RENT SEEKING AND INTEREST GROUP CONTESTATION:

A HARMONY-OF-INTEREST APPROACH TO VIETNAM'S ECONOMIC REFORMS

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ABSTRACT

This dissertation investigates the questions (a) how an authoritarian regime like Vietnam could demonstrate to the global markets a credible commitment to limited rent seeking, and (b) why economic and coercive (political) elites do not collude with each other at the expense of non-elite groups. These questions are crucial in explaining (*i*) how Vietnam became an investment magnet with one of the world's highest capital inflows when measured by size of the economy, and (*ii*) why the often hypothesized convergence toward the lowest common denominator in terms of labor protection and wage levels did not take place. In response to these questions, this dissertation proposes a harmony-of-interest theory, in which each major societal interest group is better off in the new arrangement that followed from Vietnam's 1986 market-opening reforms than from an alternative approach. Taking a political-economy, rational-choice, game-theoretical approach, the dissertation shows the inter-relation between (1) central government, provincial governments both in (2) jurisdictions that benefit from reform and (3) those that are (relative) reform losers, (4) investors and (5) workers. It concludes that a harmony of interest among these societal interest groups arises when all factors – goods, capital and labor – are mobile and as a result can bargain with each other in an expanding economy where all factors are scarce. This harmony-of-interest theory represents a model by which one can explain successful elite self-restraint and the associated social and economic changes. For this self-restraint to function, it does not require democracy, constitutional checks and balances or enlightened rulers. Instead, it functions based on the harmony of interest among interest groups that comes with contestation for benefits that no group can command by coercive power, but instead must attract by exhibiting a credible commitment to mutual benefit and limited rent seeking among all actors.

TABLE OF CONTENTS

LIST OF TABLES

LIST OF ILLUSTRATIONS

NOTES ON TERMINOLOGY

In political science, half the discussion is in the definitions. Tomes have been written about the meaning of 'the state' or 'nation.' No less contested is the notion of 'development' or even what 'social science' encompasses. But not every study can take on every one of these debates anew. To assure that this study can truly explore what it has set out to, we define terms that are not at the center of the analysis on the outset, and leave the reader with the understanding that a different definition of the basics will necessarily influence the conclusions. To avoid having definitional discussions in the text and interrupt the flow of the argument itself, we define recurring terms here and then use them without further debate in the text, unless otherwise noted.

State/nation/country: The concept of the state is a constant debate in political science. In this discussion, we do not see 'the state' as a physical entity, such as a territory within recognized boundaries, nor is it synonymous with 'the government' or 'national institutions.' These are manifestations of what we consider 'the state.' Instead, we define 'the state' as the *outcome* of the *continuous process of capturing and recapturing the benefits of control* over these manifestations *by various interest groups*. A 'nation' is generally associated with ethnic groups, whether they form a 'nation-state' or inhabit a country together with other such groups. Vietnam is a fairly homogeneous country with 86% of the population being ethnic *kinh*, but it is not a nation state in the narrow sense of the term. When it comes to a territory with defined boundaries on a map, or the domestically claimed or internationally recognized entity over which a government claims the monopoly over the legitimate use of violence, in this discussion we will use the term 'country.'

Foreign direct investment: Defined as investment from abroad with controlling ownership and management participation, as opposed to portfolio investment, where investors buy a share in a company without direct control over management decisions.

Race to the bottom: This term is widely used in the globalization debate. It denotes a situation in which countries either provide the weakest regulatory regimes or are bypassed by international investors. In this study, we adapt the term to mean that political and economic elites on a given level of government collude so as to allocate as many resources to themselves and away from the non-elite majority in society. If political and economic elites in a province were to trade wealth in return for low environmental regulations or minimal workplace protection standards, a race to the bottom would be taking place.

Reformed/laggard province: One analyst's economic reforms are another's decline into neo-liberal oppression. The term 'reform' is contested, as we shall see in the study, but we will use it in a way that supports the research question. Provinces are reforming when they make changes to the regulatory system that reduce rent seeking and provide a better business climate as a result. One way of assessing level and success of reform is thus the amount of investment that flows into a province – successful reformers are those that have achieved high levels of economic growth and high levels of capital investment. This measure is, of course, simplistic. A province could obtain high levels of investment because of its natural resource endowment or the fact that the center pushes investment the province's way. We must measure reform – the amount of reform that was enacted as well as its successful completion – in a different, less ambiguous way. The *Provincial Competitiveness Index* (PCI), a cooperation between the Vietnam Chamber of Commerce and Industry and the United States Agency for International Development, operationalizes governance reforms while controlling for natural advantages and disadvantages to investment and economic growth. We use the PCI score as a primary definition for reform. Provinces scoring high on the PCI are considered reformed, low scorers are reform laggards. The PCI broadly correlates with investment levels, but some provinces that are successful reformers still attract few investment projects due to extreme remoteness and other factors that do not respond to government action. In this study, we refer to successful reform when a province scores high on the PCI. In some contexts, we analyze investment levels directly (not only as a proxy for successful reform). In such a context, a successful province may simply be one that attracts a lot of investment.

VND: Vietnamese dong. The dong was relatively stable for the period in which much of this study is situated. It moved from approximately VND13,000 per U.S. dollar in the late 1990s to approximately VND16,000-17,000 per dollar. During the global economic crisis in 2008, stimulus spending exacerbated the inflationary pressures that had begun just prior to that time, and the dong began a downward slide to VND22,000 by mid- 2011. This currency exchange rate change has made imports more expensive (which impacts the Vietnamese economy because a large percentage of its exports is based on importation of parts that are assembled and re-exported). Because the exchange rate decline is paired with significant domestic inflation (since the beginning of the overheating of the economy in approximately 2007), not only consumers of imported goods, but all Vietnamese suffer from the monetary consequences associated with domestic growth as well as the reactions to the international financial crisis. We generally refer to Vietnamese dong in the text, without calculating the amount into dollars.

A NOTE ON SPELLING

In Vietnamese, all words are monosyllabic. Hanoi is correctly spelled Ha Noi, Saigon Sai Gon and Vietnam Viet Nam. Many English language publications contract the most common terms into one word. In this study, proper names are spelled in the original, Vietnamese way (minus the tone markers), unless this causes a problem with derivatives of the word. We will spell Vietnam, for example, in one word, to be able to be consistent when referring to the adjective or the inhabitants as Vietnamese. All place names within Vietnam are spelled in as many words as the original requires – Ha Noi, Da Nang or Ho Chi Minh City.

FOREWORD

Until the bottom fell out of the housing market in 2008, one could have been forgiven for not knowing what a sub-prime mortgage is. Regulators should not be forgiven, however, for knowing about it and not addressing its fatal flaws. A system that rewards brokers for pushing unaffordable mortgages; rewards banks for making excessive loans; rewards buyers for buying a house twice the price they can afford; such a system leads to collapse. All these economic actors involved in a catastrophe-in-the-making only did what was rational and beneficial for them – at least in the short run. Yet the economy, national and in this case even global, ended up going into a tailspin not seen since the Great Depression some eight decades ago. While everyone did the right thing from a short-term point of view, the outcome was clearly sub-optimal for the economy overall. Adam Smith may still be right in claiming that the enlightened self-interest of butchers and bakers provide us with our meals. On the other hand, the self-interest of mortgage brokers, real estate agents, bankers and excessively exuberant home buyers did not enhance our economic welfare from a broader, societal point of view.

In this study, we discuss how incentive structures created within the institutional framework of the politico-economic system can reduce rent seeking by individuals to a level that prevents excesses like the one that led to the collapse of the U.S. mortgage business. Rather than trusting in the personal qualities of agents, we look at institutional arrangements that create an enlightened self-interest, in Smith's terms, for economic agents to conform more closely to activities social optima over acting like destructive roving bandits.

Agency matters in the margins. Strong, charismatic leaders leave an imprint on their societies and can alter policy. But if we want to explain the economic development successes of East Asia and the failures of so many other countries, we cannot easily resort to agency. Doing so would require that we assume that Asian leaders are inherently better, more intelligent, less corrupt human beings than Africans or South Americans. Doing so would further require that we neglect the evidence that shows that similarly structured societies do similarly well or badly, and have done so historically. An agent-centric view of the world would be either random or racist, depending on whether we believe the success stories just had better leaders coincidentally, or that their leaders – and by extension probably their people overall – are of better human stock. Instead, I investigate the assumption that the structures within which agents act and which set the boundaries for successful agency are largely responsible for outcomes. Not coincidentally did China and Vietnam do as badly as, or worse than, most of Africa at some point, yet much better after broad social and economic reforms. Changes in the incentive structure made all the difference, not culture, genes or the vagaries of the emergence of an enlightened leader. Particularly in Vietnam, no individual leader can be identified who could be credited with the initiation of reforms, and much less with their success. A constellation of circumstances altered incentives for multiple leaders to do things differently, and with some luck, initial decisions set the country on a path toward success.

Such a structural view will undoubtedly be criticized for being overly deterministic, for what individual country could alter the incentive structures that shape the economy? Without giving away too much of the plot of the following argument, let us start by stating that structures are not written in stone. The case study that forms the foundation of the argument that I advance in this study provides evidence that the incentive structures that provide the boundaries for human behavior can be shaped and reshaped in relatively short time. In the case of Vietnam, this reshaping, which came in the form of trade opening and economic decentralization, took the lesser part of a decade. Ten years are a very short period indeed for altering institutional arrangements of political and economic control in a society, moving half of one's population out of poverty and creating a palpable change in the relationship between elites and subordinate groups.

I also argue that Vietnam's success can be replicated to some degree. The reforms hinged on a system that presents all dominant elite groups with benefits (or the potential for benefit) from change, but in the process does not allow any one group to monopolize these benefits. That is the hard part in the attempt to create incentive structures that work for society overall: how do we prevent the elite from appropriating the benefits for itself in disregard of the common good? Only where multiple elite groups live in constant contestation with each other will they be forced to self-limit their predatory instincts in order to avoid losing out on benefits. This is the story of fractured Europe's history, China's classical period and Japan's feudal era. The Vietnam case is one of the successful applications of the concept of fractured power in a modern, economic context. It is not the only one, but one of the few cases where intentional policy change led to intense contestation in such a short time, compared to the centuries the process took in other circumstances. Nonetheless, the end result of an incentive structure based on elite contestation is always unintended. No elite starts the process with the intention to reform itself out of power. Thus, the initial conditions are crucial. Just like the global financial system will have the 2008 meltdown to thank for reforms, Vietnam needed near-starvation in the mid-1980s to initiate change to the orthodoxy of earlier years. China, of course, faced similar problems after the Cultural Revolution to launch its reforms, which have served Vietnam as a model, albeit one that the Vietnamese elites have significantly adapted to suit their specific interests and conditions.

In this study, then, I address the problem of elite rent seeking, a human universal. Elites seek power for their own sake, and use it to gain more of it. Political elites translate this power into wealth, economic elites translate their wealth into power, more wealth or a combination of the two. Medieval feudalism's collusion between church and feudal lords is an illuminating example of the ways in which power seeks power for its own sake. In an era where wars were waged with swords and pitch forks, numbers mattered, and the poor serfs had the numbers. The feudal lords could not have permanently kept their serfs from revolting without the power of the religious discourse of predestination and acceptance of one's fate. The clergy could not have lived the good life had they not been able to feast at the lords' tables. Even today, the subordinates have the numbers. In fact, this is necessarily so, since redistribution from the few to the many would not make the many much richer. Who would want to be a feudal lord if there were dozens of lords to every one peasant? It is inherently more satisfying for the few to take from the many, a point made with great clarity and across a great many examples by Mancur Olson (1982) in his *Rise and Decline of Nations*.

If the few have both incentive and power to distribute power and wealth toward themselves and away from the many, and if such redistribution causes misallocation of resources and economic inefficiency, how can economies ever grow? Or, more specifically, how could Vietnam's economy have grown so strongly and with the surprising degree of social equity it has exhibited throughout its reform path? I will draw on a number of theories with respect to rent seeking, trade and investment in the context of economic globalization and economic development, and decentralization. I make use of approaches based on political science and political economy. The discussion of these strands of the academic literature in light of the Vietnamese case will hopefully shed some new light on some aspects of theory. The main contribution I hope to make, however, is to show how combinations of factors, which have largely been analyzed in isolation, are crucial in changing incentives structures in a way that can put a faltering economy with a predatory elite on track toward economic growth. These factors are, on the political economy side, elite competition for exogenous benefits (benefits the political elite cannot command by political power, but instead must lure in and then nourish) and a (quasi-)federal economic system that makes such competition *necessary*. On the political science side, we need to understand the dynamics of contestation for the allegiance of citizens, without which elites of all stripes – domestic and international, central and provincial, political and economic – would see it in their interest to collude with each other, creating in the process the often-theorized race to the bottom.[1]

In addition to the academic literature, my research has benefited from conversations with dozens of policy makers, government officials in the central and provincial governments, domestic and foreign investors and small businesspeople in Vietnam, and not least with a good number of regular citizens who have to live within the system the policy makers create, officials administer and investors employ for their benefit. I thank them all for sharing their time with me. The consulting firm ABBO found my research interesting enough to offer me generous help, ranging from office space to staff time for translation to their company vehicle. Maybe most importantly, I gained important insights from people who had been on the ground floor of Vietnam's investment boom – a small, indigenous consulting firm in the field of inward investment. These are views that often get lost in the world of abstract theorizing, yet they are what all theory ought to be about, application in the real world.

This project really started with my first trip to Vietnam in 1997 for my Master's thesis field work. It developed slowly, as over the course of the many conversations I had and observations I made in Vietnam, I asked myself more and more questions that led to the puzzle and the set of research questions and hypotheses that finally formed this dissertation.

I owe a huge debt of gratitude to my committee, Professor Shalini Venturelli, Professor Jon Wisman and Professor Pek Koon Heng at American University, who were

[1] For a definition in our context see Chapter 2.4.

as supportive as they were patient as I drifted between this dissertation, teaching, research and consulting work in Vietnam, and the task of not being an absentee, solely dissertation-writing father to my demanding little girl. Professor Doug Fuller was on my committee before moving to China, and was of great help in directing my thoughts in the early stages of the process. Importantly, my committee prodded and pushed me away from my dedication to grand unified theory, and moved me toward a humbler dissertation that could indeed be accomplished.

My family has given me leave for countless hours, including long absences for travel in Vietnam. My special dedication has to go to my daughter Nora, born into this effort, who said many times "Papa, you work too much," and who has been remarkably successful in keeping this project on track much longer than it would have taken without her help.

Too many people have had influence on this work to list them all, but I am grateful for every snippet of knowledge and all the poking and thought provoking I got over the years. The two who stand out are Barry Weingast, whose market-preserving federalism inspired my hypothesis, and Ed Malesky, whose work, amply cited in the following pages, has been the spark for my own argument.

Needless to say, the shortcomings in the outcome of this journey are my own.

CHAPTER 1: INTRODUCTION

This study asks what political logic prevents power holders in the authoritarian one-party state Vietnam from using their coercive apparatus in diverting more wealth and control away from other interest groups that lack the means to protect themselves against a state in full possession of the monopoly of violence. It concludes that the reason for moderation by all actors – the central state, the provincial political leadership, and even the business elite without coercive power but in possession of resources it can trade for political protection – is a harmony of interest that emerged during market reforms in 1986. Within the structure of this harmony of interest, all interest groups are better off cooperating than defecting. As a result, political economy theories of how rational actors in a polity or economy ought to behave must be re-evaluated. Some of those theories assume a zero-sum game in which one interest group's gain is another's loss. We specifically refer to the partial reform equilibrium (Hellman 1998), which suggests that winners in each stage of reform will try to prevent further reforms to cement in their gains (see Chapter 2), and assumptions in rent-seeking theory about collusion among elite interest groups against non-elite societal actors.

For many, Vietnam is the story of a war, but for the political economist, it is the story of a rapid, government-decreed economic transformation from a Marxist, planned economy to an industrializing, trade-open, globally integrated, investment-seeking one. To be sure, Vietnam's is the East Asian model of targeted trade opening and continued government intervention. Nonetheless, Vietnam moved from a national goal of economic autarky to a trade-to-gross-domestic-product ratio of 160% in just two decades. And while the government keeps a close look at the economy, it has passed some of the most liberal investment laws in Asia (and beyond) as part of the reform process.

Moreover, it is a story that challenges several theories about the consequences of trade- and foreign-investment-based development and the impact of economic opening on governance and on the working classes in developing countries. The reforms created a number of intriguing results that warrant further analysis, both as lessons for other developing economies and as tests for established theories about post-communist transition, development and late industrialiation. Such a story is of interest both for the lessons it can potentially teach other transitional economies and late industrializers, and for the theoretical impact the case of Vietnam should have on political economy theories that predict dramatically different outcomes.

