jobs. Although domestic value-added and upstream linkages are limited in this industry, the presence of a large components industry could help attract downstream investment in assembly away from China as wages there continue to rise.

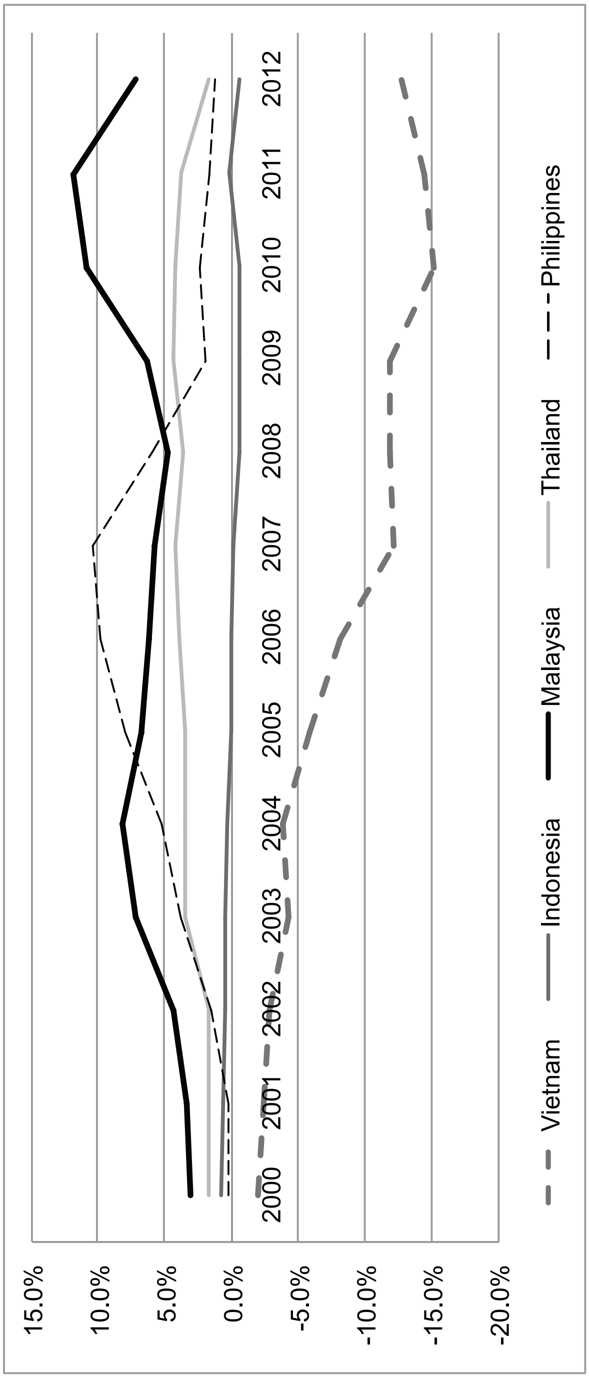
Nevertheless, the point remains that demand for inputs from Vietnam's expanding labour-intensive manufacturing sector has not stimulated the development of supplier industries such as cotton and synthetic cloth, dyes, chemicals, plastics and steel (Nguyen 2010, p. 3; Ketels et al. 2010; World Bank 2013*b*). Many explanations have been put forward for the limited degree to which downstream demand has stimulated investment in upstream industries, including the poor quality of transport infrastructure, seasonal power shortages, insufficient numbers of appropriately skilled workers, a weak national research system, poor linkages between firms, universities and research institutes, bureaucratic red tape, corruption, and an underdeveloped legal system (World Bank 2005; 2011; 2013*b*; UNIDO 2011). These are common problems in lower and lower-middle income countries. Countries that are members of the WTO and regional trade agreements like the ASEAN Free Trade Area must also grapple with the problem of promoting industrialization without the kinds of infant industry protection that were used to such great effect in the United States, Europe and Japan. Vietnam has limited recourse to the instruments used by Malaysia and Thailand just twenty years ago, let alone those adopted by Japan, Korea and Taiwan during their rapid industrialization (Wade 2003). As Richard Doner has shown, Southeast Asian policy-makers have not taken full advantage of the options that are still

FIGURE 6
Trade Balance as Share of GDP



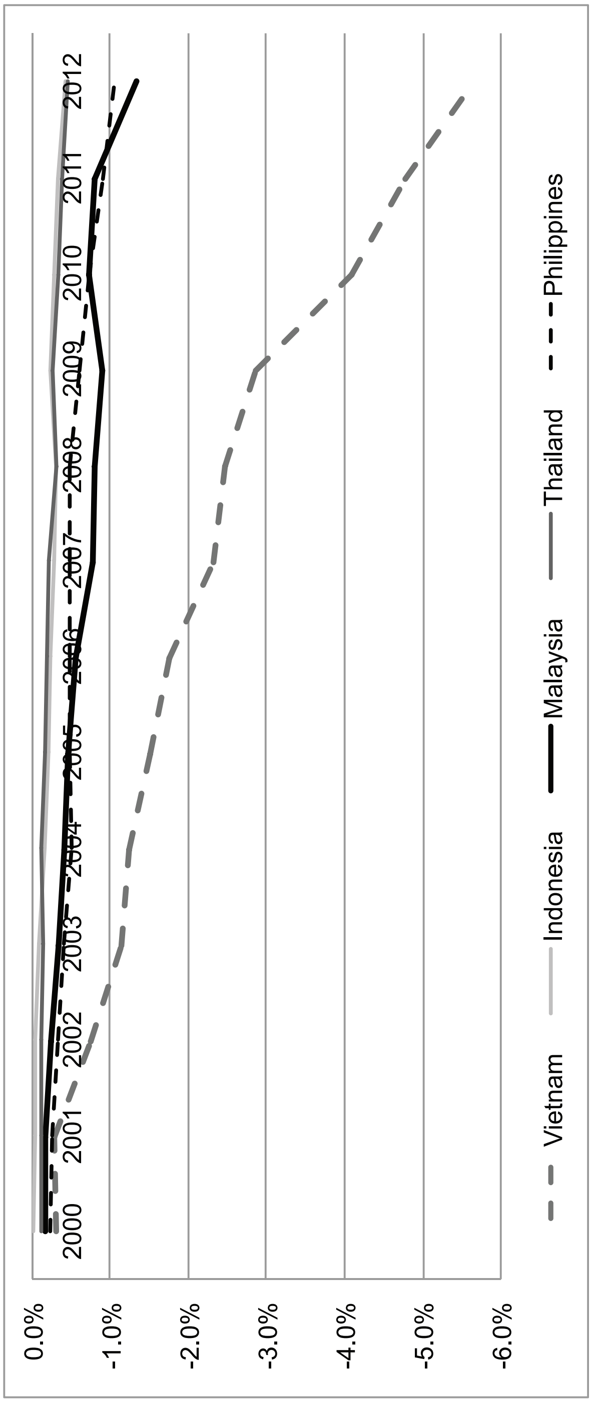
SOURCE: World Development Indicators.

