

Trade and Economic Development in Vietnam

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Background

The Doi Moi (“Renovation”) policy, instituted in 1986, brought significant improvements to the Vietnamese economy but was quite limited in scope. The constraints imposed on a number of economic sectors were liberalized, but the power of the state – and hence the bureaucracy – as a determinant of economic activities has been left untouched. For these reasons, economic growth also brought systemic corruption and other social excesses. As a consequence, in 1997 - 1998, the exit of foreign direct investment (FDI) from the country culminated due to a business climate that has essentially become harsh and unpredictable. Vietnam’s GDP per capita was the same as China’s in 1975, it is currently about a third of her Chinese counterpart. That trend may be worsening.

In this context, the recent ratification of the United States – Vietnam Bilateral Trade Agreement (BTA) has brought renewed belief that its implementation may represent the single most important factor that will bring significant change to the Vietnamese economy. It is argued that the process of trading will require the compliance to rules that, in turn, will promote the free market economy. It is said that free market will do the “three things businessmen say it always does: weaken the coercive power of the state, create a democratically minded middle class, and expose the populace to liberal ideals from abroad²”. However, there are opposing forces at work as well. They may constitute potent contenders against the benefits of trade and will not assist Vietnam to rise above her current conditions. These points and counterpoints are elaborated as follows.

Challenges to Development

The role of the state

The argument about the diminishing role of the state is based on the assumption that economic power will become separated from political power and “in this way enables the one to offset the other³”. Although the role of the state in controlling the “commanding heights⁴” of the economy in Vietnam has radically evolved over the years, it is also quite obvious that it has not decreased in importance. For instance, international organizations have been assisting Vietnam to evolve beyond its deficit-plagued state-owned sector. This process of “equitization” – as it is called in Vietnam – is proceeding ahead for a number of SOEs that represent money-losing operations. This will allow the Vietnamese

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² “Why trade won’t bring democracy to China”, Lawrence F. Kaplan, July 09, 2001, TNR. A number of ideas developed in Kaplan’s article are repeated in this draft.

³ “Capitalism and Freedom”, Milton Friedman.

⁴ Attributed to Lenin.

government to cope with the magnitude of these financial losses. On the other hand, support for the industries that are deemed critical to the survival of the Communist Party of Vietnam is continuing unabated.

The status of the private sector is as murky as ever. In fundamental ways, the distinction between the public and private realms does not exist. The lack of a private property regime means that wealth created under the free market process ultimately rests under the control of the state. In case of a dispute, the interpretation of the law still remains under the control of the party-controlled court system.

The state capture phenomenon

According to the IMF⁵, corruption in certain countries goes well beyond the phenomenon of rent extraction⁶ from the economy for the benefit of a few. To be able to survive, economic actors initially seek to secure their rights from public officials. To further compete, these same actors will seek conditions that will provide them essential competitive advantages in the existing or new regulatory framework. Policy changes and institutional reforms are thus shaped in their inception stage by collusion between firms and government officials. State capture becomes the operational mode that would allow these firms to gain competitive advantages at the expense of other firms. “We define state capture as the efforts of firms to shape the laws, policies, and regulations of the state to their own advantage by providing illicit private gains to public officials”. State capture is no longer a symptom but a central cause of poor governance

This focus over income capture and its redistribution at the expense of the creation of wealth includes all the key attributes of a “distributional coalition”, a social condition thoroughly studied by M. Olson⁷. The members of the coalition define policies, rules and regulations to make themselves better off through the control of both legal and economic rights and capture of income and power generated by those rights. Interests that basically seek to weaken the state fuel the capture economy. By instituting a system of incentives that reward the coalition, economic reforms are deliberately devised to hinder political reform. These phenomena represent the most serious challenges to sustaining economic development. The constraints to long-term development become self-evident.

The Director of Vietnam’s Legal Institute⁸ reported that “his office had found 3,339 legal documents issued by various government agencies last year that contravened relevant regulations”. To say it otherwise, distinct vested interests are in effect affirming their stakes. Opportunities for capture are created based on power that can be yielded. The government’s drive to root out corruption has little effectiveness⁹. Vietnam counts among the most corrupt countries in the world¹⁰. The FDI exodus from Vietnam in 1997 – 1998

⁵ “Confronting the Challenge of State Capture in Transition Economies”, J. Hellman and D. Kaufmann, Finance and Development, Sept 2001, Volume 38, Number 3.