The reforms of 1986 encompassed a reduced role of the government in economic planning and privatization of much of the economy; an emphasis on attracting foreign investment in the failing domestic economy; and a greater role for provinces in economic governance. Vietnam was at the verge of economic collapse on the eve of the 1986 Party Congress, with poverty rampant and starvation only averted by Soviet aid. It was no surprise that the Party abandoned the planned economy, whose plans had brought about only a litany of explanations why they went unfulfilled. What is more surprising is that the Communist Party elite decided on reforms that reduced its own power, yet this move can equally be explained by the desperate need for change in the economic model. Later on, Chapter 4 will provide the historical context for the reforms. Once the reforms were successful, investment started flowing into the country, standard of living indicators improved, Vietnam turned from a starving country into one of the world's top food exporters, and the government had succeeded in re-establishing its legitimacy in the eyes of its people, the ruling Communist Party could have resumed what political theory considers the end goal of government: increasing the power of the elite by concentrating control on the top of the power pyramid and gaining rent in the process. It is at this point where Vietnam diverges from mainstream political science theory with respect to the expected behavior of the governing elite. Why it does so is less easily explainable than the run-up to the reforms. Prior to 1986, necessity was the mother of decisions; now the Party, with the wind of the successful reforms in its sails, could have acted again in a more traditional way and focused on concentrating power and on seeking rent. Yet this is not what happened on the ground. What did happen raises four questions that are at the heart of this study:

(1) Why do the provincial governments that have gained power during the reform years not engage in heavy predation against the investors who have set up factories that are difficult to move and therefore make them sitting ducks against predatory coercive elites?

(2) Why do provincial elites and investors not collude in sharing the spoils of economic growth at the expense of regular workers? The improving living

standards of non-elite groups, whom we refer to as ‘workers’ in this study, indicate that no such misallocation of resources took place.

(3) Why do poor provinces not use their political power[2] to stop or reverse reforms? Provinces have political power during the Party Congresses, when leaders vie for support as they campaigns for higher office. Provincial officials could use that power to divert more of the benefits of growth to themselves, or to stop the few beneficiaries from forging further ahead.

(4) Why does the center, which still enjoys a monopoly over the coercive power of government, not reverse devolution and benefit from the fruits of economic growth alone – or at least to a much greater extent than it does now?

The five interest groups considered here are the central government, the provincial governments in provinces that benefited from reforms and those that did not, investors and non-elite workers. Earlier work on elite self-limitation and incentive structures (Malesky 2004a; 2004b) lays out convincingly how the benefits of foreign investment in a province alter incentive structures in ways that make it beneficial for local coercive elites to check their predatory instincts and cooperate with investors instead. This study builds on what Malesky (2004b) calls a “push, pull and reinforce” dynamic[3] by explaining why other interests groups, whose cooperation is required to allow the provincial governments’ cooperation with investors, play along. Another interest group

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[2] Political power, or voice, comes from numbers. The majority of provinces stayed relatively poor compared to a handful of beneficiaries of reform. This majority could have choked off reforms during Party Congresses by electing a conservative, anti-marketization leadership.

[3] Investors push for better business conditions, the government pulls them in with good infrastructure and conducive conditions, and the benefits both sides draw reinforce the interest both have in playing the game.

often discussed is state-owned enterprises. They are important in the context of reforms because they are considered early losers in reforms that eliminated their monopolies. Yet the reforms did not abolish the state's monopoly on land ownership, and foreign investors needed a domestic partner to get the land on which to build their factories. State-owned companies gained significant bargaining power as a result, and began to make more money from 'partnering' with foreign firms. Partnering means no more than signing an agreement that gave the foreign partner access to land in return for an oversized share in the joint venture. By the time this land use system was amended, the new harmony of interest structure had taken hold and the state-owned enterprises had lost their influence. Equally important, many state-owned enterprises are owned by provincial governments, some of which had an early interest in the benefits they gained from foreign investment in their province. These officials pushed their policies over the objections from managers of state firms. Nonetheless, it is not surprising that analysis of the structure of investment has found that much of the foreign capital found its way into provinces where state-owned companies did not contribute significantly to the local economy. There, this possible veto player simply did not have enough clout to hold up foreign companies (Malesky 2004a). In the final analysis, government elites are principals, the state-owned enterprises are their agents. The principals, in this case, are highly effective in imposing their will on their agents. As a result, in this study, state-owned enterprises do not play a central role – they are not independent actors in the harmony of interest theory.

In summary, this study shows how each interest group is empowered by and beneficiary of reforms in one form or another (sometimes via the trickling down of benefits from another interest group), and how cooperation with the other interest groups, while requiring self-restraint, is beneficial in the longer run. Self-interested agents provide the assurance investors need to come to Vietnam and sink their capital there in brick-and-mortar projects that cannot be rapidly removed. They trust not in the noble characters of the leaders, but in their base self interest and their ability to determine what that interest is in the medium and long run.

To make this case, we first review the literature relevant to the study (Chapter 2), followed by a description of the methodology and the logical framework of the study. This part (Chapter 3) also formulates a hypothesis and five testable assumptions. Chapter 4 provides a historical context for the study. Its goal is to introduce the reader to the context in which decisions are made, because context is, after all, crucial to an actor's determination what his or her *interest* is. Rational choices are always made in a cultural, historical and material context. Chapter 4 also discusses an alternative hypothesis about center-local relations, based on research from Vietnam's model, China. That divergence-of-interest view, a principal-agent model, forms an alternative view, which we argue does not hold in Vietnam. After these theoretical and contextual sections, the study tests the five assumptions in Chapters 5 through 9. Finally, Chapter 10 concludes by putting the findings in the broader context of development policy in Vietnam, lessons for Vietnam's own future and generalizability for other developing economies, and the implications of the Vietnam case on political and economic theories that were applied and tested in the course of this research.

In a last note, data focus largely on the period leading up to 2008. The investigation aims at developing insights into Vietnam's experiences. The severe economic crisis that struck the United States and from there radiated around the globe has had an impact on Vietnam as well, albeit a less severe one than in many other countries. This impact represents an exogenous shock, not a variable in Vietnam's political economy. We do not want to taint a study about Vietnam's policy choices with such externally caused, temporary changes.

CHAPTER 2: THE LITERATURE

A rich literature exists on rent seeking by special interest groups and how to address this growth-inhibiting problem. The segment of the literature that informs this study can be grouped into three categories: the work on rent seeking and contestation as the two theoretical foundations, and the case study literature on Vietnam and comparable cases.

First, the work on rent seeking in the fields of economics and political economy analyzes the impact of the wealth transfers through the use of coercive, political power. It describes the strategies of transfers, from allocation of resources through tariffs, monopolies and other directly allocative rules, to indirect means of providing rents, such as import restrictions, limiting entry of new competitors or restricting the use of new technologies.

Second, in response to the study of rent seeking and its impacts on economic welfare, a body of literature has emerged that studies policy responses to rent seeking. In broad terms, this literature can be subsumed under the umbrella of *contestation.*[4] It investigates how coercive elites can be brought to self-limit their rent-seeking tendencies for the sake of improved allocative efficiency, better economic growth and less unequal distribution of resources. In the field of economics, the term contestation corresponds to that of competition among firms in the market. Political science and political economy add to this limited view of unencumbered market competition, by recognizing that markets are rarely free of distortions either from market failures or

[4] Contestation is a form of controversy or dispute, or assertions contended for (Webster's Encyclopedic, Unabridged Dictionary 2001 edition). It includes, but is broader than, competition, as it covers debates over ideas, competition for power, claims of elite status as well as competition for economic gain.

from interest groups with coercive power to override market mechanisms for their own benefit. As a result, emphasis must be placed on structures that create incentives for elite interest groups to limit – if not forego – their rent-seeking activities. In political science, a focus has been on democracy and constitutions, where through a systems of checks and balances even the ruling coercive elite is held to certain standards and can be removed by voters at regular intervals. Yet most developing countries are not democratic. The more powerful and entrenched the elite interest groups are, the less will the rest of society be able to impose checks and balances on them, and the more skewed in their favor resource distribution is likely to be. How illiberal, non-democratic societies can address the issue of predation and rent seeking by elite interest groups must be addressed outside the democracy and institutionalist schools of thought. The literature has identified *incentive structures* as causes for elite groups' willingness to limit their predatory powers. One such structure is a federalist organization, which provides exit options to subordinate groups. Exit is the ability to escape the predatory ruling elite by removing oneself from its realm of influence. With this mobility comes bargaining power – no ruler wants to lose the subjects on which power and rent depend. With bargaining power comes a shift in incentives for the elite to choose among a set of policy options, ranging from oppression and predation to bargaining and self-limitation.

The third body of literature we consult is the one that applies the theoretical approaches and studies from other cases. Vietnam is a country with a deeply entrenched elite, but one that has engaged in self-limitation for the sake of economic development. This makes Vietnam a good case, yet one that is understudied. In this chapter, the literature on monopoly rent seeking is reviewed, with a focus on the relevant aspects for this research.[5] Then, the literature on contestation is discussed, both in its aspects of political contestation and economic contestation in the form of decentralization and federalism. Lastly, we draw on the case literature applying rent seeking and contestation to Vietnam, in order to lay out the parameters of this study as it builds on and broadens our understanding of structural forces altering incentives for elite self-limitation in the case of Vietnam.

2.1. Rent Seeking and Resource (Mis)Allocation in the Literature

The rent-seeking literature starts with the recognition that it is perfectly possible for an agent to benefit individually from a resource allocation that is less than optimal from a societal point of view. Individual and social costs routinely differ (North 1981). Elites do not seek elite status without a promise of compensation; all elites want to be paid for their effort. Interest groups with power to coerce, or political elites, routinely use their power to make decisions that serve themselves well while harming society. As a society's main coercive institution, the state is always a leviathan whose dominant interest is power and economic rent (Rodden and Rose-Ackerman 1997: 1532).

Early rent seeking scholarship grows out of this interplay between power and wealth. Gordon Tullock (1967) defines rent seeking as a socially costly pursuit of wealth transfers. Other definitions add the aspects of "[r]esource-wasting activities of

[5] Rent seeking covers a wide variety of activities, including some, like patent enforcement or licensing of some professions, that are widely considered positive for economic performance. For our purposes, we consider the negative, predatory aspects of monopoly rent seeking, defined as the use of coercive power for economic gains.

individuals in seeking wealth transfers through the aegis of the state" (Buchanan et al. 1980: ix), and "a behavior where individual profit maximization creates social waste rather than benefit" (Buchanan 1980: 4), where "[t]he institutional reason for rent-seeking activities lies in the interference of the economy by the state" (Xia 2000: 94). Aggregating the various definitions, rent seeking always involves the allocation of resources through coercive power and can be defined as *the collusion between economic and political elites to establish and enforce rules of the game (regulations, legislation) for the sake of allocation of resources to the benefit of the colluding elites*.

Mancur Olson in his seminal book about *The Rise and Decline of Nations* (1982) shows through case studies of several societies that any small interest group will organize for its own disproportionate benefit rather than societal welfare, as long as doing so is in its interest. He demonstrates how decision making that is responsive to particularistic group interests routinely leads to outcomes that are sub-optimal for society as a whole. Entrenched interest groups create sclerosis in an economy. A society where all interests engage in bargaining equally would be efficient; yet such a society cannot exist. Larger interest groups (taxpayers, consumers, workers) do not have the incentive to organize, for the cost of organization is higher for large, dispersed groups. Smaller interest groups (associations of specific industries) could more easily pool their resources and lobby for their best interest. The smaller groups will therefore be better organized (Ibid: 37). Tullock (1989: 73) has pointed out that the benefits of lobbying never go from the rich to the poor or from the few to the many, but from the less organized to the better organized. Olson's study explains why this is so.

As a consequence, symmetrical organization of all groups in a society is impossible to attain. Pressure groups that face concentrated gain or pain will establish themselves faster and more effectively than those with diffused pain or gain. Redistribution is almost always the better option for a small interest group than growing the economy overall, since the cost associated with rent seeking is paid by the interest group, while social benefits are shared by all. Conversely, Olson shows how a redistributional coalition can gain at the expense of society overall. As Olson (1982: 44) puts it,

> There is for practical purposes no constraint on the social cost such an organization will find it expedient to impose on the society in the course of obtaining a larger share of the output for itself. ... The organizations for collective action within society that we are considering are therefore overwhelmingly oriented to struggles over the distribution of income and wealth rather than to the production of additional output – they are "distributional coalitions" (or organizations that engage in what, in one valuable line of literature, is called "rent seeking").

The only exception to this rule occurs when distributional interests are themselves so vested in the overall growth of the economy that the cost of redistribution would obviate the gains.

In a society with an authoritarian government, elites tend to be narrow and vested in distribution, not growth. To limit elite rent seeking, interest structures must somehow be created so that elites benefit from self-limitation. The literature has identified inter-elite contestation as a means to shape such incentive structures conducive to elite self-limitation.

2.2. Contestation as Incentive for Elite Self-Restraint

Subordinate groups contest the power of the elite in a variety of settings. In one line of investigation, critical theorists have shown that subordinates do not suffer from false consciousness – the mistaken belief that the existing societal arrangements are in their best interest or the only possible ones. Instead, they are keenly aware of their oppression and react to it by deploying what one seminal study calls "the weapons of the weak," derision, gossip, disobedience, petty theft, withdrawal and non-compliance (Scott 1985). Similarly, a study not of oppressed peasants but of the working class in industrializing South Korea suggests that the elite must offer tangible benefits, or else the masses simply withhold participation. They can do so by placing their savings under a mattress and by working as little as possible, instead of trying hard to get ahead and saving (Yap 2005). Scott's field study of a Malaysian village describes a conflictual relationship between an elite whose legitimacy is based on tradition and is therefore different from the harmony of interest described here in the case of Vietnam. Yap's work on Korea is more compatible. The elite must earn participation by offering shared benefits as an end result. This represents a bargain between two interest groups whose end goal is to move from conflict to mutual accommodation and cooperation.

In the literature, lines of argument can be discerned on how to shift incentive systems toward cooperation. In the field of economics, Adam Smith already suggested that nothing keeps taxes lower than two competing tax collectors in immediate proximity. In *The Wealth of Nations,* he argues that the possibility to choose one's ruler through an exit option represents the most effective restraint on excessive taxation

(Smith 1776). In political science, Charles Tilly studied Europe's exceptionalism and found that the decentralized nature of the continent made excessive predation impossible. Small countries in close proximity to each other made people mobile – they could remove themselves from the realm of a tyrant easily by walking away. Thanks to this credible exit option that allowed subjects of European rulers to bargain for rights and protections from arbitrary rule, they were over time granted certain rights and assurances (Tilly 1990: 99). "The core of what we now call 'citizenship,' indeed, consists of multiple bargains hammered out by rulers and ruled in the course of their struggles over the means of state action, especially the making of war" (Tilly 1990: 102). Jones (1987: 233) extends the argument from political liberties to economic development:

> But how did Europeans escape crippling exploitation by their own rulers? How was risk reduced and the depressants on investment lifted? The answer is a compound of processes, but what stands out is that the rulers of the relatively small European states learned that by supplying the services of order and adjudication they could attract and retain the most and best-paying constituents – for their subjects must be thought of as constituents in some degree. Within each state there was a clash between kingly interest in taxes and noble preoccupation with rents, an unsettled competition in which the royal concern offered the peasantry some faint protection and some provision of justice. Competition among states led later to programs of services. Once more there was an environmental component, since, had the core areas of their states been larger and richer, kings might have felt less inspired to offer as much as they did in return for taxes (it was little, but in the very long term it was enough to make European history special).

These historical studies of Europe's political and economic development are based on the federalist literature. Tiebout (1956) presented a model of small federal states in which household mobility and public goods provision are elastic and information is perfect. An equilibrium exists when all households reside in the jurisdiction that matches their preferences. Where mobility is high, agents seek out jurisdictions that reflect their preferences. If a jurisdiction provides too few public goods, or provides too many at too high a cost, they vote with their feet (Tiebout 1956: 418-19). Federalists argue that local power holders who are close to their citizens will rapidly learn what the optimum mix of public goods is and can react to demands. By competing for the loyalties of citizens, taxpayers, workers, consumers and investors, local elites are also self-limiting their predatory powers.

Resulting from this federalist theory, decentralization has become a global trend. Countries trying to improve their economic efficiency as they integrate into the global economy decentralize their political or economic decision-making structures. Some 95% of democracies have elected sub-national governments, and even in centralized, unitary states like China or Vietnam, economic decision-making is increasingly devolved to provincial level governments (Rodriguez-Pose and Ezcurra 2010).

2.2.1. Decentralization and Economic Efficiency

Decentralization[6] is the assignment of fiscal, political and administrative responsibilities to lower levels of government (Litvak et al. 1998: 4). Three levels of decentralization can be discerned:

- Deconcentration: The center gives more responsibility to regional branch

6 Federalism commonly describes a system of government in which authority is divided between a central government and constituent sub-units. Not all decentralized systems are federal in nature, and the main case study of this paper, Vietnam, is not *de jure* a federal state, but has a quasi-federal economic system with inter-provincial competition.

offices, but keeps control. In Vietnam, the Ministry of Planning and Investment has branch offices in every province, called Department of Planning and Investment. In Vietnam, there is a problem with dual subordination (Gomez 2006: 217). Planning and Investment Departments are administratively placed under the provincial People's Committee, but functionally they report to the ministry in Ha Noi.

- Delegation: The central government delegates functions. The agent continues to report to the same principal, the central government.
- Devolution: Authority effectively devolves from the center downwards toward lower level jurisdictions. Such a system prevails under truly federal constitutions, through which the center is legally or constitutionally prohibited from intervening in certain affairs of sub-units (Litvak et al. 1998: 4-6).