FIGURE 7
Trade Balance with China as a Percentage of GDP



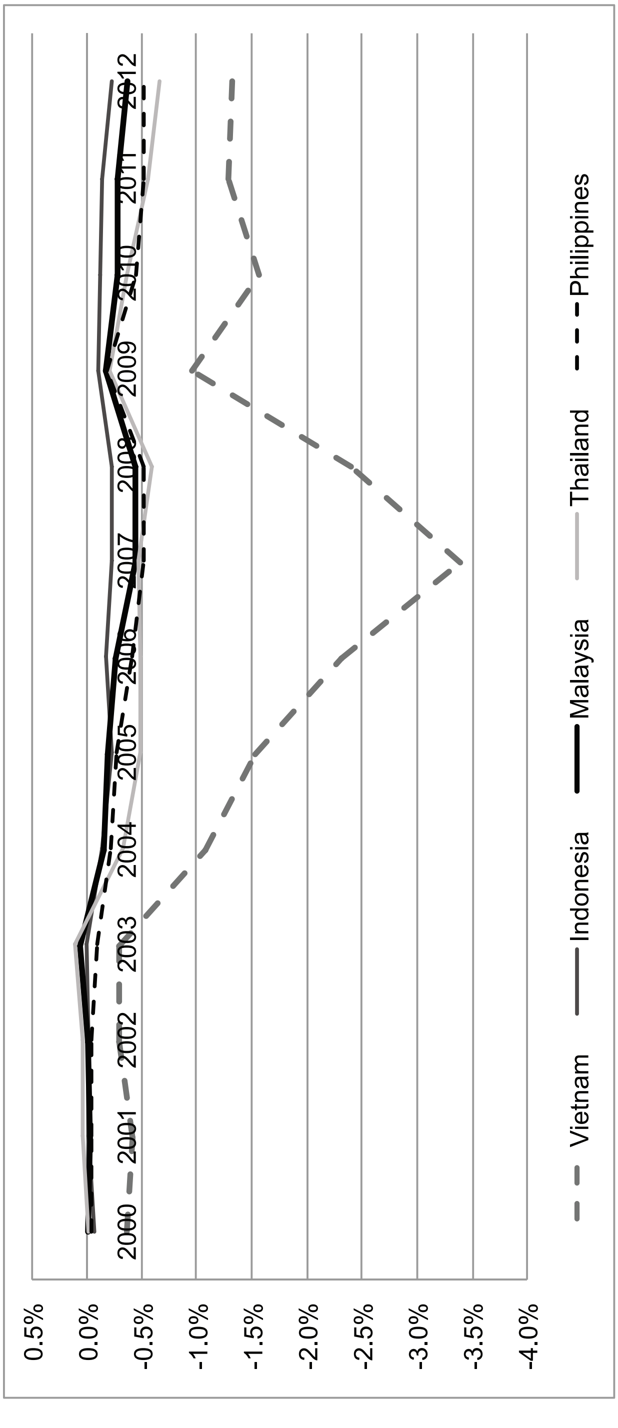
SOURCE: UN Comtrade database.

FIGURE 8
Net Exports to China of Fibres, Cloth and Garments as a Percentage of GDP



SOURCE: UN Comtrade database.