⁶ A neutral way to say “bribes”

⁷ “The Rise and Decline of Nations”, Mancur Olson, Yale University Press, 1982.

⁸ Vietnam News, Feb 18, 2000

⁹ “Southeast Asia Regional Reports: Global Corruption Report 2001”, Transparency International

¹⁰ “Data and Research: Global Corruption Report 2001”, Transparency International.

was the result of unbridled corruption. Indeed, all the traits of state capture can be found in the current conditions in Vietnam.

Relation-based capitalism and the business class

The bureaucrats own all the levers of the commanding heights. And hence, financial credits, licenses, contracts, etc. are awarded to those who have formed cozy relationships with them. Interests and rights are not protected by institutions but by special relations with those in power. The state capture economy rewards connection over competence. In Vietnam, the bureaucrats represent the power structures. The emerging Vietnamese business class, under these conditions, may not at all represent the independent forces that have been suggested.

History has shown that in the case of the 1848 revolution in Germany, as well as the case of nineteenth century Japan, the business class had eagerly complied with the political leadership to defend the state since they would otherwise lose everything. In China, the recent co-optation of business leaders as party communist members may well show Vietnam how power – economic or political – can remain the exclusive prerogatives of the Communist Party. Almost every possible force is covered under the party-state umbrella including foreign investors who are required to do business as joint ventures with Vietnamese partners in targeted sectors.

The Physics of Hard Constraints

Trading has now become a strategic policy of the government of Vietnam since trade is perceived as a necessity for economic development. What is possibly misunderstood is the fact that trade does only reward efficiency. Institutional frameworks that are not conducive to the rule of law and competitive practices will provide ample opportunities for rent seeking and other systemic abuses in the trading process. The speed at which the effects of economic performance can be felt will be magnified many more times. The effects will be swift and will yield profound consequences – for better or for worse - on the trading countries. The recent Asian financial crisis perfectly illustrates the effects of economic inefficiencies.

Political acumen and coercion measures that are used to maintain the monopoly of the Communist Party can undoubtedly be effective. *However, for economic development to take hold and become sustainable, the central question of how to instill efficiency in the production of wealth and equal economic opportunity for the Vietnamese citizens remains to be addressed.* In that equation, time is a parameter that may no longer be available for Vietnam. Unlike other countries, Vietnam is facing very hard and pressing constraints:

- She has a very young and fast growing population; a factor that is requiring the creation of more than a million of new jobs a year.
- In terms of natural and physical resources, Vietnam has also reached its limits. Taking the case of rice as an example, no further expansion can be expected whether

it is about progress in yields or in more acreage for cultivated land¹¹. In fact, disastrous ecological imbalances have already been attained since natural resources are being abused beyond their capacity to maintain a balanced environment. Floods, which used to happen every four to five years, have now become a yearly event with unparalleled ferocity. And yet, deforestation is continuing unabated.

How can the country break out of the vicious cycle of state capture, assuming that this condition has become entrenched in Vietnam?

A Framework for Enabling Prosperity in Vietnam

The lack of efficiency in the economy compounded by the preceding constraints will in time cause internal crises and external shocks (unemployment, inability to repay mounting debts, etc.) that will in turn disturb the political order. Broader consensus will have to be gained and other constituencies will be included to break the existing political monopoly of power. This may be a plausible scenario but unplanned transition is hardly a desirable option to lead the country out of its current conditions. As the case of the Former Soviet Union clearly shows, uncharted changes are quite precarious.

Prosperity will necessarily requires the population at large to have a stake in society. In order to support and enable the various constituencies of Vietnam to become active participants in societal changes and reform processes, their specific needs and issues have to be addressed. Formulating practical alternatives with the objective of improving their welfare represents a necessary step. For Vietnam, it is urgent to enable such a process to develop and take root¹².

The ensuing debates introduce an element of competition, which is uniquely effective when it comes to effecting changes. The support of leading researchers and field experts as well as the participation of major institutions bring much needed credibility to these endeavors. These involvements will command the attention of the political leadership in Vietnam. In terms of the promotion of beneficial changes, the exposure that is gained possesses a potency that cannot be over-emphasized.

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¹¹ “Rice Market Liberalization and Poverty in Vietnam”, F. Goletti and N. Minot, IFPRI, 2000

¹² See “A framework for Enabling Prosperity in Vietnam” on the Vietnamese Professionals of America, Inc.’s web site at www.vpa-inc.org/conference/pdf/framework.pdf