Among the earliest arguments in favor of decentralization is the gain in efficiency when local authorities, rather that the distant center, identify and provide local needs. The local government is less likely to provide public goods for which there is no local need, or, by *argumentum e contrario*, it is able to supply more of the public goods that are locally desired when it can focus on a narrow public goods basket that is tailored to local needs and conditions. This argument is commonly referred to as *allocative efficienc*y, which increases the closer the providers or public goods are to the users (Tiebout 1956; Oates 1972). Administrative decentralization also gives local authorities the flexibility to react rapidly to changes in local conditions, and to learn from other jurisdictions both which policies work and which to avoid. The result is more services at a lower cost to society (Buchanan and Tullock 1962), mirroring the arguments in the field of economics about the benefits of competition, in this case with emphasis on administrative efficiency (Schneider 2003: 8).

Local governments are not only able to provide desired public goods more efficiently; they also enjoy informational advantages in determining what these preferences are (Hayek 1948). Moreover, preference homogeneity[7] is higher the smaller the area for which these preferences are considered (Oates 1972). Importantly, in the federalist view, this homogeneity is not coincidental. Where mobility is high, agents (such as citizens or businesses) will actively seek out politico-economic units that reflect their preferences. If a jurisdiction provides too few public goods, or provides too many at too high a cost, agents will vote with their feet and move to a jurisdiction that better suits their preferences. Hence, where jurisdictions are free to compete with each other, they will provide a basket of public goods and economic incentives at a cost that suits the local conditions, or else they will fall behind other jurisdictions that do a better job in providing that optimal basket (Tiebout 1956: 418-19). Federalists thus argue that local power holders who are close to their citizens will rapidly learn what the optimum mix of public goods is and can react to demands. By competing for the loyalties of citizens, taxpayers, workers, consumers and investors, local elites are also self-limiting their predatory powers.

[7] Larger jurisdictions tend to include more diverse populations with differing preferences – rural/urban, ethnic groups, industrialized versus traditional. Smaller jurisdictions are more likely to exhibit greater homogeneity. That is why a government that governs a larger jurisdiction is less able to reflect the preferences of all groups than a government of a small jurisdiction.

The benefits from decentralization are based on “voice” and “exit” (Litvak at al. 1998: 22). Voice represents the ability of citizens to hold their government accountable through regular competitive elections. But even in non-democratic systems, exit, the ability to migrate to another jurisdiction, provides a powerful limit on predation and arbitrariness by local elites. The advantages of such an incentive system expand beyond a constitutionally federal polity. Vietnam is a central state, yet provinces have gained significant ability to implement central regulations locally. Thus, Vietnam’s provinces behave like a federal system of competing units for purposes of economic competition, providing an example of what Weingast (1993: 289) calls “market-preserving federalism.”

More generally, federalists argue that decentralized governance frees the center from the grip of special interest. Decentralization multiplies the loci where government decisions are made, thus reducing special interest groups’ ability to concentrate their influence on one level of government. This view corresponds to Hellman’s “partial reform equilibrium.” The partial reform equilibrium holds that all reforms come in stages. Winners in the early stages will likely attempt to translate their new wealth or power into influence in order to affect regulations in a way so as to prevent additional reforms. Alternatively, if ending reforms is not possible, they will try to assure that they continue to benefit from any additional policy changes. The more concentrated a government, the easier it is for a well-organized interest group to capture the center of decision-making power (Hellman 1998). This view has been turned on its head, though, by scholars critical of the federalist argument. It has been argued that decentralization helps the rich and powerful (Schneider 2003; Bardhan 2002). In this view, special interests with money enjoy an organizational advantage if power is more dissipated. Subordinate groups have to overcome significant hurdles in mounting organized lobbying campaigns in support of their interests. The more such campaigns they have to mount, the greater their disadvantage *vis-à-vis* the elites. Schneider takes another line of argument. He suggests that in accordance with Tiboutian federalist theory, decentralization would allow the wealthy to vote with their feet and leave any jurisdiction that proposes higher social spending paired with higher taxes (Schneider 2003).

2.2.2. The Efficiency Argument under an Empirical Lens

While theory suggests that developing countries can obtain significant efficiency gains from decentralization, empirical studies are divided. One major study supportive of a positive correlation between federal structures and economic efficiency comes from Parente and Prescott (2000). It concludes that historically, political systems with a strong federal structure are the top economic performers. Countries like Switzerland and the United States do well because their federal systems do not allow local rent-seeking elites to prevent the latest production techniques from being applied. Knowledge can flow freely, leading to efficiency enhancements for the overall economy. Federalism, a form of political decentralization where local leaders are directly responsible to their constituents but cannot create a state within the state (i.e.: they cannot erect tariff barriers or make their own monetary policy, and thus have to comply with the rules of the game created by the larger political entity), consistently reduces rent seeking and improves efficiency and social welfare.

Parente and Prescott's approach needs a federal constitution with its universally accepted principles of division of powers within a hierarchy of levels of government. Limits on elite rent seeking are exogenous. The *market-preserving federalism* approach (Weingast 1995; 2006) places the causes for elite restraint within the incentive structures of the economy within which the elite operates. This approach addresses the question Riker (1964) has called the central design problem of federal systems: how can the central government be granted enough power to police jurisdictions to ensure common rules of the game, while not having so much power that it can overawe the sub-units at will? According to market-preserving federalists, elites limit themselves independently of outside-imposed norms and laws *when the system provides them with benefits for doing so* and *punishes those who fail to take social optima into account*. Market-preserving federalism applies the principles of federalism to *de jure* unitary states whose economic structures create *de facto* decentralization. Vietnam's or China's deconcentration of decision-making power over investment decisions are good cases. China has been investigated in detail by market-preserving federalists, since China's system of a strong Communist Party in Beijing governing a country where the Party itself has deconcentrated (or *de facto* devolved) economic decision-making powers to provincial leaders reflects the tenets of the theory closely (Montinola et al. 1996; Qian and Weingast 1997; Weingast 1993; 1995; 2006). This approach has enriched our understanding of multi-level government and the benefits of contestation in the absence of a constitutionally federal government structure. Studies by market-preserving federalists, and the cited book by Parente and Prescott, show that when an economy consists of competing jurisdictions, and if these units allow free flow of goods, capital and labor, such contestation will provide a commitment device against arbitrary predation. Such a commitment then allows non-elites to feel safe enough to invest in the economy, even in the absence of a constitutionally federal system. This buy-in by workers and small entrepreneurs is crucial for economic development. It only occurs, however, when the state is strong enough to create and enforce widely acceptable rules of the game and uphold contracts and property rights reliably against all potential violators.

Studying federal systems in a rational choice, game-theoretical approach, de Figueiredo and Weingast (2005) conclude that all interest groups must have incentives to fulfill their obligations. When the cost of defection becomes lower than the benefit of cooperation, defection becomes the norm. Contestation among elites for benefits, in this line of argument, is instrumental for interest group commitment to policies that serve the common good.

The benefits of decentralization and federalism are not universally accepted, however. Some analysts have brought to light problematic aspects of sub-national governance. Davoodi and Zou (1998), for example, find no correlation between fiscal decentralization and economic growth in a study of 46 countries.[8] And a cross-national study on corruption concludes that the Tieboutian view that decentralization leads to

[8] Davoodi and Zou study developing and transitional economies with populations over 5 million to test the claims of increased economic efficiency under a decentralized regulatory regime.

greater efficiency and honesty based on competition for capital and citizens is not supported (Shleifer & Vishny 1993). Central governments have a tendency to devolve authority over service provision without the required increases in revenue-raising authority. International experience suggests that where countries decentralize responsibility, but not revenue authority, service levels drop and local governments begin to push for more fiscal transfers (Wallich 1994). It is crucial to assure that newly acquired responsibilities of sub-national jurisdictions match both their revenues and their technical capabilities (Bird 1994). If this does not happen, there is a risk of overspending under the assumption that the center will bail out the failing sub-national units. Moreover, jurisdictions can easily get involved in infighting over the fairness of transfers, as has been experienced in failed federal states such as Yugoslavia, or the Lega Norte secessionist movement in Italy.

Thus, the question whether decentralization helps or hinders elite rent seeking is not conclusively decided in the literature. It is not made conclusively clear why some economies appear to respond well to decentralization while others seem to be impervious to its hypothesized benefits. Here, we take a closer look at one case, Vietnam, to shed new light on this question.

2.3. The Vietnam Case in the Literature

Vietnam is a central state, yet provinces have gained significant ability to implement central regulations locally. Thus, Vietnam's provinces behave as if they existed in a federal system of competing units for purposes of economic competition, providing an example of market-preserving federalism (Weingast 1993: 289). The China research has found that elites indeed limit their rent seeking in response to demands from foreign investors, who can exit (or not enter) China – or any particular Chinese province – at will (Qian and Weingast 1996; Qian and Roland 1998; Maskin et al. 2000). Few studies on the effect of decentralization on rent seeking have been conducted in Vietnam. Malesky (2008; 2004a; 2004b) details how successfully reforming provinces obtain large inflows of foreign investment, which provide rents and political strength for provincial elites. As a result, bargaining power shifts from the center to the successful provinces, which fill the central treasury. Applying the game-theoretical approach by de Figueiredo and Weingast (2005; see above), the incentive structure between defection and cooperation shifts. To assure continued cooperation of the successful provinces, the center has to reduce its punishing powers and increase public goods provision. Malesky's work shows the progressive ability of successful provinces to push the legal envelope by engaging in fence-breaking activities, particularly associated with improving business climate. Success chips away at the center's power to restrain reformers (Malesky 2004a: 481). In a next step, Malesky cooperated with the Vietnam Chamber of Commerce and Industry and the United States Agency for International Development to create the *Provincial Competitiveness Index* (VCCI 2006; 2007; 2008; 2009). The PCI operationalizes quality of provincial governance in a mix of statistical data on governance, such as delays to obtain a license or the number of procedures required, and a questionnaire given to thousands of entrepreneurs across Vietnam. This annual study provides evidence that good governance and foreign investment are correlated, and that provinces actively try to catch up with earlier success stories in attracting foreign capital. Reforms traveled (i.e.: leaders in provinces near the success stories had to reform as well) and rent seeking was held to levels that investors considered acceptable in the provinces that attract the highest levels of foreign capital.

2.3.1. Corruption and rent seeking

Any argument about Vietnam's improved governance invites a rejoinder about the country's low standing in international comparisons on corruption and transparency measures. Transparency International's seminal *Corruption Perception Index* ranks Vietnam 116th out of 178 countries (Transparency International 2011). But the research question in this study asks why so many investors trust 'location Vietnam' *in spite of* the strong, central government, the absence of checks and balances, no history of rule of law, and the international perception of Vietnam as a corrupt and non-transparent polity. This study takes as its point of departure the fact that investors who have the opportunity to choose freely the location for their factory (those in the efficiency-seeking manufacturing sector) choose Vietnam over a plethora of available alternatives, including countries that rank much better on the Corruption Perception Index. Vietnam attracts very large amounts of foreign investment. Data will be discussed throughout this study, and at this point it is sufficient to point out that when measured by size of the economy, no developing country attracts as much foreign investment capital as Vietnam. Clearly, international investors see Vietnam as a worthwhile investment destination. Our research begins with this starting point, and compares changes in rent seeking among provinces. This is why we are not investigating the reasons for Transparency International's ranking in detail in this study.

One thing that can be said is that the state treats foreign investors differently from other agents, foreigners or Vietnamese. Economic reforms did not emerge from a change in attitudes within the Party toward Marxism or the moral value of individual freedom. Instead, they were a means to an end. The Party saw it in its own interest to reform in order to reestablish the legitimacy of its rule. Where relaxing control was necessary to strengthen the Party, controls were relaxed. Where maintaining them played in the hands of the Party, they were maintained. As a result, the Party still uses the state apparatus to control potential challenges to its rule. Transparency is not an overall goal of the Party – but it has increasingly become one for local officials in the limited arena of investment attraction. One one hand, people, especially foreigners, have to go through hoops to obtain the right to do very basic things, like hold a press conference. These restrictions are of great importance for rankings on transparency (see for example Global Integrity Report 2011). On the other hand, business rules about red tape and bureaucratic inertia were addressed by the decentralizing reforms and the fence breaking in successful provinces. While tourists who overstays their visa by one day may chafe under the bureaucratic rules and cost of obtaining an extension, investors may be taken care of by the province's Department of Planning and Investment with hardly any bureaucracy at all.[9] International organizations like Transparency

[9] An anecdotal footnote: The author once arrived in Vietnam with a spelling error on the visa. The immigration officer first pointed out the error and proclaimed that he needed to talk to a supervisor. (Maybe a bribe was expected to smoothe things over.) When the author pointed out that this was a business visa and that a driver from the Ministry of Foreign Affairs was waiting outside, the immigration

International make no distinction between political repression and general corruption versus the more specific topic of improved governance for the specific purpose of economic development we discuss here.

Specifically, three reasons can explain the difference in international corruption and transparency rankings and the perception of business climate. First, the Corruption Perception Index measures overall perception of the state's corruption and transparency, but it obviously does not measure the perception of investors in the manufacturing industries that choose Vietnam as one of their preferred destinations. A large number of countries ranked above Vietnam are trying hard to attract manufacturing investment with significantly less success, hence perception by international manufacturers apparently does not follow the international ranking. This is an interesting puzzle – most likely one based on the methodology of the ranking – but one that has to be left for different research.

Second, it is important to compare countries in similar situations. Singapore may be much more transparent than Vietnam, but it also much more expensive and will hardly attract much of the investment that Vietnam receives –low-end manufacturing that requires abundant and cheap labor. Nonetheless, the comparative success of Vietnam and Mozambique, ranked identically, has to be explained by factors other than cost of labor. If it were not for overall business climate, Nike could choose to make at least some of its footwear and garment there. Tunisia, ranked 59, has high unemployment, easy access to ports, linguistic facility with one major European

officer simply corrected the error manually with a pen. Officials obviously know when to raise and when to fold.

language, French, and is very close to the European market. Yet it receives nowhere near the investment levels of Vietnam.

Third, rent seeking does not equal corruption. A country could be perfectly transparent but still not satisfy the needs of investors. It could, for example, impose an extremely high regulatory burden and red tape on investors officially by law. Investors may prefer a little illegal side payment to a corrupt official over a large official payment to an honest one. They may prefer greasing a wheel rather than waiting forever for the highly transparent and legal process to run its course. Since this study does not concern itself with international comparisons, it cannot address this possibility.

2.4. What Is Missing in the Vietnam Literature – The Role of Non-Elite Groups

The literature on Vietnam's rent seeking, while forming the framework for our study, is not complete. Malesky's Vietnam-specific account of decentralization, devolution of power and reduced rent seeking in order to create a positive investment climate does not rule out a race to the bottom for regular Vietnamese workers, the non-elites. By race to the bottom is meant a situation in which businesses push for fewer and weaker regulations and ever-lower taxes, thus depriving the government of the revenue to provide social wages.[10] If central and provincial elites see it in their interest to provide the best possible conditions for investors, they may collude with business elites at the expense of the working class. *This study addresses this lacuna by asking why the*

[10] This definition is drawn from the race-to-the-bottom concept in the globalization literature, but it is used differently here. In the international usage, it refers to a hollowing out of the stateby international capital. Here, it refers to collusion in rent seeking by local economic and political elites.

harmony of interest, logical between investors and local political elites, extends to subordinate social groups with no coercive and extremely little economic power. By testing the Tillian contestation theory of increased bargaining power for subordinate interest groups under conditions of factor mobility across jurisdictions, we hope to close the gap in the literature left open by the focus on the relationship between economic and political elites alone, with little attention paid to the race-to-the-bottom assumption that logically follows from such a binary focus. This study expands the scope of the hypothesis, investigating whether a *harmony of interest* exists not only between local economic and political elites, but also between elite and non-elite interest groups in society. Based on federalist theory, the study tests what impact factor mobility has on bargaining power between central and provincial elites; provincial elites and investors; provincial elites and subordinate interest groups;[11] and investors and labor. We hypothesize that for that race to the bottom to be avoided, the ability of individuals to migrate is crucial. Where workers can vote with their feet, under conditions of scarcity for qualified labor their bargaining power increases.

The hypothesis is supported by a recent study by Phan and Coxhead (2010), which shows that poverty has declined across the country as a result of migration from poorer to richer areas and the resulting flows of remittances. Migration flows into provinces with most trade-oriented industrial investment have a robust inequality-reducing impact. Where migration into investment magnet provinces is inhibited,

[11] We will call them 'workers' for the sake of simplicity, but also because it is migrant workers we use to test the hypothesis.

inequalities between those and the most successful provinces are on the rise – as our hypothesis presumes because of the reduced bargaining power of non-elite actors.