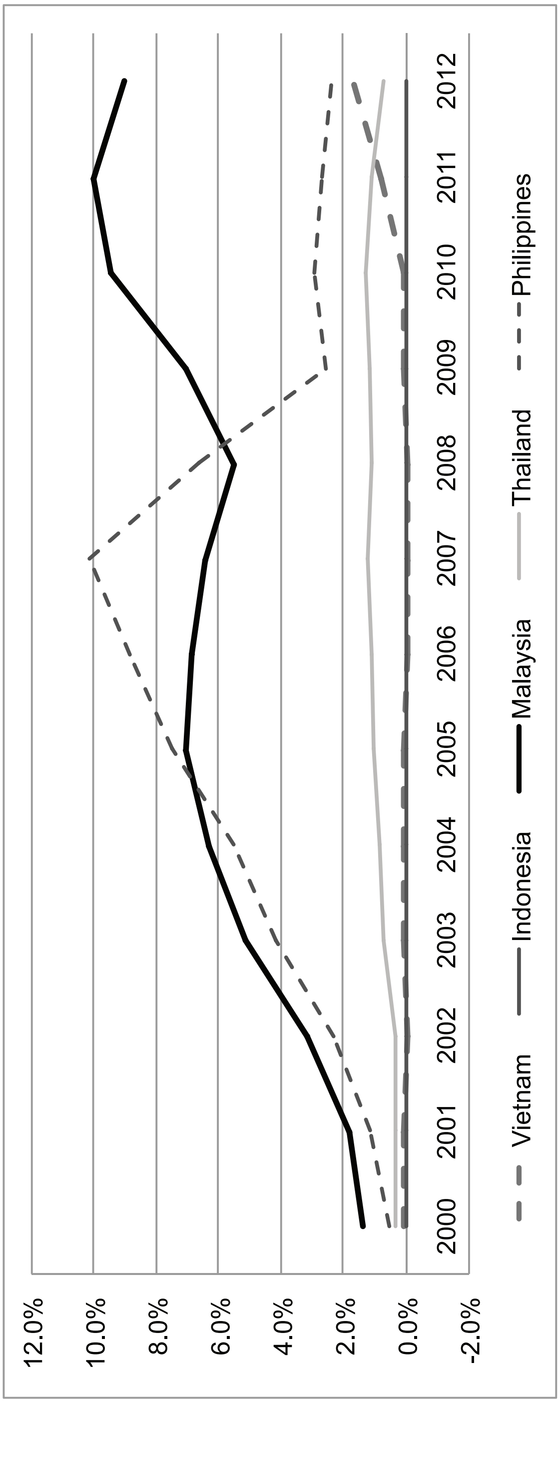
FIGURE 9
Net Exports to China of Iron and Steel as a Percentage of GDP



SOURCE: UN Comtrade database.

FIGURE 10

Net Exports of Transistors, Semiconductors and Integrated Circuits as a Percentage of GDP



Source: UN Comtrade database.

available to them to promote industrial upgrading, largely due to political cleavages among elites that work against achieving the consensus needed to design and implement industrial policy (Doner 2009).

The nature of global manufacturing has also changed dramatically over the past twenty years (Nolan 2004). The concentration of market power and control of technology in the hands of a few dominant firms in each sub-sector has increased competition at every stage of the value chain. System integrator firms at the apex of the production structure possess the power, technological and managerial capabilities to demand constant cost-cutting, shorter delivery times and improvements in design, quality and technology from their suppliers. These demands are replicated at every level of the supply chain, creating what Peter Nolan refers to as a "cascade effect", in which system integrators demand constant improvements from their first tier suppliers, which, in turn, increase their demands on secondary suppliers, and so on. Pressure on suppliers at every level enables system integrators to reduce the duration of product cycles to keep consumers in the shops: new mobile processors for cell phones and tablets come out every six months, and athletic footwear styles rotate four times a year. The resulting "technological arms race" eliminates suppliers that fail to keep up with the pace of change, giving rise to concentration at every tier of the supply chain (Baumol 2002).

The Vietnamese government is aware of these challenges (Abrami 2003), and of the particular difficulties associated with sharing a border with the world's largest producer of cotton yarn, cotton fabrics, garments, leather, footwear, steel and a wide range of other intermediate and final goods. The main policy response was to promote state corporations as national champions. Beginning in 1994, the government merged small state-owned enterprises (SOEs) into "General Corporations" as a means to reduce fragmentation, achieve economies of scale in key economic sectors and concentrate technological and managerial capacity. Inspired by the Korean *chaebol,* Taiwanese SOEs and Chinese state business groups, the General Corporations encompassed the commanding heights of the Vietnamese economy. State conglomerates in electricity, fossil fuels, cement, airlines, shipping, rubber, steel, coffee, textiles, chemicals and trade in food grains gave Hanoi direct control over investment, pricing and international trade in major commodities. In the lead up to WTO accession, the government undertook a further round of centralization with the establishment of Economic Groups. By 2012, thirteen Economic Groups and ninety-six General Corporations had been created in the state sector.

The decision to create domestic state conglomerates is understandable given the need to deepen domestic production structures, acquire technology and achieve economies of scale. The problem was less with the theory than with implementation, specifically the governance of the new entities. The central government's inability to discipline the conglomerates opened up opportunities for them to leverage state land and capital to invest in potentially lucrative but risky side-line projects like property development and finance. The subsidiary companies of these groups have not attracted private capital, nor concentrated scarce managerial and technical talent in high-priority businesses. Instead, Economic Groups have functioned mainly as finance companies, funding SOEs' aggressive expansion and diversification programmes. Investment has also been driven by political objectives, as the large SOEs delivered projects to powerful provincial leaders as a means of securing their support.

A particularly risky development from the macroeconomic perspective was the penetration of Economic Groups and General Corporations into the banking sector. State conglomerates invested aggressively in joint-stock banks, and in several cases have established their own branded banks. In 2005 only five joint-stock banks were partly owned by state entities, with an investment of VND 1 trillion. By 2010 the amount of capital had increased to VND 15 trillion and the number of banks to twenty-two. Regulations are too vague and enforcement too weak to prevent these groups from lending directly to their own subsidiaries and to other related parties. Moreover, the ownership structures of the joint-stock banks, particularly those not listed on equity exchanges, have become so complicated that it is difficult to gauge the quality of capital invested in them (Vu 2012).

Economic Groups and General Corporations rarely need to compete to survive. Natural resource producers like Petro Vietnam and Vinacomin have exclusive access to mineral reserves and, therefore, function more like government ministries than profit-oriented companies. Others, like EVN, Vinalines and Vietnam Airlines operate as domestic monopolies or as players in highly regulated markets, giving them significant advantages over private and foreign-invested companies. The main exceptions are the telecoms Viettel, which is owned by the military, and VNPT, which operates two mobile networks. These large networks must also compete with smaller providers, including a company owned by the Ministry of Public Security. Not coincidentally, the telecoms are among the best-run and least-indebted large companies in the state sector.