We assume that factor mobility alters incentive structures for various interest groups. Where labor is scarce, capital promotes public policies that improve labor satisfaction to avoid out-migration and the associated high turnover and scarcity of quality human capital. Where labor is abundant and therefore cheap, governing elites try to provide better conditions to avoid large-scale out-migration of their most motivated and entrepreneurial residents. The coalitions that form are Pareto-optimal as long as the economy does not contract and if demand for labor does not drop precipitously. Malesky's study identifies mechanism through which power devolves from the center to provinces via the push and pull forces of foreign direct investment and explains why provincial elites engage in credible self-limitation. We go a step further by explaining why no race to the bottom in terms of social service and public goods provision occurs due to the collusion between investors and provincial elites.

Moreover, this study adds to federalist theory, which only expects a realignment of agents with different preferences. Under federalist theory, all we can expect is that different provinces employ different policies and residents then migrate to where their preferences are best met at an acceptable price. We test the *implicit* federalist assumption that the exit option increases the bargaining power of subordinate interest groups, as Tilly and Jones have argued. If this is the case in Vietnam, such a finding would indicate that federal systems not only lead to a national political economy in which different jurisdictions offer different public goods baskets, but also open the door to bargaining with respect to what public goods should be offered in each jurisdiction. We hypothesize that new coalitions of convenience arise, as capital, labor and provincial elites and workers or residents experience new arrangements of harmony of interest that devolve power away from centralized elite authority. The end result is a reduced ability of – or at the least less incentive for –economic and political elites to collude in obtaining rents through an inefficient allocation of resouorces.

The findings are expected to shed light on the puzzle why studies about the economic benefits of decentralization have come to divergent results. Vietnam is a success story in the recent development literature, similar to the developmental states of the 1950s and 1960s and the East Asian tiger economies of the 1970s and 1980s. Since Vietnam decentralized its economy rapidly under conditions of high factor mobility, it can shed light on the conditions under which decentralization increases allocative efficiency in developing economies.

CHAPTER 3: THEORY AND METHODOLOGY

Decentralization, factor mobility and 'credible commitment' and their impact on rent seeking are not well studied in the case of Vietnam's economic reforms. The few existing studies are limited to the shift in power between central and provincial governments, but fail to address additional shifts from elite to subordinate groups – a form of economic democratization. This second shift, however, is crucial in addressing assumptions about elite collusion in rent-seeking theory. Mancur *Olson's Rise and Fall of Nations* serves as a foundation for this approach (see Chapter 2.1. for a discussion of this work). This study fills the gap, building on the literature discussed in Chapter 2 and expanding to a theory of *harmony of interest* not only between different elite interest groups, but one that includes other, non-elite societal actors. This interplay among multiple actors with compatible interests gives rise to a form of competitive pluralism that provides credible commitment against government predation and prevents a race to the bottom.

The previous chapter has summarized the debates in the two strands of academic literature directly relevant for our inquiry: (1) the impact of rent seeking on economic efficiency and subsequently economic growth and development; and (2) pluralistic contestation (through economic decentralization) as a means to limit the rent-seeking powers of elites. Following that description of the lay of the land in the scholarly debate, this chapter first defines the research question and formulates a theory in response to it (section 3.1.), then lays out the theoretical sources that inform the debate (section 3.2.), subsequently provides an analytical framework of the case study (section

3.3.), thereafter formulates the testable assumptions and explains the data treatment (section 3.4.), and concludes by listing the data sources (section 3.5).

3.1. The Research Question

Vietnam's reform path represents a puzzle. Few autocratic, low-income late developers have attracted large amounts of efficiency-seeking foreign investment in the early stages of their reform efforts. Such countries, as the credible-commitment theory points out, lack mechanisms to assure investors that their money is safe, property rights respected and the rules of the game do not change throughout the lifetime of the investment project (Weingast 1993, 1995; Qian and Weingast 1997, Montinola et al. 1996). When the elite commands coercive power with few credible checks and balances, investors prefer to stay away. Of course, resource-seeking investment must go where the resources are, and market-seeking investment *per force* moves into large markets with present or future potential. By contrast, efficiency-seeking investor, who seek the best return on their money from cheap labor and low regulatory standards in order to manufacture products for export to the rest of the world, have a choice of location and tend to seek out stable regimes with a history of investor protection. Even success stories like the East Asian developmental state had to rely on domestic investment for their early industrialization push. China and India, two more recent foreign-investment success stories, are continent-size economies that attract investor for their future market potential at least as much as for their business climate. Vietnam is among the few locations where efficiency-seeking investment is concentrated, in spite of apparent risk factors and without vast markets or extremely abundant resources to make up for the risks. How can this peculiarity be explained?

Following a basic *rational-actor model*,[12] we assume that elite interest groups support policies that increase their power and maintain their position on top of the social hierarchy. This assumption runs through the academic literature, both in political science and economics. Yet in Vietnam, the Communist Party, which sits astride the political-coercive and economic hierarchy, purposefully reformed the system by devolving economic decision-making powers to the provinces, by granting privileges to foreign investors, and by loosening the tight controls the government had exercised over citizens' social and economic lives. While the Party reformed in order to improve the economic situation and to stay in power, it also actively opened avenues of pluralist contestation – an outcome not *a priori* predicted by rational choice assumptions. As power devolved to regional political elites, they in turn opened doors to contestation with and among other interest groups, capital and labor. Our research question, then, is this:

> *What is the political logic that caused decentralizing political reforms in Vietnam, in spite of the resulting reduction in coercive power by the elite over the rest of society?*

Did the Communist Party intentionally act against its own interest for the good of society, did it make a mistake (as is often argued the Soviet leadership did in decreeing

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12 Snidal defines rational choice as "... a methodological approach that explains both individual and collective (social) outcomes in terms of *individual goal-setting under constraints*" (Snidal 2002: 74; italics in original). Examples of rational choices in the public realm include theories on how interest groups interact strategically for their best interest (Olson 1965), theories on transaction cost and the role of relative bargaining power (North 1973, 1990) and research on institutional arrangements of governments (Riker 1964). In all these cases, rational actors – individuals as well as interest groups – generate collective outcomes through behavior aimed at individual utility maximization (Levi 2002: 20).

glasnost), or did the Party act in accordance with incentives pushing it in the direction of devolution for its own benefit? In this study, the argument is that shifting incentive structures made it rational for the Party to reform in the way it did. Before we formulate a theory and the assumptions to test it, we review the theoretical framework for this argument first.

Political logic refers to the way agents maneuver the networks of supporters and opponents in which all politics is embedded, how they calculate the costs and benefits of one policy over another, and how policy choices benefit them in the short, medium and long run. The research question about this political logic is based on assumptions from various theories how powerful coercive elites are expected to act:

1. Rational choice theory posits that self-interested actors attempt to *maximize their individual gain* without regard to the implications for societal outcomes, while under the influence of *incentives and constraints* (see footnote 10).
2. The theory on rent seeking suggests that *elite groups attempt to prevent change* (reform), since all change in the system challenges their position on top of the hierarchy.
    a. Political elites *use coercive power to prevent downward changes to their relative position* in the hierarchy.
    b. Economic elites *use their financial influence to collude with coercive elites* in assuring that change is minimized or, if unavoidable, benefits the current elite group.

3. Pluralist contestation creates incentives for elites to engage in bargaining with other interest groups, thus altering the set of choices that are rational for the elite to pursue. Among various forms of pluralist contestation, the ones here considered refer to the exogenous shocks to the political structure that come with trade opening, foreign investment and economic decentralization.
    a. It takes e*xogenous shocks* to the system to upset the equilibrium and force change, which can then be sustained through the emergence of new Pareto-optimal coalitions. In Vietnam this shock came with near-starvation conditions that placed the elite in a position of *fearing for regime survival* and provided an *incentive* to reform the failing system.
    b. *International trade and investment regimes* create contestation for benefits. This contestation forces domestic coercive elites to adapt to structures that
        (i) provide them with benefits but
        (ii) which they cannot control through their political power.
    c. Domestically, the mechanism by which contestation is created is *decentralization*. Provincial elites compete for benefits they cannot command, but must attract, such as investment, tax payers or workers. Attracting these mobile factors implies giving them a seat at the bargaining table, in accordance with the federalist theory of Tiboutian sorting (voting with one's feet) and with Tilly's theory on contested politics as the causal factor for Europe's path to democracy and economic growth.

Based on these theoretical assumptions, we hypothesize that contestation – through integration into the global economy and decentralization – has created a new Pareto-optimal alignment among interest groups in Vietnam, more decentralized within the ruling Communist Party and now encompassing two non-Party interest groups, labor and investors. A social science theory, as specified in the seminal book by King, Keohane and Verba (1994) is "a reasoned and precise speculation about the answer to a research question, including a statement about why the answer is correct." Furthermore, social science theories are based on several hypotheses. To answer our research question about the political logic for decentralizing reforms, we formulate our theory thus:

> *International trade integration and domestic decentralization create pluralistic contestation among interest groups. This contestation leads to a new harmony of interest among the main interest groups in Vietnam, under which all interest groups are better off cooperating than defecting from the new alignment of power. Competition for capital and labor in the global as well as in the now quasi-federalist domestic sphere provides actors with incentives to reduce their immediate rent seeking in return for long-term benefits.*

The theory is supported by five assumptions, which allow us to test the harmony of interest among dyads of actors in Vietnam. These assumptions are formulated in the next section.

On a final note, it is important to recognize that the self-limitation these elite groups are accepting is not based on a constitution or democratic checks and balances. While some have argued that only democracy and the associated legal, constitutional and electoral checks on power holders can bring about self-limitation (Deese 2003; Ramaswamy and Cason 2003), we will show here that the incentive structure that leads to a preference for *self-limitation can be brought about by any form of contestation over benefits that cannot be commanded by holders of coercive power*. In Vietnam, that benefit is foreign capital. Even the (domestically) all-powerful Communist Party cannot force foreign investors to come to Vietnam; they must be persuaded. The same is true for provincial governments. The only way to bring investors into *their* province over another is by persuasion. As a result, incentives change from redistributing wealth by means of coercive power to attracting wealth into the country (and by extension into the province) through assurances of a good business climate and bargaining with all mobile agents.

3.2. Theoretical Sources

The systematic study of decentralization, factor mobility and credible commitment in the case of Vietnam is limited to the work of Ed Malesky (2008; 2004a; 2004b) and the *Provincial Competitiveness Index* (VCCI multiple years), which is itself based on Malesky's theoretical work (see Chapter 2). Yet even Malesky limits his analysis to the devolution of power from higher to lower levels of government, while ignoring further shifts in relative power between coercive elites and subordinate groups (here commonly referred to as workers) as a further consequence of the changes in incentive structure in his model. Here we build on this literature and add a discussion about the relationship between elite and non-elite interest groups.

Rent seeking, as we have seen, is the elite's use of its coercive power in allocating resources in ways to increase or sustain its power and to obtain a reward for its position at the top of the hierarchy. Following a simple *rational choice institutional model,* we assume that actors aim at gaining power, then maintaining or increasing it, within the prevailing institutional setting in the political and economic hierarchy. They act in a manner consistent with outcomes that preserve their position on top of the institutional hierarchy. The distribution of rents assists the elite in gaining supporters or in dissuading potential veto players within the elite group; rents thus form a political logic within which politics plays itself out, regardless of where the institutional setting falls on the polyarchy scale.[13] Each actor needs to give something to obtain something – in game-theoretical terms, each actor needs to offer something to reward cooperation and to punish (and thus prevent) defection by other players. Our framework of analysis, then, is one of *political logic of reform in an institutional setting in which the elite group* – the Communist Party – *enjoys virtually uncontested coercive power*, but *where choices within the elite group need to be made under conditions of contested preferences among members of the elite*.

While elites have conservative tendencies – they try to avoid change – fluctuations in the political, economic and social environment in which they are embedded regularly impose the need for policy adaptation. The *partial reform equilibrium* is a model describing reform under rational choice assumptions. When elite actors cannot prevent reform, they design reform in ways that are most likely to increase their own power (Hellman 1998). Susan Shirk's detailed description of China's

[13] Polyarchy reflects Dahl's (1971) notion that a political system is neither perfectly democratic nor perfectly authoritarian. The level of democracy is measured along a continuum of responsiveness to citizen demands.

reforms shows how the leadership in China carefully managed every step of change, isolating veto players and bringing supporters of reform into the elite's fold before making any move. She shows how the absence of democracy does not imply that elites act in a vacuum. Instead, they must appeal to what she calls a "selectorate," individuals and groups who have influence within the system and who are able to act as intra-elite-group veto players or spoilers, and in the process can select or help defeat policies and policy makers within the elite group. Proposed policies must appeal to this selectorate or they will engender opposition to the proponents of reform. While the elite interest group itself remains unchallenged, its composition can change through internal contestation (Shirk 1993, 1994).

Shirk's narrative points out that no political system, however autocratic, can be totally monolithic. Multiple actors interact and doors for pluralistic contestation are opened by exogenous and endogenous forces. In our institutional model, we investigate how exogenous change has forced Vietnam's ruling institution, the leadership of the Communist Party, to widen the avenue of pluralistic contestation beyond what the Party initially intended, and how actors used the emerging spaces to take more than was offered. The pathways through which these avenues were widened are Vietnam's integration into the global economy, made necessary by the collapsing economy, and subsequently the decentralization of economic decision making. This international integration altered the pay-off structures within which veto players could be placated and supporters cultivated.

After initial impetus for reform – Vietnam's near starvation conditions that threatened the legitimacy of the Party's rule – the decreed change[14] created new coalitions among the members of the elite at various levels of government (central and local), all perceiving reforms as being in their best interest. Credible commitment emerges from such mutual benefit, as theorists of market-preserving federalism have shown (Weingast 1995). But federalist theory since the seminal work by Riker (1964) has always wondered how federalist pluralism prevents that early "winners take all."[15] Neither the partial reform equilibrium nor market-preserving federalism nor Malesky's (2004a; 2004b) theory on the effects of foreign investment on elite predation can explain why early political winners do not collude with economic elites in consolidating their gains in a new, centralized hierarchy.

To answer this question, de Figueiredo and Weingast (2005) use a *game-theoretical model of institutional choice* in which they show how decentralized structures must be self-enforcing to survive. Center and lower-level jurisdictions must have mutual benefits from the arrangement for it to hold. This implies mutually acceptable division of powers, but also distribution of rents to central and provincial elites. Especially in bottom-up arrangements, where decentralization is not imposed from above but taken from the bottom ranks of the elite group[16] or negotiated in a drawn-out process, the costs and benefits of exit and cooperation must be balanced to

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14 Reform was essentially decreed at the Sixth Party Congress in December of 1986.

15 "Winners Take All" is the title of Joel Hellman's (1998) paper that introduces the above-references partial reform equilibrium.

16 Vietnam's decentralization is such a case, as we will show. The provinces engaged in 'fence breaking,' a term that denotes pushing the limits of central laws and on occasions clearly stepping beyond the boundaries the center had intended when it decreed reforms. Autonomy was not granted – it was *taken* by daring provinces who weighed the risks against the benefits of being first movers.

avoid defection through a unilateral re-arrangement of power or rents by the actors who have the momentary advantage in bargaining power.

We follow this game-theoretical approach to show that in Vietnam, economic decentralization was chosen to improve the economic prospects and with it the legitimization of the Party. Once in place, it took a dynamic of its own, through a distribution of powers and rents that serves all dominant interest groups in a Pareto-optimal arrangement of coalitions of convenience. We go a step beyond the rational choice institutional model of Shirk and the game-theoretical institutional choice model of de Figueiredo and Weingast by adding the *impact of factor mobility on bargaining power for non-elites* to explain why no no elite collusion against non-elites has occurred, and why no early winner could emerge as the single focus of power in the post-reform Vietnam. This added emphasis reflects the political science approach of *contested politics* (Tilly 1990; Jones 1987) and a classical *federalist model* about public goods provision starting with Adam Smith's (1776) focus on competition for reduced rent seeking, and leading to the theories of Charles Tiebout (1956) of "voting with one's feet" and Parente and Prescott (2000) about the importance of factor mobility on avoiding collusion among rent-seeking coercive and economic elites.

Marrying these approaches, we identify harmonies of interest among different social groups – elite and subordinate – and identify conditions under which these harmonies hold. We hypothesize that the Vietnamese model is bounded by certain conditions – economic growth with increasing demands for labor, and a consensus within the elite group that economic growth is a *conditio sine qua non* for staying in power. We conclude that such a model cannot be universally applied, given the need for specific conditions at the outset, but that it is one that can inform a number of late-developing countries. Since the conditions under which the harmony of interest holds are self-reinforcing (they depend on, but also lead to growth and high demands for labor throughout the catch-up phase of industrial development), the model is of use in informing policy on economic governance for an extended period of early industrialization.

3.3. Framework

This study takes a *game-theoretical approach*, in which all parties cooperate as long as a harmony of interest is maintained and all actors experience a positive cost-benefit calculus. The following matrix shows an iterative game in which a shadow of the future allows the five main interest groups to calculate the benefits they will obtain from the respective others and how each group is better off within this system than outside it.

Table 3.1. Vietnam's harmony of interest matrix

		provides to				
		Central Gvt	Rich Provinces	Poor Provinces	Investors	Workers
obtains from	Central Gvt	--	tax transfers allegiance	allegiance		
	High-Investment (Rich) Provinces	autonomy political protection	--	migrants	rents, taxes political rent	business climate (no workers – no FDI)
	Low-Investment (Poor) Provinces	fiscal transfers	*fiscal transfer (via center)*	--	*remittances (via workers)*	remittances
	Investors	*credible commitment (via decentralization)*	credible commitment (contestation)	migrants	--	labor
	Workers		social wages (to keep them in the province)		jobs	--

The matrix shows the web of shared interests among the five main interest groups relevant to Vietnam's economic reforms. A dynamic interaction exists among all the interest groups – each group receives benefits from another and passes benefits on to the next. These dynamics cause continued cooperation among actors.

<u>The central government obtains</u>

- from the rich provinces allegiance in return for autonomy to pursue their own successful policies (non-interference in developing the economy in exchange for no challenge to Ha Noi's rule)
- from the rich provinces tax transfers in return for preventing the poor provinces from ending policies that benefit the rich provinces over-proportionally
- from the poor provinces allegiance in return for fiscal transfer payments

<u>The central government provides</u>

- to the rich provinces autonomy (non-interference in their successful economic policies)
- to the rich provinces a credible commitment that the poor provinces will not use their numbers (their political power) to end the trade-opening and investment policies that have benefitted the rich provinces over-proportionally
- to the poor provinces transfer payments received from the rich provinces
- to investors a credible commitment of limited predation through decentralization (via the competition among provinces and the harmony of interest between center and rich provinces)

The harmony of interest lies in the flows of money from rich provinces to the poor provinces via the central government; in the flows of allegiance from poor provinces to the center in return for the transfer payments; and in the flow of allegiance from the rich provinces to the center in return for autonomy to pursue their successful economic policies. Defection (in game theoretical terms) of any actor would lead to the loss of the benefits for all.

<u>The rich provinces obtain</u>

- from the center autonomy (non-interference in their successful economic policies)
- from poor provinces migrants whom they need to satisfy labor demands in their burgeoning industrial parks and adjacent boom economies
- from investors rents and taxes
- from workers the labor needed to attract more investors

<u>The rich provinces provide</u>

- to the center tax transfers in return for preventing the poor provinces from ending policies that benefit the rich provinces over-proportionally
- to the center allegiance in return for autonomy to pursue their own successful policies (non-interference in developing the economy in exchange for no challenge to Ha Noi's rule)
- to the poor provinces tax transfers (via the central government)

- to investors credible commitment (through the competitive environment that comes with decentralization and allows investors to bargain with provincial elites before making site location decisions)
- to workers social wages to prevent labor loss (which in turn would deteriorate the business climate for investors)

The harmony of interest lies in the interdependence of all actors to provide one aspect of positive business climate in exchange for a share of the benefits. Any change to the flows outlined above would deteriorate business climate, which in turn would reduce investment, which in turn would reduce money flows to center, poor provinces and workers.

<u>The poor provinces obtain</u>

- from the center fiscal transfers, the funds for which the center received from rich provinces
- from the rich provinces fiscal transfers (via the central government)
- from investors remittances (via migrant workers)
- from workers remittances

<u>The poor provinces provide</u>

- to the center allegiance in return for fiscal transfers
- to rich provinces migrant workers for their labor needs
- to investors workers (via migration to rich provinces)

The harmony of interest lies in the flows of migrants from poor provinces where there is a surplus of labor and a shortage of jobs to the rich provinces which depend on migrant workers to provide the human capital needed for a good business climate; and the flow of capital from rich to poor provinces via remittances and fiscal transfers that assure social peace (since the poor provinces benefit indirectly from the market-opening policies that have benefitted the rich provinces over-proportionally)

<u>Investors obtain</u>

- from the center credible commitment (via decentralization that grants rich provinces autonomy in business regulations and enforcement)
- from rich provinces credible commitment (through the competitive environment that comes with decentralization and allows investors to bargain with provincial elites before making site location decisions)
- from poor provinces labor (via worker migration)
- from workers labor

<u>Investors provide</u>

- to rich provinces taxes and rents (direct rent payments from side payments, land transfer fees, increased land value, jobs for family members and other, sometimes illegal or unethical activities; indirect *political rent* via economic performance and social peace that enhance career opportunities of local officials)
- to poor provinces remittances (via workers)
- to workers jobs, benefits

The harmony of interest lies in the symbiotic relationship between investors and local elites. The local elite benefits directly (financially) and indirectly (through career enhancements as a result of the economic performance in their province) from investment. As a result, the elite provides investors with a good business climate. The center benefits via the tax transfers and the social peace it can buy with that money. Poor provinces receive transfer payments and remittances while exporting the problem of unemployment through outmigration.

<u>Workers obtain</u>

- from rich provinces social wages to prevent labor loss (which in turn would deteriorate the business climate for investors)
- from investors jobs and benefits

<u>Workers provide</u>

- to rich provinces the labor they need to maintain a good business climate
- to poor provinces remittances
- to investors labor

The harmony of interest lies in the benefits all parties receive from migration. Poor provinces can export the problems associated with underemployment and poverty. Rich provinces need to increase the labor force proportionally to job creation to avoid labor shortages and excessive salary increases, which would drive investors elsewhere. Workers obtain a better life for themselves while their families benefit from remittances. Investors require workers and find willing, relatively cheap labor in migrants from poor areas.

The *harmony of interest* among all these actors assures that no interest group has an incentive to defect from the balance of bargaining power that has emerged under decentralization and international economic integration.

3.4. Testable Assumptions and Data Treatment

To test the harmony-of-interest theory under conditions of decentralization and inter-jurisdictional and interest group contestation, we formulate five testable assumptions:

> <u>Assumption 1:</u> *Foreign direct investment leads to a reduction in rent seeking via incentives for provincial elites.* We assume that rent seeking is less pronounced where elites have incentives to compete for benefits they cannot control through political power – foreign direct investment. Local elites have an interest to keep investment coming rather than slaughtering the goose that lays the golden eggs through excessive rent seeking.

This assumption tests whether a *harmony of interest* exists between *governments of provinces with high levels of foreign investment and investors*. We test whether there is indeed a connection between the levels of foreign investment and the amount of money plowed back into infrastructure of interest to investors, as opposed to surplus being skimmed off by elites. This test reflects the theory that contestation provides an incentive for elites to limit their predation levels voluntarily, in return for long-term benefits, as suggested, among others, by Adam Smith (1776), Charles Tilly (1990) and Parente and Prescott (2000).

Variables are foreign investment and rent seeking. Rent seeking cannot be observed directly; instead, it must be operationalized through its effects. This operationalization, based on the *Provincial Competitiveness Index,* is detailed in Chapter 5. A reduced level of rent seeking is indicated by higher investments in human capital formation and infrastructure, improved business climate through lower predation levels and legal changes supportive of industry.[17]

> <u>Assumption 2:</u> *Proximity of a poor province (one with low levels of investment) to a wealthy one results in a higher likelihood that the poor province will engage in reforms itself, owing to the threat of out-migration.* Due to the transaction costs of migration, proximity should breed contestation. The closer less economically reformed, poor provinces are to a wealthy one, the higher we expect the outflows of citizens toward the wealthier province to be. Since elites do not want to see their citizens leave – especially the most motivated and entrepreneurial ones – we should see laggard provinces reform more vigorously if located near a successful province.

We expect to find increased migration from less to more investment-attracting provinces, correlated positively with proximity. As a result of that loss of citizens (and local capital, that also migrates to the more interesting, wealthier markets), we should observe catch-up reforms concentrated around the most successful provinces by laggards trying to stem their losses in population and business to their better-managed neighbors. This reflects federalist theory on factor mobility by Charles Tiebout and Charles Tilly (above). The *political logic* in this assumption reflects the *harmony of interest between provincial governments with low foreign investment levels (poor provinces) and their residents*. Local officials will reduce their rent seeking (by instituting reforms) in order to emulate more successful provinces and provide

17 Tax reductions fall in that category, but are of minor concern in Vietnam, where tax rates are set by the central government and only some fees are determined by provincial governments. Two major rent-seeking instruments for local officials are red tape and land rent. Every step in the licensing process is a potential for a bribe. The top investment-receiving provinces' one-door-shopping program took corruption largely out of the licensing process and represents a major self-limitation by local officials. Land transfers to industry are a second source of large profits for officials with the power to zone and designate land for various uses. As we shall see, different provinces have taken significantly different approaches to land transfer.

economic growth and wage earning opportunities for their citizens in an attempt to prevent them from migrating to a wealthier, more economically attractive province.

Variables are inter-provincial migration levels and proximity on one hand, reforms to emulate more successful nearby provinces on the other. Migration is determined by census data and, for unregistered migrants, surveys conducted by the Vietnamese government, the United Nations and non-profit organization working on poverty and migration issues. With respect to emulating reforms, we look at the degree to which economic success comes in clusters. Since we assumed the proximity of a successful province putting pressure on laggard ones, we investigate whether there is a connection between catching up with the early leaders in terms of foreign investment, quality of governance (Provincial Competitiveness Index ranking), employment, industrialization levels and income on one hand and proximity to early success stories on the other. We compare time series of investment and employment data to see whether catch-up reforms are indeed associated with out-migration levels and proximity to successful provinces.[18]

> <u>Assumption 3:</u> *A high level of investment correlates with higher provincial government investment in social services and social wages, as provincial governments recognize the importance of abundance of high-quality human capital for its investment climate.* In provinces with high levels of investment, a large number of workers is needed. If the province cannot meet the demand for workers, it will see its business climate decline and investors leave. This demand for labor gives regular workers bargaining power *vis-à-vis* the local government. We expect to see less

18 We are indeed checking for the same variable twice – we assume that proximity facilitates migration through lower transaction costs, and also check on hard migration data. The reason is twofold: First, the census only covers registered households. The closer the home of a migrant to the workplace, the more likely it is that the migrant remains unregistered, residing with friends and family, and seeking social services in the province of official residence. Second, provincial leaders have reason to preempt large-scale out-migration and may begin reforms before a flow of migrants becomes statistically observable.

> predation against regular citizens in provinces with high levels of investment and industrialization, resulting in better social wages and services.

The testable hypothesis in this assumption is that in provinces with high levels of investment, social services will be better, not worse, than in less industrialized provinces, in contrast to the assumption of a collusion among elites against non-elite interests. The *political logic is one of harmony of interest between local governments in rich provinces and their citizens* (including in-migrants who may not be officially citizens or residents of the province). This assumption tests the race-to-the-bottom hypothesis and federalist thought.

The *variable* 'provincial success' is measured in foreign investment and employment levels. Predation against subordinate groups is measured by the difference in living standard between elite and subordinate interest groups (approximated by income quintiles), widening of income disparities, poverty rates, direct government predation (as measured by perception of corruption by businesses in the *Provincial Competitiveness Index* and by citizens in a recent United Nations Development Program survey), changes in net income, access to social services (access to public schools and health facilities), and the differences in income and social services in in- and out-migration provinces (to indicate what portion of surplus is returned to social services versus being appropriated by elites).

> <u>Assumption 4:</u> *In provinces with high levels of foreign investment, labor conditions are better than in ones with lower investment levels, due to the fact that labor scarcity is more troublesome for investors where there are lots of factories in relation to workers.* When labor is mobile and industrial investment concentrated, investors will pay more attention to worker recruitment and retention and push local governments for higher,

> not lower social wages to assist in creating and maintaining a pool of qualified human capital and reduce turnover cost. As labor becomes a scarce factor with bargaining power, there is no race to the bottom. The more investment in a province, the more will investors and local government emphasize worker welfare over short-term rent seeking.

The assumption we test is that investors in highly industrialized provinces lobby for more social wages and services, not fewer, as race-to-the-bottom theory suggests. Where labor is similarly mobile as capital and scarce because of high and increasing demand, interests of investors and workers begin to overlap. Both want good working conditions and a reasonable public goods basket – workers to improve their standard of living; investors to avoid costly turnover and strikes. The *political logic is the logic of federalism* and *Tilly's contestation theory* (Chapter 2). A *harmony of interest emerges between investors and their workers* via *the local governmen*t, which investors lobby for provision of better living conditions for their workers.

The *evidence* to test this assumption is support for workers' quality of life and lobbying for legislation that supports workers even at a cost to companies. Evidence is collected in interviews and surveys of companies and officials of industrial parks and investment authorities whose job it is to support the investors in their province. We assess local attitudes toward spending on workers satisfaction (construction of dormitories, provision of public transportation for commuting workers), the amount of voluntary social spending by companies, and the lobbying for higher versus lower taxes, welfare spending and social wages by industry.

> <u>Assumption 5:</u> *Politicians in provinces with high levels of tax transfers to the central government enjoy better career opportunities regardless of their obedience to central government rules.* The central government grants autonomy to successful provinces that pay into the federal budget.

> The center then uses the surplus provinces' money to allocate resources to laggard provinces for the sake of assuring political peace. This indicates that the center recognizes the harmony of interest in the 'autonomy-for-fiscal-transfers' trade, since it accepts and even rewards successful rule breaking rather than obedience to central government edicts.

This explains why the center does not crack down on 'fence breakers' as long as they were successful and continue paying into the central treasury. A *harmony of interest exists between the central government and both rich and poor provinces*. The system is Pareto optimal; no party would gain from a change in the arrangement. The center benefits from the fiscal transfers it receives from the rich provinces which it can use for transfer payments to poorer provinces, a Robin Hood equaling out wealth among provinces. The center gains political benefits from being able to keep social peace. Poor provinces gain from the transfer payments, while rich provinces gain from being allowed to shape their own business climate with little interference from central governments. While some have assumed that rich provinces might prefer to challenge the 'federalist' rules (or *in extremis* even secede) in order to keep more or all of their income, it is clear that as soon as they no longer contribute to the common good, their influence evaporates and the center is free to crack down by force. Thus, the arrangement represents a well-balanced harmony of interest.

Successful versus unsuccessful fence breaking represents *evidence* for this assumption. In 2008, only 11 out of 63 provinces paid into the central treasury, and we can check whether these provinces and their leaders receive different treatment from poor, transfer-receiving ones. Where pushing or even overstepping the law leads to success and increased fiscal transfers, it is tolerated. Where it is unsuccessful or leads to reduced transfers (as in the case of a province reimbursing investors centrally imposed taxes, leading to reduced provincial income), fence breaking is reigned in. Another important indicator in support of this assumption is the political success of fence-breaking politicians. If provincial politicians break the central Party's rules but get promoted, this indicates that the government pragmatically evaluates success of policies, rather than obedience and ideology.

A last note on Assumptions 2, 3 and 4, which seem to test similar political logic. In Assumption 2, we assume that local governments in poor provinces want to prevent outflows of citizens and business. In Assumption 3, we assume that rich provinces want to provide better human capital in order to lure in investors. And in Assumption 4, investors are expected to want to reduce turnover, and in the process support workers' demands rather than colluding with the political elites against the working class. The three assumptions are complementary in testing elite reaction to migration, but from different viewpoints.

3.5. Data Sources

Owing to its communist past with a highly centralized, planned politico-economic structure, and to its recent role as a model reformer, Vietnam has developed an excellent General Statistical Office. Data[19] are continuously made available online, and in print annually. With the help of international donor agencies, Vietnam conducts censuses on

[19] As is the case in most countries, there is always debate about methodology and confidence in data. Chapter 7, for example, elaborates on a discussion about the counting of the poor. What is meant here is that in Vietnam, the government has set up a system of collecting data routinely and with a constant methodology, and provides in-depth break-downs to the provincial level. These data are thus of good use for comparison across time and across provinces.

households, businesses, migration and other social phenomena. All data are available for the country as a whole and in disaggregated form for provinces. Statistical government data used for this study come from:

- Statistical Yearbook 2008: The *Statistical Yearbook* is the compilation of all data collected by the Government Statistics Office. It is based on the Statistical Handbook, but adds analysis and background information. It disaggregates data by province and region; where applicable by ownership and industrial sector, and provides comparative timelines for the data provided. The following data are based on the Statistical Yearbook:
    - gross domestic product
    - investment (domestic and foreign)
    - employment by sector, by region, by province
    - wage levels by sector, by region, by province
    - income quintiles by sector, by region, by province
    - social service provision (hospital beds, kindergarten and school places, number of teachers, doctors and nurses) by region and province
    - taxation levels, tax transfers between province and center
    - migration levels by region and province
- Statistical Handbook 2009: The *Statistical Handbook* provides the same categories of data as the Statistical Yearbook, but with less analysis. It is published earlier and includes more recent data, including some estimates for the most recent months. It is used when one additional year of data is required.