The end of the property boom in 2008 pulled the rug out from under the conglomerates' diversification strategy. Vinashin, the ship-building group, defaulted on a US$600 million international syndicated loan at the end of 2010. The Global Financial Crisis (GFC) was one factor leading to the group's financial woes: Vinashin lost US$8 billion in contracts in 2009, denying the company cash that it urgently needed to service its domestic and foreign debt. But there were others — in particular, the lure of easy credit. The government lent it US$750 million in 2005 (proceeds from the country's first sovereign bond issue), and Vinashin got another US$150 million in government support in 2009. According to audit reports leaked that same year, Vinashin had accumulated a total of US$4.5 billion in debt.

Vinashin had not used its state resources to build a national champion in a technologically advanced industry. Rather than set to work creating a vertically integrated corporation capable of achieving scale economies and acquiring technological capabilities in its core business, Vinashin's management exploited its insider status to engage in numerous speculative ventures. At its peak, the Vinashin Group consisted of 445 subsidiaries and twenty joint-venture companies that included initiatives in property development and finance, handicrafts and breweries along with shipbuilding. Government investigations revealed widespread malfeasance, including the purchase of a Polish ship built in 1973 that was so unseaworthy that it could not be introduced into service.

Not long after the Vinashin collapse, Vinalines, the state-owned shipping and port operator and development group, defaulted on US$1.1 billion in debt. A government investigation turned up numerous irregularities, including investments of more than US$1 billion in second-hand ships, many of which were not commercially viable, and overruns at fourteen of the group's port projects. Other state conglomerates are also heavily indebted and have made losses in the property and finance sectors. The government estimates that SOEs account for more than half of non-performing loans. According to the Ministry of Finance, the General Corporations and Economic Groups had suffered a combined loss of US$1.5 billion by the end of 2011.

The government, unwilling to abandon its strategy of state-led industrialization, has put forward a restructuring plan that would force conglomerates to divest from non-core activities by 2015. One should not underestimate the magnitude of this challenge. The Vietnam National Textile and Garment Group (VINATEX) consists of something on the order of 120 subsidiaries operating in all aspects of garment production and trade including spinning, weaving, dyeing, design, assembly, distribution, retail and import-export. The group is also heavily exposed to the property sector, finance and banking. Under a plan approved in 2013, Vinatex will divest from thirty-seven subsidiaries in non-core industries and reduce its control to less than 50 per cent in twenty others. Vinatex is also planning on increasing investment in the production of yarn and fabrics to reduce dependence on imported intermediates and to meet yarn forward requirements under the Trans-Pacific

Partnership (TPP) now being negotiated with the United States and ten other countries.

2.2 Vietnam's Commercialized and Fragmented State

Broad agreement exists among government officials, donors and researchers that a return to rapid economic growth will require thoroughgoing restructuring of the SOEs. For donor agencies and much of the international business community, the obvious solution is large-scale privatization, including relaxing limits on overseas investors' shareholdings in domestic firms. Government and party leaders, on the other hand, reject this proposal as politically unacceptable. The various versions of SOE reform mooted by state and party officials seek to impose tighter discipline over SOEs and hold them accountable for their use of state capital.

Gauging the likely impact of these divergent approaches is complicated by the unique nature of the Vietnamese state and our rather limited understanding of it. Vietnam is governed by a Leninist party that has presided over the dismantling of central planning, de-collectivization of agriculture, liberalization of the trade and investment regime, and a radical financial liberalization that has seen (nominally) non-state banks and finance companies supplant state-owned banks as the largest providers of credit to the economy. On the surface, political power remains concentrated in the political bureau (politburo) of the Communist Party, while economic power has been dispersed to firms and households as markets have overtaken planning as the main means of allocating capital, labour, goods and services. However, this formulation oversimplifies both the political and economic situation: political power, although ostensibly concentrated, is in fact highly fragmented; and economic power, although decentralized, is still wielded predominantly by the state or institutions and individuals with close relations to the party-state. Vietnam's gradual transition from central planning did not remove the state from the market: instead, the market deeply penetrated the state, commercializing the functions of state entities which have leveraged their authority and access to state-controlled assets to create lucrative income-earning opportunities for government officials and related businesses.

The commercialization of the state is a recurrent theme in the political economy of Vietnam's transition from central planning. Vietnam's experience of central planning was brief and shallow, limited to several years of Soviet-style industrialization in the Democratic Republic of Vietnam prior to the escalation of the American War, and the failed attempt to resurrect planning on a national basis in the years immediately after reunification. Trading outside of the plan was pervasive even during these periods, made necessary by war, pervasive shortage, weak administration, and poor logistics and communications (Fforde and Paine 1987; Abrami 2002). Managers of state companies grew adept at out-of-plan trading in state assets and scarce commodities, and local authorities tolerated cross-border smuggling in exchange for illegal levies, partly funnelled into local government budgets to reduce deficits and partly captured by the official themselves. Starting in Ho Chi Minh City, local authorities established trading companies to export agricultural products and to import goods for sale on local markets. The growing tolerance for these "fence-breaking" activities created markets for commodities and factors of production that began underground and were subsequently legitimized by *Doi Moi* reforms. Legitimation of fence-breaking had also created markets for government positions that conferred control over state resources. The state not only increased the space for market transactions, it was itself effectively marketized (Cheshier 2010; Fforde 2007).