- National Census 2009: Vietnam conducts censuses at regular intervals, with smaller, sectoral censuses in between census years. The National Census of 2009 is a major, decadal census. Census data are summarized in the Statistical Yearbook. In most cases, Yearbook data are sufficient. The National Census is used for methodological background information and analysis of population and migration trends. The census provides population data broken down in national, regional, provincial and smaller categories. It analyzes:
    - migration between regions and provinces
    - data on the changing urban-rural dynamics
    - educational achievement
    - employment data
    - health status
    - living quality data
- Vietnam Living Standard Survey 2008: This survey represents a census of quality-of-life data similar to those in the census. The VLSS is more detailed and includes significant analysis of the raw data. The census uses VLSS data. VLSS provides data on:
    - household data (size of house, ownership structure, number of persons per room)
    - educational achievement data
    - health data (access to institutions, amount of money spent per patient, source of health spending)

    - employment data, including salary, unemployment, underemployment numbers
    - level of household consumption (expenditures measured in cash expenses plus subsistence and barter expenditures plus expenditures based on intra-family transfers)
    - remittance data
- Enterprise Census 2000-9: The Enterprise Census surveys the number, sectoral distribution and legal status characteristics of enterprises. It disaggregates by ownership structure, sector, turnover, number of employees, region and province, and by applicable law (law on enterprises, law on cooperatives, foreign investment law, joint stock company regulations, collective companies). The data enter the Statistical Yearbook, but are more detailed and undergo significant statistical treatment and analysis in the Enterprise Census.
- Foreign Direct Investment Survey 2000-7: This survey collects and analyzes data on foreign-invested companies. It analyzes economic activities of these enterprises by sector and by region and province. It provides data on
    - number of enterprises
    - employment structure and employee compensation in foreign-invested enterprises
    - turnover
    - tax payments
    - profits

In addition to official government statistical data, we use surveys and studies by international non-governmental organizations, the United Nations and the World Bank. On migration, surveys from private organizations and the United Nations are used to assess the number of unregistered residents. Due to the household registration system, migrant workers who do not intend to use social services in the province where they work often do not register there. These workers are not systematically captured by the census, but play a significant role in the analysis of the impact of labor mobility on the relationship between provincial government and workers as well as the perception of labor needs by investors.

Rent seeking and quality of governance are closely related, but neither can be measured directly. We use the *Provincial Competitiveness Index*, a cooperative effort between the Vietnam Chamber of Commerce and Industry and the United States Agency of International Development, as a proxy for good governance. The Provincial Competitiveness Index is a complex quantitative and qualitative analysis of a variety of indicators. It will be explained in detail in Chapter 5.

Assumption 4 is based on interviews and surveys of investors in Vietnam conducted specifically for this study. For Assumption 5, we conduct a desk review of the career paths of political leaders who have engaged in fence-breaking activities and their counterparts who have not. We only look for leaders who have made significant careers in the central government, which for the purposes of this study is sufficient in showing that fence breaking does not represent a career barrier for local leaders. A broader study as to whether it is generally helpful to a career is outside the scope of this research.

To support statistical data, we use qualitative data from interviews and surveys in Vietnam. Interviews in country have been conducted in the fall of 2007 with political leaders, generally in the Department of Planning and Investment of a province, in both highly industrialized and less developed provinces. Officials were interviewed with respect to their policies on foreign investment attraction. These interviews aimed at (in)validating the assertion that political leaders in less successful provinces will be proactive in stemming the tide of emigration from their provinces to more successful provinces, and to investigate how and why successful provinces engage with both investors and workers. Interviewee selection was based on a geographical component and a selection of highly invested provinces and laggards.

Second, we used Provincial Competitiveness Index surveys, complemented with interviews with investors, with respect to location choice. The Provincial Competitiveness Index surveys several thousand companies of all sizes and ownership structures with respect to their perception of quality of governance. The survey includes questions about desirability of location and where the company would invest today if it were free to do so. Some additional interviews were conducted specifically for this study.

Third, we use a large-N United Nations survey that interviews both migrants and non-migrants about their choice of location and their perceptions of costs and benefits of migrating or staying put. This study allows us to draw causal conclusions from the statistical data – why migrants chose to move, and whether assumptions about migrations, for example push versus pull assumptions, are accurate in the case of Vietnam.

The rest of this study is laid out as follows: Chapter 4 provides a brief overview of the *doi moi* reforms, which are at the beginning of decentralization in Vietnam. The chapter lays out the motivations for reform and its initial direction, which in turn leads to the emergence of the incentive structures which this study analyzes.

Chapter 5 describes the rise of Vietnam's provinces during *doi moi*. The chapter tests Assumptions 1: rent seeking is reduced as elites see more investment in their interest through the benefits they gain from it in the long run. In the course of testing this assumption, the chapter also operationalizes governance, which is crucial for measuring rent seeking. It was determined in the definition of rent seeking that it can only be measured by its effects, the most prominent of which is good governance. Owing to the importance of good governance in measuring rent seeking, Chapter 5 goes into detail in operationalizing governance and linking it to the phenomenon of rent seeking.

Chapter 6 tests Assumption 2, which states that proximity to successful reformers (successful reforms being measured in high influx of foreign investment) should push laggards to engage in catch-up reforms to reduce out-migration of residents who seek opportunity in the highly-invested provinces. We expect to see concentric circles of reforming provinces around early reformers in accordance with federalist assumptions of people "voting with their feet."

Chapters 7 and 8 tackle the issue of the elite collusion view reflected in Assumptions 3 and 4, which is often made in the context of roaming investment capital. Why do we not see collusion between investors and provincial elites to the detriment of regular workers? We show that Vietnam follows less the dependency theorists assumptions of such a collusion than a “flying geese” model in which early developers must interact with their poorer neighbors in search of human capital, but later pass benefits of growth down to the latecomer developers. Chapter 7 makes the case by looking at social service provision as an indicator for (or against) a race to the bottom; Chapter 8 validates the findings from the data analysis through interviews with regulators and businesses.

Chapter 9 discusses the question of the cohesion of (quasi-)federal systems from the point of view of political incentive toward secession. Taking cues from theoretical federalist literature and specific case studies on China, the study evaluates what factors assure that leaders of successful provinces continue to find it beneficial to support the central state rather than to demand more autonomy beyond the economic realm (Assumption 5).

In Chapter 10, we conclude by bringing the various, now tested assumptions together and by drawing lessons for Vietnam. Any theoretical study must propose a potential range of applicability beyond the immediate case. Chapter 10 fulfills this function as well.

CHAPTER 4: FROM ROVING TO STATIONARY BANDIT – BACKGROUND ON REFORM

This chapter lays out the foundations in history on which this study builds. Like many other studies of economic reform, trade opening and decentralization, this study starts with the impact of political change on the politico-economic structures in Vietnam. Most similar studies leave open questions that undermine the persuasiveness of the conclusions: How could reform begin in the first place? Why did the Communist Party choose to decentralize over alternative reform options? And not least, why did international investors flock to Vietnam, based only on the assurances of a hitherto unsuccessful governing elite with no history of respecting property rights or the rule of law?

It is important to note, however, that this chapter is not a historical treatise on the political struggles inside the Communist Party or society overall in the run-up to the Sixth Party Congress in 1986, which decreed the *doi moi* reforms. This chapter states no argument nor does it address testable assumptions. It only provides a context in which Vietnam embarked on the *doi moi* reforms. Only in the last section, it moves to providing *one* plausible explanation why foreign investors from some countries, but not others, took the bait offered by *doi moi* early on. This is useful to place agents' choices in their context – what makes a given choice rational is determined within a structure of incentives and disincentives, which are generally dependent on cultural and historical forces.

This study looks at present-day interactions among societal interest groups. There is no compelling need to address the question how these interest groups emerged. The study can stand alone as an investigation of current social interactions. Yet it is preferable to present a plausible foundation for the environment within which these interactions play out, if only to be able to compare the results of this study to other cases, which may not share the same historical background.

Vietnam has a rich – and, as all societies, unique – history. Much has been written about this history itself, and about its connections with its northern neighbor and eternal suzerain, China. The long entanglement with China has left Vietnam with a sinitic culture and traditions, including a political history that is modeled after China's mandarinate. Moreover, Vietnam has actively emulated the Chinese reforms. As a result, it is useful to relate Vietnam's reforms to China's model. The chapter does not, however, attempt to analyze the pre-*doi moi* struggles in Vietnam or the currents in Vietnam's body politic; that requires a different, historical dissertation. It only wants to provide the context in which the real subject of this investigation, the bargaining among the main interest groups laid out in Chapter 3 – was conceived and took place. To lay out the historical context in which we set the theoretical framework, this chapter

1. provides a brief history of the events leading up to the need for *doi moi*;
2. summarizes the Chinese model, which Vietnam's leadership has

followed, but also explains why the Vietnam case is independent enough to warrant its own study;

3. describes the way *doi moi* came about at the Sixth Party Congress; and
4. suggests a plausible contextual explanation in which foreign investors from Taiwan and Korea accepted the credibility of Vietnam's reforms and became trailblazers in Vietnam's foreign-investment-based development model.

4.1. The Need for Historical Background for a Contemporary Research Question

In the theory section, we formulated a research question which focuses on a hypothesized harmony of interest among actors within the new, reformed economic structures of Vietnam. The theoretical foundations underlying the assumptions this study tests – market-preserving federalism, Malesky's theory on the push and pull forces of investment in Vietnam's political economy – require a certain politico-economic dynamic to be in place in order for the harmony of interest to become self-perpetuating. These theories do not spend much time asking where these dynamics come from; instead, they take decentralizing, power-devolving reforms as their starting point. That is not satisfactory. An investigation how rent seeking can be kept in check should first theorize where the initial spark for reform comes from. Why does a rent-seeking government decide on reforms that reduce its predatory powers (or permit a reform which leads to this effect); why would a strong central state accept decentralization in the first place?

After reform has been decided, why would international corporations trust a strong, authoritarian government not to reverse itself and engage in predatory behavior once the capital is in the country? The harmony of interest that underlies all theories of checks and balances only applies once the dynamics of reform are established and have shown their benefits to the political actors. Why, then, would investors with a wide variety of options take the plunge into a high-risk location like Vietnam, with hardly a market to speak of, language problems, a work force with mediocre skills and no free-market background?[20] These questions are not *at the core* of this study, but need to be addressed at the outset, to avoid constructing theory in a contextual vacuum. We provide a plausible answer to this question in Section 4.5.

To understand why a powerful elite with almost total control over social and economic life would implement top-down reforms that limit its own power, we have to examine the history of the ruling Communist Party, its legitimation and the conditions that prevailed when the political struggles for reform were fought and won. Politics is by definition about the acquisition of power; rent seeking is about using power for the acquisition of wealth. A power elite can appropriate wealth outright, or trade power for wealth with economic elites. An economic elite can trade wealth for political protection with a holder of coercive power. In both scenarios, power and wealth are traded in a client-patron relationship, the essential underpinning of rent seeking. The Communist

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[20] Profit-loss accounting, for example, was not practiced in Vietnam prior to *doi moi*, and accountants had to be brought in from abroad or trained.

Party combined political and economic elite in one body until *doi moi*. The Party devised a system of control over production and distribution that gave it almost absolute power over most aspects of citizens' lives. Why it gave up this position voluntarily requires explanation.

The *proximate cause for reform* lies in the dramatic deterioration of the country's economic conditions. Declining living standards, a majority of the population living in absolute poverty, one in four families not being able to procure the minimum required daily calories and recurring famine conditions all are powerful reasons for reflection. Yet we also know that a number of countries in the underdeveloped world suffer from similar conditions while their rulers did not feel the need for reforms that limit their own powers. In Vietnam, the confluence of five factors explains the particular reaction to the economic decline:

(1) Antecedent social conditions: The literature on the East Asian developmental state has argued that one main difference between the successful East Asian industrializers and other states was social cohesion. In a society where a large majority belongs to the same ethnic, linguistic and social group, it is difficult to use 'othering' as a justification for predation. In societies where a minority rules (often thanks to colonial powers that used the minority as a support group during colonial reign), politicians can appeal to ethnic divisions to justify redistribution from the majority to the minority (Haggard 1990; Öniş 1991). Rent seeking is justified by arguments of ethnic justice, historic wrongs to be righted or religious rationales for one's group's predominance over another, as Easterly demonstrates in the case of ethnicity-based redistribution after

the end of colonial rule in Ghana (Easterly 2002). Even in very poor economic conditions, the minority that redistributes from the rest of society can satisfy its demands. Vietnam is a society in which 86% of the population belong to one ethnic group, the *kinh*.[21] Justifying predation from a neighbor who is not 'the other' is difficult. The last episode of 'othering' occurred after independence in the north, when tens of thousands of landlords, real and falsely accused, were expropriated and killed (Buttinger 1968: 427). This brutal episode of 'land distribution' created a very egalitarian society in an ethnically homogeneous country that makes 'othering' today extremely difficult.

(2) Marxist ideology: In the absence of major natural social dividing lines, elites can try to create them artificially, by exploiting any real or imagined differences. In Vietnam, this was not a winning strategy. Communist ideology emphasizes equality of the masses. With the elimination of the landowning classes in the wake of the communist victory first in the North, then after unification in all of Vietnam, the Party could no longer create artificial dividing lines without violating Marxist doctrine, which the leadership was working hard to infuse into society. The communist ideology of equality did not lend itself to the artificial division of society into "imagined communities," to use Anderson's famous phrase, albeit in a different context (Anderson 1983).

(3) Cultural norms: After three millennia of Chinese dominance, Vietnamese

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21 The rest of the population is made up of a multitude of smaller ethnic groups, some of which are comprised of only a few hundred individuals. Moreover, except for the ethnic Chinese, minorities are the poorest segments of the population, often living in subsistence communities. Little could be 'redistributed' away from them.

culture is heavily influenced by its northern neighbor. Vietnamese emperors based their legitimacy on the same grounds as the Chinese, the *Mandate of Heaven*. The emperor had to prove his legitimacy to his subjects by keeping the borders safe from invasion, by managing drought and flood and by dealing with other natural catastrophes, either preventing them or mitigating their impact. If the heavens showed their displeasure with the emperor by sending unmanageable challenges his way, his subjects could then replace him without upsetting the natural order of things. Hence, the best interest of the ruler was to do right by his subjects (Fairbanks 1983; Mote 1999). This is an early example of *legitimacy by success*, which the communist parties of both China and Vietnam have adopted. The Vietnamese Party claimed legitimacy from success in the wars of decolonization and unification, starting after World War II and ending in unification in 1975. After these tasks were accomplished, it used communist doctrine to promise a better and fairer life for all. It uprooted age-old traditions of family farming with the promise of a better life. As this better life did not materialize and the agricultural Vietnam suffered shortages and depended in Russian food aid, the Party bosses, themselves not immune to their culture in spite of their rhetoric of scientific socialism, feared the loss of the Mandate of Heaven. Such loss engenders the legitimacy of revolt, but also represents a culturally intolerable loss of face. Reform thus became a much more palatable response than the use of the oppressive apparatus of the state, which would not have restored the Mandate of Heaven or the leaders' respectability from a cultural point of view.

(4) No compensation for political service: If elites captured the state for the

benefit of society, governance would be cost free. But governing elites are always leviathans who want to be compensated for their service (Rodden and Rose Ackerman 1997: 1532), or even organized protection rackets whose title of 'the state' only means that they have predominance in this game of capture (Tilly 1985). In a country where the vast majority lives in poverty, even the most powerful elite can gain little rent unless it is willing to divide the population into groups and redistribute massively from a large group for the benefit of a small. For that, as was explained, the Vietnamese political and social system was not suitable. For the governing elite to obtain a rent for its government service, it had an incentive to make changes to the failing system. Moreover, money is not the only incentive. As Adam Smith already pointed out (Smith 1854), people have historically done things for the respect that comes with it. Money is a means to obtaining respect. In Confucian society, the role of the elder is highly revered. Party officials in East Asia rarely flout their wealth as ostentatiously as African potentates. Showing off wealth is less acceptable in Confucian society, and outright shunned in egalitarian communism. While officials are not poor and corruption levels prove that material gain is an incentive for government service, social status comes more from respect for the role of the 'elder' that the political leader represents than from a big house or car. As a result, failure in one's duties represents a loss of face, while the respect that comes with successful dispensation of one's responsibilities represents a non-monetary reward (Mote 1999). Vietnamese officials do seek financial rents and engaging in corrupt behavior (much of which is explained by Confucianism as well), but they have always exhibited a strong interest in succeeding in their tasks. In 1986, prior to the Sixth Party Congress that would decide on the *doi moi* reforms, Vietnamese leaders saw the prevailing economic conditions as personal failure and loss of face. They had a sincere interest in rectifying the situation, both from the perspective of staying in power and from the cultural prerogative showing that the heavens still smiled on them. It will be shown later how leaders across the country tried early on to do the right thing even when the pay-off in terms of rent or political gain was unclear.

(5) Model policies available to leaders: Early fence breaking[22] showed the way. Vietnamese provincial leaders engaged in fence breaking to provide food and increase economic output during the pre-*doi moi* era. Since they gained popularity from their successes, the central Party became aware that reforms are possible without loss of control, unlike the experiences in the Soviet Union and Eastern Europe. Moreover, China's reforms guided the Vietnamese comrades. In China as well, reform improved material conditions of the masses, and as a consequence increased the Party's legitimacy instead of undermining it. Fear of loss of legitimacy and power paired with a model for reform that can preserve the paramount position of the Party were the argumentative ammunition of the reformers. As Malesky put it,

> These reforms were in response to the economic crisis, so they were not so much improper [with respect to communist doctrine] as necessary behavior ... . If the Party was to retain its relevance it had to allow necessary local reforms to be legitimized and even spread. Therefore pressure from the bottom combined with an accurate sense of urgency resulted in major change of direction for the communist country (Malesky 2004a: 164).

These five factors in sum provided the Party with incentives to engage in reforms. Reforming instead of using the heavy-handed power of the state had the additional

22 Fence breaking is the act of pushing the boundaries of the allowable. See Chapter 3 for an explanation.

advantage of being culturally acceptable. The rest of this chapter provides a brief history of the Party and its role in post-colonial Vietnam, gives data indicating the state of the economy prior to *doi moi*, discusses similarities with and differences to the Chinese model that Vietnam's elite has tried to follow, and an overview of the changes the Party decreed at the Congress in December of 1986. Lastly, we address a question that has gone largely undebated in the literature on Vietnam's reforms. The government may decide to allow foreign investment into the country, but why would investors take such a high-risk plunge. In later chapters we take a new look at contestation among provinces and the impact of investment on domestic policies. That has been discussed, and this study will take a different view on the issue. But, as mentioned at the outset, most studies begin with the changes in domestic politics *as a result of investment* already in the country. For a complete picture, we need to find a plausible rationale why an investors would take the jump into a place as thoroughly mismanaged as Vietnam at the eve of *doi moi*.

4.2. A Brief History of Post-Colonial Vietnam

"Vietnam," it was said, "is an ancient land, but it has rarely been able to be itself" (Morley and Nishihara 1997: 3). Over three millennia, Vietnam was dominated by China. The first Vietnamese migrated into the Red River Delta from China, and over the centuries found themselves under Chinese suzerainty, interrupted by hard-fought moments of independence. Vietnam's mythology is all about this struggle for being itself. Even the stories that describe how lakes and mountains were formed invariably relate to tales of Chinese invasion and dragons defending the beloved Vietnamese against the Chinese forces of darkness. The Vietnamese psyche is fixed on the struggle against the outsider, and nationalism is easy to inculcate in Vietnamese of all social strata. In spite of the intense dislike for Chinese mingling, Vietnamese culture is based on Chinese influences. The court, the mandarinate, the entire system of governance and social organization were thoroughly Chinese. French colonialism ended Chinese dominance, political and cultural. The French ended the empire and the mandarinate and replaced the Chinese script (Elliott 1999; Buttinger 1968). After the Second World War and Japanese occupation, a new, French-educated leader by the name of Nguyễn Ái Quốc, better known under his *nom de guèrre* Hồ Chí Minh (Ho Spirit of Light), declared independence (Duiker 2000: 323). Unmoved by his citation of the American Declaration of Independence, the United States supported the French return to their colony. Led by Ho, Vietnam fought yet another war of independence. To unify the nation under a common ideology, he set the new national goals as independence and Marxism. Following the 1954 Geneva Accord, the country was divided in two parts, with the North controlled by Ho Chi Minh and his Viet Minh forces. In the North, landlords were persecuted and thousands were forced to confess their sins against their fellow Vietnamese and executed (Buttinger 1968: 427).

After partition, the war between North and South killed three million Vietnamese and exposing the North to aerial bombings and mass mobilization. A war economy was built in which much of agriculture and light industry was undertaken by women, while most young men were fighting. Again, the war was seen as a fight against foreign invaders. Unification in 1975 ended the war era only briefly. First, the end of the war did not end in reconciliation. Many South Vietnamese ended up in reeducation camps, many more took to the seas as refugees, the legendary boat people. In 1978, Vietnam invaded Cambodia after Cambodian incursions into Vietnamese territory. China retaliated with a short invasion of North Vietnam in 1979. War and social trauma, whether inflicted by others or their own, are a common memory for the Vietnamese. Building a peace economy not aimed at colonial exploitation was a new task.

4.2.1. Building socialism from unification to doi moi *and beyond*

This section summarizes the decisions taken by the government, especially after unification, to build a socialist economy, and the near-catastrophic economic consequences. While predating this study, this era of Vietnam's history is significant because decisions made at that time are responsible for the economic conditions that make reform urgently necessary by 1986. We do not discuss causes for or struggles over decisions; we only lay out the historical events of relevance to our investigation.

After unification, the government enjoyed the legitimacy of success in war and of having unified the country. Nationalism was widespread, and thoughts about a glorious future were ubiquitous. After all, Vietnam had defeated the French colonizer and the United States through will power, tenacity and ingenuity. Building a prosperous society was the next goal. And the government, which had drifted toward doctrinaire Marxism in the war years, collectivizing agriculture throughout the North to support the fighters at the front and to make do without a whole generation of young farmers and workers who were gone for years on end, declared shared prosperity as a national goal. With the Communist Party firmly in power in Ha Noi, Marxist ideology was unchallenged in the adoption of a plan for a peace economy. The Party declared an accelerated road to socialism (leapfrogging the intermediary stage of *embourgeoisement,* which Marx had considered a prerequisite for the final victory of socialism). The decision to embark on Marxism-Leninism as the development model was taken at the Fourth Party Congress in December of 1976, just one year after unification and the end of the American War. It was decreed to move without intermediary stages from small-scale production to large state-owned industry and to turn Vietnam into a fully socialist country within 20 years (Thien 2005: 26).

Collectivization was pushed southwards into the Mekong Delta, one of Vietnam’s two rice chambers (the other being the Red River Delta in the North). In the North, the government had used the mobilization for a popular war against imperialism to overcome resistance to breaking up the traditional family farm structure. In the post-war South, however, peasants resisted and collectivization never reached the same levels as in the North. Transition to socialism was slow, even nationalization of businesses did not proceed as fast as planned. The entire productive system threatened to break down, and annual income stagnated around an extremely low $200 per person following unification (Morley and Nishihara 1997: 4).

At the Fifth Party Congress in March of 1982, the failure of the project was already emerging. The second five-year plan (1976-80) had projected growth of 13-14%. Reality was starkly different: a 0.4% growth rate was unable to keep pace with population growth. Food production reached 14 million tons, short 7 million tons of the plan. Famine had hit several provinces during the plan period (Ebashi 1997: 37). Pham Van Dong, who had presented the 1976 Congress with the plan, asked why in spite of Vietnam's potential and the correctness of the plan, five years of implementation had yielded insufficient results. He answered his question by claiming that targets had been set too high, unsuitable policies were not amended, especially with respect to subsidies and bureaucratic command, and giving first priority to heavy industry had been a mistake (Thien 2005: 27). A *New Economic Policy* that liberalized small businesses and allowed farmers to produce at least part of their production for the market was decreed, and growth reached 7% annually between 1981 and 1984, but brought with it huge government deficits and high inflation, and increased graft and corruption (Ebashi 1997: 38). The Fifth Party Congress reinstated small private enterprises and the "family economy" on farms (Wescott 2006: 211).

The New Economic Policy and the subsequent reforms officially sanctioned by the Fifth Congress averted collapse, but not continued economic decline. Decree 100 CT/TU, covering the marketization of agriculture, improved food production, although rationing stayed in place. The 1980s witnessed high migration from rural to urban areas, high inflation of up to 700%, but also income increases and industrial growth. The Party did realize the challenges that a failure to provide economic progress would pose to its legitimacy and accepted change gradually. At the Fourth Congress in 1976, three new members had joined the Politburo, one conservative who had been overseeing the collectivization of the South, Vo Chi Cong, and two reformers, Nguyen Van Linh and

Do Muoi. In 1982, at the Fifth Congress, six Politburo members retired, allowing technocrats to replace revolutionaries (Morley 1997: 16). One of the new faces was Vo Van Kiet, one of the most prominent names in southern fence-breaking reforms.

A full reversal of economic policy apparently was not possible as long as Le Duan was in charge. He was a 26-year veteran at the helm of the Communist Party and a personal comrade of the nation's founding father Ho Chi Minh. Le Duan's leadership represented a direct link to precisely that part of the past that created the Party's legitimacy – the wars of independence and unification. Only Le Duan's death in the run-up to the Sixth Party Congress in December of 1986 (he died in July of the same year) finally allowed the Party to rejuvenate itself and the policy documents for the Congress were revised after his death. At the congress, the Party admitted "serious errors in strategic guidance" and swept the revolutionary war time leaders from the Politburo. A southern reformer, Nguyen Van Linh, was elected Party Secretary. Together with a change in faces, the Party altered its course and decreed a switch from a "bureaucratic centralized state subsidy system" to a regulated market economy (Rondinelli and Litvack 1999: 20-1). Old guard conservatives retained a foothold in the Party, but so far have failed to dislodge the reformers from a majority of top positions. The Seventh Party Congress (June 24-27, 1991) replaced Linh, but the top positions in the Politburo went to Do Muoi, a northern reformer who became Party Secretary, General Le Duc Anh from the central region as Defense Minister, and Vo Van Kiet, the southern reformer as Prime Minister. Fearing loss of Army loyalty, Anh was named President shortly after the Congress (Morley 1997: 24). The Eighth Party Congress

(June-July 1996) finally added the reformist (and current Prime Minister) Nguyen Tan Dung, a southerner and one of the few who spent the war years in the South, to the Politburo.

The strength of reformers within the Party has been waxing and waning depending on the performance of the economy. The Party never officially abandoned its basic principles of building a socialist society. Doing so would have required an explanation as to why the Party should still govern. Instead, it merely redefined what building socialism means. Even the discussion over the failures of the Party's guidance was led in terms of Marxist ideology. Critics questioned whether it had been a mistake to try to leapfrog the capitalist phase on the road to socialism. Based on such a critique of Vietnam's path to socialism, reformers could support reforms that were blatantly un-socialist, like privatization and support for foreign investment, while still shrouding themselves in Marxist orthodoxy. Vietnamese communists, they claimed, were now building capitalism because Marx had squarely declared it a prerequisite for socialism.

4.2.2. The Communist Party's legitimacy

Throughout the intellectual acrobatics over the course of Vietnam's socialism, the Party was aware of its need to maintain its legitimacy. All through the years of repeated failure and reform, the Party was not seriously challenged. Morely argues that political apathy is a product of Vietnam's history. In the imperial era, the mandarins ruled without accepting a challenge to their dominance. And in French times, the country was divided in the small elite that lived in cities and wanted to blend in with their European overlords, and the rural masses that looked toward Confucian wisdom and the ancestors for guidance, not a distant government. When the Communist Party took over, it eliminated much of the pro-European class and found that the rest of society was largely pre-industrial in its cultural outlook. What bound the peasantry was a historical feeling of foreign oppression that needed to be resisted. The Party appropriated these feelings aptly. Many Vietnamese say they never supported the Party for its ideology or economic reasons, but for its role in ridding the country of foreign domination. For that, they are grateful. Anyway, they say, there is no alternative (Morley 1997: 27).

Organized opposition to the elite does emerge when the livelihood of the people is threatened. The Communist Party, for example, ran into open opposition over forced collectivization in the South, and when famine caused people to challenge some dictates of the government. Illegal migration out of the district in which the government wanted to bind them through household registration is one form of rebellion, caused by existential fear for survival. Opposition for ideological or principled reasons is rare.

Political science recognizes success in war as one legitimation for the rule of a regime (see Spruyt 2002; Tilly 1985 for a discussion of government legitimacy in political science). Securing the borders against the barbarian hordes from beyond was one legitimating factor under the Mandate of Heaven. The Party had done well in this task, but the country was bled out and the Party had early on claimed that after unification, the next goal would be the improvement of the material situation of the people. Vietnam's historical narrative is one of resistance to foreign dominance, for which elites mobilized the populous. Older Vietnamese are willing to give the Party credit for achieving independence. Today, however, the young generation is less and less getting reared in the fear of foreign dominance. Today's youth have been born into a Vietnam free of foreign dominance and want to see their quality of living improve. The Party has therefore switched to a discourse of legitimacy by economic success. The common refrain today is, a poor people needs material progress first, political rights can wait. Public opinion seems to confirm this position. Vietnamese are not clamoring for multi-party elections, but strikes begin as soon as inflation erodes incomes. In 2007 and 2008, a wave of strikes hit Vietnam, in spite of their illegality (Lao Dong 2008a; 2008b). The wealthier and better educated the young population gets, the more the Party's legitimacy is questioned when the economy does not deliver what the Party promised. In wartime, the people were willing to accept unpalatable policies. This was part and parcel of a social contract based on implied mutual obligations and expectations. After the end of the war, the Party did not fulfill its promise of improved conditions, and the legitimacy – based on the successful liberation struggle – began to wane (Dixon 2004: 17).

The *doi moi* market reforms, then, were a reaction to a shift in popular sentiment as to what legitimates Party rule and whether there are alternative options; a shift from gratitude for the past to demands for the future, and an understanding that in other previously very poor East Asian nations, such as Taiwan and South Korea or nearby Thailand, the private sector had been the engine for improved living conditions, not the five-year plan. Most of all, Vietnamese could look north, to China, where their sister Confucian culture with similar revolutionary history and comparable form of government was reforming successfully. What made China such an attractive model for the Ha Noi government was that the reforms were aimed not at replacing the Party with something new, but on the contrary *to create something new in order to avoid the replacement of the Party*. China's reform looked to the Communist Party in Ha Noi like the proverbial cake one can have and eat, too. By liberalizing the economy the Party hoped to provide the material improvements it had promised but Marxism had failed to deliver. The Party could prevent political reforms and stay in power. Vietnam tried to emulate the Chinese model, and did so with increasing fervor as the Soviet Union collapsed and the source of foreign aid disappeared. In the following sections we discuss briefly the Chinese reforms that serve as the foundation for Vietnam's.

4.3. China – The Model for Vietnam's Reforms

The Vietnamese government has looked north, to China, as a model for its own reforms. This is not coincidence, since Vietnam was under Chinese dominance for most of its history (for a general history see for example Lam 2010), and shares with China the political system of single-party rule under the leadership of the Communist Party. China and Vietnam faced similar economic problems that led to comparable legitimacy challenges for the elites, and China started its reforms[23] a few years before Vietnam set out to accomplish the same task. Most of all, China's reforms had the same end goal as those envisioned by the Ha Noi leadership: to re-legitimate, not to replace, Communist Party rule. China's reforms emerged as a natural model for the Vietnamese leadership.

[23] China's reforms are generally dated back to 1979, compared to Vietnam's *doi moi* in 1986.

Yet there are some differences as well, both in the conditions in which reforms played themselves out and in the processs that emerged from the reform decrees coming out of the two capitals, Beijing on one hand, Ha Noi on the other. Here we take a look at both these similarities and differences. We show how Vietnam's reforms were influenced by China's, but also why Vietnam is worth its own case study, due to the differences in underlying conditions, implementation and outcomes.

Just like China, Vietnam is not a liberal democracy. It lacks competing branches of government and an effective judicial control of the state. Yet it is not a monarchy, a tyranny or a theocracy either. Democracy is an amorphous concept. It is not just a question whether there are regular, free elections. More to the point is the question to what degree a regime must respond to popular demands for its own good (Dahl 1971: 1-2), and in Vietnam's case, it certainly must. Both China and Vietnam have intricate political institutions that regulate political power, succession and policy shifts. In that sense, Vietnamese and Chinese politics are analytically not entirely different from democracies. Both have observable "patterns of competition among politicians who operate in an institutional political setting" (Shirk 1994: 7). Leaders need to cultivate win coalitions and isolate veto players. Change requires alliance building and two-level games. These are the same objects of analysis as in Western democracies. They are not arranged in the same way as in a liberal democracy, nor are their incentive structures identical. Analyses of democracies study the extent to which politicians respond to electoral pressures; in Vietnam we study the political logic of interests among various interest groups. In this respect, this section informs our study of a harmony of interest among interest groups.

One hypothesized difference between democracies and authoritarian governments in terms of development policy is the time horizon within which policy making takes place. The argument has been made that democracy with a short-term view on staying in power in the next elections focuses on short-term gratification of the electorate. Politicians need to show results for all in the short run. Authoritarian regimes, on the other hand, have a longer time horizon, since it is much harder for the citizenry to throw them out than the simple act of an election (Ramaswamy and Cason 2003). In the system of Vietnam's intra-Party selectorate (see below), however, this is debatable. The Party knows that it needs to manage the economy successfully in the long run to stay in power. Individual leaders, on the other hand, also have five-year terms within which they need to show their peers – the selectors – that their policy preferences work.[24] The fact that there are challenges to the Party leadership at most Party congresses is an indicator that the assumption that Vietnam's leaders have a long time horizon for policy success may be exaggerated. On the other hand, the small number of *successful* leadership challenges shows that Vietnam's Party leaders have a stronger hold on power than their counterparts in liberal democracies. Time horizons may indeed be affected by this difference. The swiftness with which the government has addressed the challenge of inflation when it emerged as a problem in 2007 would indicate that leaders inHa Noi are at least not assured about their staying power. Their failure to make the required hard decisions shows how strong the influence of the Party

[24] An aggravating factor is that these policies have to work for the selectors (allow them to maintain power and rent) and for the economy overall, since that overall success assures the Party's survival.

selectorate, and especially veto players in the Party, is.

Vietnam has based its reforms on two models, China's reforms that started in 1979, and Vietnam's recurrent fence breaking, small-scale reforms that had – and often achieved – the very same goals that the Sixth Party Congress set out to achieve. It is to a descriptive analysis of those two models that we now turn.