One of the unintended consequence of gradual economic reform in the absence of political change was the creation of a pro-reform coalition within the state consisting of powerful managers of state enterprises with access to subsidized imports and/or domestically produced goods and local and national authorities in a position to benefit from international and domestic trade. A powerful elite formed during the 1980s and 1990s that lent its support to economic reform measures to the extent that they created opportunities to profit from access to state power, but who resisted efforts to increase transparency and accountability in the use of public resources, regulatory consistency or the rule of law (Beresford and Đặng 2000). This is the system that Alexander Woodside and others refer to as "Market-Leninism" (Woodside 2005; London 2009).

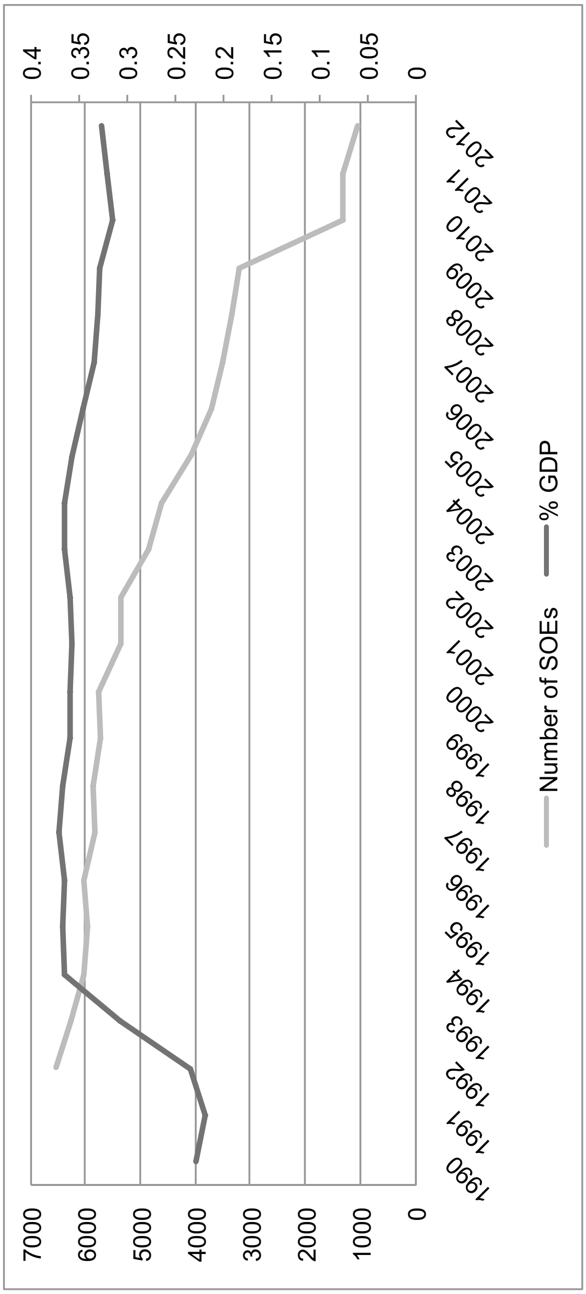
The first round of reforms saw a proliferation of new state companies as local authorities used their access to credit to create opportunities for speculation and arbitrage in an overall context of shortage. The total number of SOEs rose from 3,000 in 1985 to 12,000 by 1989. The resulting credit growth and deterioration in the government's fiscal position triggered inflation, which forced Hanoi to adopt an orthodox macroeconomic stabilization programme in 1989. This was to become a pattern in Vietnam: reform; speculative activity on the part of state agencies; credit expansion; inflation; and then crisis. Hyperinflation temporarily strengthened the hand of the central authorities, and in 1991 all state enterprises were forced to re-register as a means of eliminating chronically money-losing firms. Over the subsequent three year period nearly half of all SOEs — many created after the 1986 reforms — were shut down or merged. Employment in state enterprises fell from 2.7 to 1.7 million workers over the same period.

Yet, the fall in the number of state enterprises did not signal the retreat of the state or the rise of the private sector as the main means of imposing discipline on state enterprises. From 1991 until the end of the decade; the government's role in the economy actually grew (Figure 11). Some of this is explained by the policy of requiring foreign investors to form joint ventures with state firms; as these companies established themselves, the public sector claimed a larger share of output. But state enterprises also expanded as domestic purchasing power grew and private enterprise remained largely restricted to small firms. As late as 1998, the private corporate sector — as opposed to household businesses and small farms — accounted for just 1 per cent of employment and 7 per cent of GDP.

The economic slowdown in the wake of the AFC sparked a new round of reforms in the early 2000s, including a new enterprise law that provided private businesses with clearer legal status, and a renewed programme of equitization of state firms. But as Martin Gainsborough has shown in his study of the political economy of Ho Chi Minh City, the growth of private activity and the acceleration of equitization did not represent a challenge to the commercialized state: on the contrary, it signalled a change in the accumulation strategies of managers in state enterprises and other officials in a position to profit from these policies (Gainsborough 2003, p. 24). SOE managers, local authorities and central ministries have used equitization to siphon off valuable public assets, particularly land, into quasi-private companies under their control. The market economy has developed as an extension of the party-state and not in opposition to it as is often supposed. Capitalizing on their privileged access to resources and mobilizing relationships with state agencies, equitized companies and related quasi-private businesses capture local markets, dominate procurement and contracting with state agencies and launch new ventures to earn large profits in the property market, domestic distribution and trade, banking and finance (Cheshier and Pincus 2010). The commercialization of the state has driven the monetization of politics, in which party and government officials trade political influence and positions for cash among themselves and with businesses and individuals in a position to profit from state favours. Hence the monetization of politics and the politicization of the market are two sides of the same coin.

One of the consequences of Market-Leninism or state commercialization in Vietnam is the fragmentation of state power (Gainsborough 2002, p. 360). Although ruled by a Leninist party and possessing political institutions that in many instances appear similar to their Chinese analogues, Vietnam shares with its Southeast Asian neighbours a political tradition of localism and weak central control, conventions that were reinforced by decades of war and shortage (Woodside 1988). A constant tension has existed between attempts of central institutions to

FIGURE 11
Number of SOEs and Their Share of Economic Output



SOURCE: GSO.

coordinate and rationalize policy and the efforts of local government at all levels and subordinate units of central government to assert their autonomy. These tensions have increased with the formation of a business class from within the state and linked to state functionaries: government agencies at all levels operate to maximize returns from their physical assets and official prerogatives, and thus have a financial interest in resisting coordination horizontally and from above. State commercialization rewards agencies that maximize their authority and exercise of discretion. Local government institutions and central ministries routinely issue decisions and regulations that conflict with those of other agencies, and no mechanisms exist to achieve consistency or arbitrate among competing claims.

3. Fragmented Authority and Ho Chi Minh City's Port System

The development of the Ho Chi Minh City port system is a good example of institutional fragmentation at work (Nguyen and Pincus 2011). Numerous ports operate within the city's borders and in neighbouring provinces, each developed by different local and central agencies. Sai Gon Port is a subsidiary of Vinalines, the national shipping General Corporation. Ben Nghe port is operated by a local state-owned company under the People's Committee of HCMC. The Vietnam International Container Terminal (VICT), the country's first purpose-built container terminal, is a joint-venture of the state-owned Southern Waterborne Transport Corporation, the NOL Group of Singapore, and Mitsui & Co. of Japan. Sai Gon New Port (SNP) is another dedicated container port developed by the navy in the late 1980s. The Ba Son Shipyard, which was historically a shipbuilding facility, is also located in the port area, and is operated by the Ministry of Defence. There are also a number of small domestically operated and joint venture ports in the area.

Maintaining working ports in the central districts of the country's main commercial hub no longer makes economic sense. Container trucks rolling through the city's main thoroughfares cause congestion and increase transit times for importers and exporters. Saigon Port is located immediately adjacent to the central business district, and the land underneath it could be profitably redeveloped as a riverside commercial-residential complex. In 2005 the government completed a master plan for sea ports in Ho Chi Minh City and vicinity which required four of the largest ports to relocate to the coastal province of Ba Ria-Vung Tau by 2010 at the latest. The plan was approved by the prime minister in August of the same year. In March 2005, the Japan Bank for International Cooperation approved an ODA loan of ¥36.4 billion (US$328.6 million) for the Cai Mep-Thi Vai port complex in Ba Ria-Vung Tau.

The central government was unable to enforce the decision to relocate four ports to the coast by the 2010 deadline. Saigon New Port, now the region's busiest port, relocated to a site further down the river but still within Ho Chi Minh City. The city government is unwilling to surrender its port businesses and related services to neighbouring provinces for fear of losing jobs and tax revenue. Other agencies, notably Vinalines, are concerned that if they agree to relocate they will lose control over valuable land assets. Vinalines has developed a plan to convert its city ports into a passenger ship terminal and supporting commercial services, but has not received permission from the city government to do so. The city has ignored repeated instructions from central government to develop a land use plan for the site. Lack of coordination is most apparent in the failure to develop highways to link the city to the Ba Ria-Vung Tau ports, or even to link the ports themselves.

The stand-off between Vinalines and the city government demonstrates how insecure and poorly defined property rights contribute to economic fragmentation. If Vinalines held secure title to its valuable land along the Saigon River, the company could redevelop it for commercial use or sell the land (at a considerable profit) and use the proceeds to invest elsewhere. However, land rights in Vietnam are awarded for specific purposes; in this case, Vinalines has no rights under the law to convert the use of the land from port to commercial-residential development without approval from the city government. Approval is not forthcoming because the city would like to reclaim the land for its own purposes.

The case of Ho Chi Minh City's port system illustrates several key characteristics of state commercialization and fragmentation. Numerous state agencies compete with each other in the same market, using the regulatory powers at their disposal to advance their financial interests. The central government is unable to enforce its decisions, and thus cannot honour its own commitments to donors and investors. Insecure property rights prevent the formation of a market for valuable assets like land that could be put to more productive use if the "owners" could assert their claims without recourse to political infighting. The end result is a system that is resistant to rationalization because competition is based on the capacity to wield state authority and control public assets and not on the price or quality of the goods and services sold on the market. In this sense, the state has been marketized but investment decisions are not based on market criteria.

4. Implications for SOE Reform

In the context of a commercialized and fragmented state, the central government's ambition of tightening control over state-owned companies is a logical strategy. The creation of General Corporations in 1994 and Economic Groups in 2005 was an attempt to reduce the number of agencies involved in SOE management, impose discipline and concentrate assets and capabilities while still maintaining core corporate assets in the state sector for political reasons and because of the government's dependence on them for revenue (Painter 2005, p. 272). Creating larger entities out of the existing patchwork of state companies would enable the state sector to realize economies of scale in upstream industries such as textiles, steel, chemicals and machinery, following the industrialization path followed by Taiwan half a century ago (Wade 1990, p. 78).

Unfortunately, the creation of an additional tier of control did not reduce fragmentation, in large part owing to the extensive commercialization of the offices of the state. Economic Groups and General Corporations behaved in ways identical to ministries and local authorities that enjoy access to public assets and government authority. State-owned conglomerates were formed from disparate collections of SOEs previously held by ministries and local authorities. Instead of setting about rationalizing these holdings, centralizing control and establishing internal discipline, managers of General Corporations and Economic Groups replicated the strategies pursued by SOEs throughout the reform period, namely leveraging access to state land and credit to undertake a wide range of often unrelated projects implemented by numerous subsidiaries. In 2013 Petro-Vietnam reportedly controlled 239 subsidiaries and the Vietnam Rubber Group controlled 168 (*Saigon Times*, 11 April 2013). Companies under these groups continued to operate scattered, small-scale facilities rather than consolidate production to achieve economies of scale and concentrate limited technological and managerial capabilities. The economic logic of this strategy reflects the structures of awards and punishments facing state sector managers. Rationalizing sprawling conglomerates would require divesting from potentially profitable businesses, focusing on money-losing core activities, disposing of valuable assets and laying off workers. These are risky and potentially career-ending decisions in a system geared to generating short-term profits for managers and revenues for government. Proliferation of assets has a political logic as well: investing in numerous provinces, and districts within provinces, is an effective means of expanding one's network among local officials, some of whom sit on provincial and even national party committees that decide matters such as the oversight of state companies, the allocation of party and government posts and the selection of government contractors. The expanded role of provincial delegates in the Central Committee of the Communist Party since the 1990s has increased the importance of nurturing relationships at the provincial and district levels (Abuza 2002).

State commercialization and fragmentation also have important implications for the policy of restructuring state enterprises through equitization or privatization. As Martin Gainsborough has argued, "equitization should be seen not as the retreat of the state but rather as its advance" (Gainsborough 2009, p. 262). Equitized firms may be partly owned by private individuals, but shareholders also include past and current managers. Many are also still majority owned by the state and report to the same local and central agencies that were responsible for them before equitization. Moreover, in a context of insecure property rights and conflicting regulations, reduction in the state's share does not reduce the firm's dependence on networks of supporters within the government. The unpredictability of policy and decision-making means that firm managers continue to rely heavily on the protection of and support from party and government officials.[5]

Another way in which equitization may lead to state advance is through the growing importance of "quasi-private" conglomerates, for example — Masan, Hoang Anh Gia Lai, Vincom and Sovico — just to name the most prominent groups. These groups, often established by overseas Vietnamese business people who have returned from the countries of the former Soviet Union, have replicated the state conglomerate strategy of investment in finance and land with support from powerful allies in the party and state. They are also highly diversified. In 2013 the Masan Group controlled seventy-one subsidiaries, including Techcombank, the Nui Phao tungsten mine project and the country's second largest food company. Sovico, a property, banking and infrastructure group, moved into the aviation sector with the start-up VietJet Air in 2011. In September 2013, Sovico surprised the market with the announcement that it had signed a memorandum of understanding with Airbus to buy ninety-two A320 aircraft at an estimated cost of US$9 billion. Some of these groups have expanded their holdings in the banking sector in the wake of the recent crisis, and appear to have the financial wherewithal to take on large-scale investments. Dismantling state groups only to recreate them as quasi-private conglomerates may not in the end help Vietnam solve the problem of industrial and technological deepening.

The commercialization of state agencies, fragmentation of authority and poorly specified property rights represent a challenge to both approaches to state enterprise reform. This suggests prior reforms, notably reform of the party and state's personnel system and strengthening of property rights, particularly to land, will be necessary to create an environment that is more conducive to SOE reform. Regardless of the approach to enterprise reform that the government chooses to pursue, it must first achieve a greater degree of control over the actions of its own officials, and more consistency and coordination among various units of government both at the central and local levels.

Perhaps China's experience is relevant here as a country that has undergone considerable economic and fiscal decentralization and yet, despite considerable evidence of corruption, the party and state central authorities have maintained control over central and local government agencies. In the view of Pierre F. Landry, "Personnel management is the glue that turns the fragments of the Chinese local state into a coherent — albeit colourful — mosaic" (Landry 2011, p. 79). The centre maintains the right to select and promote provincial leaders, which has served to preserve the link between compliance with central rules and directives and the career advancement of local party and state officials. An important difference between China and Vietnam is that most provincial leaders in the latter country originate from the provinces that they govern. According to a paper published by the Fulbright Economics Teaching Program in 2012, only eight of sixty-five provincial party secretaries did not have strong pre-existing ties to the province to which they were assigned. Only two people's committee chairmen fell into this category. Nearly 70 per cent of senior provincial officials in Vietnam serve in their native province, and the percentage increases to almost 90 per cent when officials who served the bulk of their careers in the province, but who were born elsewhere, are categorized as locals. In China, by way of contrast, only 18 per cent of provincial leaders served in their native province in 2010 (*Structural Reform for Growth* 2012).

The problem of fragmentation is not confined to provincial government. Central government ministries issue conflicting regulations and decisions to accommodate specific interests, and the capacity of the government to monitor itself and coordinate policy is limited.[6] Ministries do not share information and even resist using data produced by other agencies.[7] The Communist Party, although responsible for the selection and promotion of government officials, is itself fragmented by regional loyalties and patron-client relationships.

Perhaps in this regard Vietnam is similar to its non-Communist Southeast Asian neighbours. The process of structural change entails centralization of resources, the implementation of long-term investment plans, training and retention of technicians and managers; and the capacity of the political system to build a consensus on the distribution of these costs and benefits is an essential prerequisite to success. Richard Doner has argued that a crucial difference between the East Asian industrializers like Taiwan and Korea and the countries of Southeast Asia is the fragmentation of the political elite in the latter group of countries and the failure of domestic political institutions to achieve and sustain a consistent policy framework (Doner 2009). The precise form that political fragmentation takes differs from country to country, but throughout the region, powerful individuals within and outside of government have the capacity to frustrate efforts to place national goals above particularistic aims.

5. Conclusion

With the introduction of market reforms Vietnam enjoyed two decades of vent for surplus growth, mobilizing underutilized land and labour for the production of bulk commodities and labour intensive manufactures for export. These reforms are often naively portrayed as the advance of the market and the retreat of the state. Markets did indeed advance, but the agencies of the state adapted, leveraging access to state assets and authority into lucrative income earning opportunities. As the state commercialized it also fragmented, as central authorities lacked the capacity or will (or both) to impose discipline on subordinate agencies and force agencies of central and local government to collaborate rather than compete.

Growth has slowed since 2007, which turned out to be the peak of the credit cycle globally and in Vietnam. By early 2008 rapid credit growth had led to inflation and asset price bubbles, and the government was forced to step in to cool off the market. The GFC hit at the end of the same year, at which time the government abruptly reversed course to compensate for the loss of export earnings. A domestic banking crisis followed in due course, brought about by over-borrowing in the corporate sector, partly fuelled by a government's monetary stimulus. Domestic demand growth has slowed as corporations, households and banks work through the slow process of paying down the mountains of debt acquired during the long boom and the stimulus from 2006 to 2010. The weak recovery in the United States, Europe and Japan — Vietnam's main export markets — has not helped.

Economic growth on the order of 5 to 6 per cent is disappointing compared to the higher rates recorded in the recent past, but it does not constitute evidence that Vietnam has reached the demographic or geographic limits of vent for surplus growth. The share of the population living in cities has increased but is still low by regional standards and although fertility rates have fallen, the labour force is still growing. Exports of commodities like rice and coffee may grow more slowly or even decline, but these will be replaced by new commodity exports and labour-intensive manufactures. The challenge facing Vietnam is to translate the country's impressive export performance into productivity growth through the development of upstream and downstream industries that can realize economies of scale. This has not yet happened largely because of state fragmentation and commercialization. The country remains heavily dependent on imports of capital and intermediate goods from China, including fabrics and fibres, chemicals, steel and machinery, among others. Processing of agricultural commodities limited, and because most production is carried out on small farms quality standards are low. As a result, labour productivity growth has slowed despite the country's impressive export performance.

The government devised a strategy to realize economies of scale in these industries by combining existing state enterprises into large state corporations and Economic Groups. However, in a context of a commercialized state, managers of state-owned firms have leveraged access to state land and credit to generate short-term profits rather than build capabilities through centralization of control and rationalization of operations. State corporations and Economic Groups launched risky ventures in property development and finance, including stakes in joint-stock commercial banks. They created numerous subsidiary companies in sectors unrelated to their core businesses to exploit domestic market opportunities and build political networks in support of their activities. These empires collapsed when land prices fell and credit conditions tightened after the withdrawal of the post-crisis monetary stimulus. The state-owned and joint-stock banks are now awash in bad debt largely as a result of over-borrowing in the state sector.

The failure of the government's centralization strategy has led to calls for extensive privatization of state-owned enterprises. However, previous rounds of equitization have not produced the expected outcome of private firms unconnected to state power and competing solely on the basis of price and quality. Indeed, it is hard to see how this could have been achieved given the absence of a class of investors independent of the state and party. Equitization has changed the organizational forms of state participation in industry but has not reduced the role of state companies, local government and other agencies in production and distribution for the domestic market. The large quasi-private conglomerates, which have largely replicated the strategy of state corporations and Economic Groups, are unlikely to reinvent themselves as champions of competition and export manufacturing. Vietnam has no shortage of capitalist firms, but they have emerged overwhelmingly from state entities or are closely allied to the party-state. With easy profits to be made from access to state land and credit or control of domestic markets, they have not shown much interest in competing with Chinese producers of yarn, cloth, steel or other upstream industries.

Imposing discipline on networks of state corporations, equitized firms, quasi-private conglomerates and local and national government agencies that own and operate businesses will not be easy. Although some may see it as paradoxical, improving the operations of the decentralized market economy in Vietnam will likely hinge on the capacity of central government authorities to consolidate sufficient power to force through necessary reforms. The creation of independent boards of directors, the recruitment of professional managers — including overseas Vietnamese and foreigners — with the power to hire, fire and promote staff would improve the governance of state-owned enterprises. Rotating provincial and district party leaders and promoting cadres on the basis of clear performance indicators would help achieve some consistency in government decision-making. Greater transparency in the assignment of land use rights and a prohibition on non-financial corporations owning shares in banks would reduce rent-seeking opportunities. Limiting the discretion that officials now enjoy in licensing businesses would help achieve separation between the commercial and regulatory functions of government. These and other reforms would amount to a reversal of deeply entrenched practices, and a direct confrontation with powerful interests within and outside of government. However difficult it may be to achieve them, they are necessary if Vietnam is to make full use of vent for surplus exports to achieve rapid rates of labour productivity and economic growth.

NOTES

1. For a discussion of Verdoorn's Law, see McCombie, Pugno and Soro (2002) and Kaldor (1978), especially Chapter 4.
2. For example, in 2009, *Tien Phong* newspaper disclosed that state-owned Southern Food Corporation (Vinafood 2) was under-invoicing rice shipments to its Singapore subsidiary Saigon Food, which would then export the rice from Singapore at the world price (*Tien Phong*, 10 October 2009).
3. Statistics from the *Financial Times*, 24 May 2013.
4. Data are taken from UN Comtrade database using ISIC commodity groups at the 3-digit level.
5. Edmund Malesky's contention that Vietnam is an example of a country that has managed to escape "partial reform equilibrium," in other words capture of the system by early beneficiaries of partial reforms, may be overly optimistic (Malesky 2009).
6. A manager of a major international company operating in Vietnam explained the situation with an anecdote. Her firm is regulated by three central ministries. It would be impossible to comply with regulations published by all three because they have issued contradictory rules. When she reported this problem to one of her regulators, the official said, according to her, "I know. Follow mine."
7. For example, both the Ministry of Labour and Social Affairs (MOLISA) and the GSO conduct regular labour force surveys.

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