4.3.1. The Chinese precedent

Chinese as well as Vietnamese leaders respond not to an electorate, but a "selectorate" of political insiders, including Party members, high-level bureaucrats and key leaders in the Politburo and the central party leadership.[25] During periods of leadership selection, infighting is fierce, and candidates for top positions have to seek allies by aligning themselves early and adroitly. At Mao's death in 1976, the Party agreed that improving the material conditions for the masses was necessary to retain the Party's leadership claim. The Party's claim to legitimacy changed from virtue to competence, it had to demonstrate "that it could deliver the goods" (Shirk 1993: 23). Deng Xiaoping favored market reforms; his rival Hua Guofeng was popular with the central Party apparatus, which drew its power from the command economy. Hence, Deng recruited provincial leaders for support. By designing reforms that squarely benefited the chosen provinces (they could retain all revenue above a predetermined level and gained huge access to rents), their leaders were early and enthusiastic converts to liberalizing reforms.

Deng pushed through his reforms by limiting them initially to areas far away

25 The China discussion is based on Shirk's (1993) *Political Logic of Economic Reform in China* unless otherwise noted. The term "selectorate" is from that work. The book represents a rational choice institutionalist approach, comparable to the one taken in this study.

from the center.[26] This strategy assured that in case of failure, problems could be contained in the periphery. Between 1979 and 1985, four special economic zones in Guangdong and Fujian provinces were designated, and 14 coastal cities plus Hainan island and the coastal deltas of the Pearl River, the Yangtze River and southern Fujian obtained special economic privileges. By 1989, 20,000 joint venture contracts had been signed, 8,000 were in operation. Exports increased from $10 billion in 1978 to $52.5 billion in 1989. Total trade quintupled in the same period, to $111.7 billion. Leaders of other provinces were envious, but rather than opposing the privileges of the few, they demanded that they be expanded to all (Ibid: 48). By maintaining political control, the Party could distribute rewards in order to nurture political support. Opening went far enough to give benefits to supportive leaders, but not so far as to allow new entrants to challenge the privileges of the early empowered leaders. But the system took a dynamic of its own. Once international markets and foreign investors had become instrumental for Chinese domestic leaders' political power and personal enrichment, they could demand further liberalization. Dependent on its foreign partners for export markets and investment capital, China feared retaliation if it did not accede to demands for further liberalization (Shirk 1994: 55-6). While leaders were actually only interested in partial opening beneficial to themselves, they ended up in a mutual relationship with foreign partners that forced them to accept some policies that they did not initially support. They only accepted them in order to avoid a backlash and the outflow of the very capital they needed to keep the system going that benefited them.

[26] Shanghai, for example, was exluded from the special economic zones due to its proximity to Beijing (Vogel 2011).

Shirk (1993: 90-1) summarizes the policy process that underlies the Chinese reforms in the following:

1. Leaders promote policies that appeal to the selectorate, or their win coalition within the selectorate.
2. During power struggles, potential successors promote policies that conform to the preferences of the current leader, to get a foot in the door and to avoid opposition from the current strong man, who wants to see his legacy preserved.
3. When the selectorate is redefined at the Party Congress, government policy changes.
4. Because of the narrow selectorate, policy benefits accrue to an inner circle, not, as would be the case in a liberal democracy, to a broad range of ordinary citizens.
5. Only when the leadership is divided can the Central Committee become a bargaining arena. (This means that some sort of crisis is useful to begin bargaining, as was the case in both China and Vietnam at the eve of their reforms.)
6. During succession struggles, groups represented in the Central committee can extract resources. Contenders for power give resources to those whose support they need.

Key in this process is that losers are constantly paid off, to avoid the emergence of opposition groups likely to support a challengers in the internal power struggle. But this argument is contentious. All reforms create winners and losers. Change that leaves everyone equally well off could not be defined as change. By Shirk's own account, there were losers in different stages of the process. Inland provinces lost out early on as only some regions obtained special privileges. Even mighty Shanghai was upset about being left out of the ranks of special zones early on. Some industrial sectors opposed the reforms and their leaders were replaced. It appears that enough potential veto players were paid off to avoid any coalition from emerging that could upset reforms. Once certain policies have met with success and created beneficiaries, they become path dependent. In the course of these reforms, then, it is entirely possible that early winners are challenged, as is the case for leaders who opposed further liberalization but found themselves unable to prevent them for fear of losing what they already had in case of retaliation by foreign trading partners.

The Chinese reforms were well sequenced, bringing crucial leaders into the fold early, while holding out opportunities for others later. Deng focused on fiscal decentralization to give provincial leaders a stake in the reforms and make them a crucial ally, since his opponent Hua was well entrenched with the central Party in Beijing. This is a feature that repeats itself in Vietnam. Communist structures tend to be organized around functional, not geographic aspects. Provincial leaders in Vietnam were, just as they were in China prior to reforms, the extended arms of the Party across the country. Just like in China, the central government extended benefits to provincial leaders to bring them on board, and extended fiscal benefits to others to prevent them from becoming veto players. Yet local officials obtained no political authority. Not coincidentally, Vietnam's most successful provinces became known for fence breaking, a process of testing the boundaries or even knowingly ignoring them to get things done. Decentralization in Vietnam, unlike in China, was *taken* by daring provincial leaders, *not granted* by the center.

Vietnam and China are also similar in that foreign capital played a key role in overcoming reluctance, when foreign investors pushed reluctant leaders to accept more liberalization. Only in Vietnam, the reluctance to be overcome was not that of provincial leaders afraid of economic openness, but of central leaders who wanted to reign in wayward provinces. Only the fear of losing the tax transfers from the successful provinces if investors are unhappy about central interference in provincial reforms put a damper on central intervention.

Since neither Chinese nor Vietnamese leaders were too concerned about the responses by regular citizens, they cultivated allies and maneuvered around veto players from within the Party. Shirk's narrative makes it clear that it was crucial for reforms that few veto players could be hurt, while a great many benefited. The same was undoubtedly true in Vietnam, but the situation is evolving. In both countries, concentrated economic growth causes what Pomeranz called "the making of a hinterland" (Pomeranz 1993). Labor is becoming a scarce factor, and as such gains bargaining power in societies where movement of labor is free. Shirk's argument is about the political logic of reforms, not their consequences. In Vietnam, where the government has been less restrictive about migration since *doi moi*, mobility gives workers bargaining power. The Party-internal selectorate may still be what matters, but to an increasing degree the selectorate feels an impact from the mood (and actions) of the working classes. Vietnam's Communist Party (like China's) started the reforms in order to stay in power. Which factors determine whether the Party still enjoys the Mandate of Heaven is changing in people's minds. Our argument about a harmony of interest that includes the working class is closely related to this change.

4.3.2. Politics and reform in Vietnam

Vietnam's leadership followed China's reforms closely. Vietnam shares with China a cultural background, a comparable political structure and a series of problems following the implementation of a centrally planned economy. Vietnam's political power structure is anchored by a triumvirate of a Party secretary, a president and a prime minister. The prime minister appoints his ministers as well as leaders of the provincial People's Committees. The sub-national government works on three levels, province, district and commune (or in urban areas the ward), but governance is hierarchical – each level responds to the higher one. Each level of administration has an executive arm, the People's Committee, and a legislative arm, the People's Council (Kerkvliet 2004; Koh 2004). The overlapping membership of Council and Committee creates the same problem of circular controls that exist in China and that can make coalition building particularly open to mutual favoritism. The national Party Congress outlines the direction of all policy, usually held every five years. Party Congress and Central Committee of the Party meet two or three times per year to discuss implementation. The Central Committee elects the Politburo, which meets regularly to discuss day-to-day management. Within the Politburo, the Standing Committee manages Party affairs.

In the mid-1980s, all levels of leadership had come to realize the economic collapse and the failure of the plan to realize its goals. Reforms were needed and China's model attracted Vietnamese leaders because they fulfilled the dual requirements of the Party of (a) increasing economic flexibility in order to improve the material condition of the population, as the Party had promised after unification; and (b) leaving the Party in control by avoiding *political* reforms. While there were similarities, there were also some differences. Vietnam had just unified the country and could not just grant Sai Gon, newly renamed Ho Chi Minh City, special capitalist privileges. The South was still eyed suspiciously about harboring unreformed reactionary feelings. Special status for Ho Chi Minh City could only be discussed after leaders who had emerged from the South, rather than being transferred south from the central Party, came to position of national authority. These leaders then criticized Han Noi for leaving the commercial capital languishing in the margins instead of using its strengths. Turley and Womack (1999: 89) have identified politics in Chinese and Vietnamese reform periods and have this to say:

> Formal recognition of Ho Chi Minh City's special character came with the rise of its own leaders to power. This occurred after a conservative retrenchment in the early 1980s provoked southern leaders to develop a comprehensive program whose basic elements foreshadowed *doi moi*. To promote this, they joined forces with reform-minded leaders at the center headed by a former Party general secretary and elder statesman, Truong Chinh. ... Nguyen Van Linh openly criticized past failures to exploit the city's 'industrial and service center for the South and the country as a whole.' ... The success of local experiments provided ammunition for reformists to defend reform policies that had been politically vulnerable. In Vietnam, echoing Linh's advocacy of a leading role for the city, Vo Van Kiet, a member of the Political Bureau, deputy premier and chair of the State Planning Commission since 1982, in 1985 held up the city's Food Trading Corporation as a model worthy of emulating.

This reverses the Chinese experience. While Deng gave special status to a handful of coastal regions and *allowed them to become successful*, in Vietnam, provincial leaders[27] were *promoted to the central government thanks to their successes* and brought their policies with them. Since many of these early success policies had not been authorized, Vietnam's success model is based largely on the entrepreneurialism and risk-taking of provincial leaders acting at the margins – of plainly outside of – the law.

The economic success of southern leaders has ignited the debate over the causes. Its economic policies were said to be due to its recent capitalist history and its status as a commercial center under French rule (Rambo 1972; Beresford and McFarlane 1995: 53-4). Southerners, the argument goes, are more willing to raise claims and stand up for their rights, thanks to their history. In fact, the south ultimately refused large-scale collectivization.[28] This view of a special status of Ho Chi Minh City based on its history has been challenged as well. Gainsborough argues that Sai Gon was far from a free-wheeling capitalist city, but one in which the government and the military called the shots and where making political demands was not easily possible. Moreover, unification under communist rule represented a huge rupture during which virtually all those with business experience either fled or were re-educated in new economic zones outside the Sai Gon region. Lastly, those leaders who governed southern provinces were Party men, who often hailed from the North or had spent the entire war years in the

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[27] Most of these leaders are Southerners, but one must keep in mind that successful fence breakers exist in all parts of the country, and that a number of Southern leaders were not successful. The criterion was success, not geography.

[28] Of course, today's Binh Duong was known as Song Be province and, although adjacent to Ho Chi Minh City, was an agricultural backwater until the investment boom. Any claim to historical affinity and experience with capitalism would be complicated to sustain for Song Be.

North or in training abroad, mostly in Moscow (Gainsborough 2010: 45-8). In fact, the only leaders associated with the early stages of *doi moi* who were southerners and had remained in the South throughout the war years were the current prime minister, Nguyen Tan Dung and former President Nguyen Minh Triet (see Chapter 9 for more on this issue).

Typical for communist systems, Vietnam's government is centralized and reaches deeply into all nooks of society. Central governing structures and institutions are replicated at the provincial, district and commune level. At the national level, the National Assembly, the various line ministries, headed by a prime minister, and the Supreme Court exercise legislative, administrative and judicial functions.[29] The parallel structure in province and district consists of the People's Councils, the People's Committees and the People's Courts. Politically, these institutions exist in a strict hierarchy in which lower levels report to the higher ones. One result of *doi moi's* decentralizing economic development policy is the change in relationship among the various levels of government and elites. Fence breaking is a direct result of reforms, and the reason for continued reforms beyond what the Party originally had in mind.

All provinces have a Department of Planning and Investment, the local representative of the Ministry of Planning and Investment. The Ministry is responsible

29 Constitutionally, these institutions govern the country. In reality, the Communist Party dominates politics by determining appointments and policy. Other organizations, such as the People's Army or mass organizations representing social groups (Women's Union, Peasants' Union) are also influential, especially through their ownership of productive assets. Before recent legal changes, foreign investors needed to engage in joint ventures with such organizations to obtain access to government-owned land. Recently, the National Assembly has used its constitutional right to vote down proposals presented by the Prime Minister, including the ambitious high-speed rail link between Ha Noi and Ho Chi Minh City (Voice of Vietnam 2011). Whether this is the beginning of a more independent parliament or a sign of intra-party infighting that has spilled over to the Assembly is not yet clear.

for national investment rules and policies, while the Department implements them and promotes the province in which it is located. The provincial departments respond to the Minister of Planning and Investment in Ha Noi with respect to the implementation of national rules and regulations. They report to the provincial People's Committee Chairman with respect to promoting the interest of the province, to the Minister with respect to the fulfillment of central government policies. This system is known as 'dual subordination.' Where provinces market themselves aggressively and push the limits of the law, Department of Planning and Investment officials face a conflict of interest. The success of foreign direct investment in some provinces has given these officials an interest in favoring their allegiance to the province over the ministry in Ha Noi. While their careers within the line ministry's structure are controlled by the ministry, they are under the immediate supervision of the provincial authorities and their success is measured by how much investment they can bring into their province. Strict obedience to ministry policies that are not optimized for the province where they serve can, ironically, hurt their chances for career promotion in the line ministry, because their success on the job would be worse than if they engage in fence breaking and bring in more investment. Adding to such career consideration the potential for rent seeking – for the official or family members – as the stock of investment in the province grows, officials have an incentive to rank their allegiance to the performance of the province above that of the ministry. By contrast, in provinces with weak investment performance, officials have less opportunity for rent seeking and cannot use their job performance as an argument for promotion. In provinces with little economic growth and investment, local officials subject to dual subordination have an interest to exhibit strict loyalty to the ministry in Ha Noi, in the hope of being promoted that way. In this respect, Vietnam's reforms differ from China's. While in China the center pushed reforms onto the provinces (Shirk 1994), in Vietnam the government wanted to maintain control over investment and lost it only because energetic provincial leaders took more than was offered to them (Malesky 2004a). China controlled officials through fiscal benefits and promotions, while in Vietnam's successful provinces, local officials had incentives to favor the province over the center in cases of conflict.

4.3.3. Deviation from the Chinese Precedent – Vietnam as a Case

While tomes have been written about China's reforms, there is a dearth of studies on Vietnam. By studying Vietnam's reforms in their own right, we can add another piece to the post-communist-transition and economic reform[30] literature and allow comparativists to assess similarities, differences and generalizability of the reforms in these two internationally recognized success stories. Beyond this aspect of adding another piece to the puzzle of economic reform and transition, there are three distinct differences between the Vietnam case and that of China, in spite of the latter being the model for the former.

The first difference is that China is a continent-size economy. In 2010, 1.3 billion Chinese produced a gross domestic product (in purchase power parity) of $10.1 trillion, which amounts to $7,800 per capita (CIA 2011a). In comparison, Vietnam's 87

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30 While China and Vietnam remain nominally communist countries, their reforms have *de facto* done away with most of the hallmarks of a communist economic structure.

million people generate a power parity gross domestic product of $276.6 billion (CIA 2011b), or $3,200 per capita. This means that China's market is 15 times more populous and produces a GDP 36.5 times the size of Vietnam's. The average Chinese has a purchasing power of 2.5 times the average Vietnamese. These numbers are not only quantitatively different, but lead to a qualitative difference in investor decision making.

We already discussed the three forms of foreign direct investment. *Resource-seeking investment* follows resources, such as oil or minerals. Firms in this sector have little choice as to what kind of regime or part of the globe they prefer. *Market-seeking investment* goes where the markets for its products are. Investors in this sector are freer than resource-related firms to choose locations for their investment as they weigh benefits of a large market with pitfalls of investing there. The size of a market can outweigh other considerations, like cost and sub-optimal business conditions. The high labor cost and corporate tax rates in the United States, for example, have not prevented the United States from being the world's top investment destination. In the case of China, even if only one in four Chinese belong to the middle class and can afford modern consumer products, that creates a market approximately the size of that of the United States. The decision-making dynamics for investors in such a situation are qualitatively different than in a location where the local market is extremely small and the only criterion is business climate for export processing.

Finally, *efficiency-seeking investment* searches the globe for the best conditions. It is this form of investment that is associated with the bulk of the critique of international investment regimes. It has been argued that poor countries with little market power must offer good conditions, which is said to include low wages and minimal regulations, or lose the foreign investment to competitors willing to offer international capital a better deal. This is why only efficiency-seeking investment is a good gauge for business climate. Investors pick a location from a long list based on the benefits and ease of doing business there, unencumbered by considerations of domestic market size or local resource base.

Both China and Vietnam attract a large amount of efficiency-seeking international investment. Export manufacturing falls in this category. But in the case of China, the huge domestic market is always a second consideration for any investor. This is an advantage that Vietnam cannot bring to the table. The emerging Chinese market with a middle class as large as the population of the entire United States adds to the calculations as much as the large clusters of manufacturers already in China, many of whom are there of the “too big to ignore” argument. Vietnam cannot bring this scale and scope argument to the negotiating table. Hence, Vietnam depends more immediately on cost and business climate than its continent-size neighbor. To study rent seeking – not attractiveness to foreign investment more generally – Vietnam represents a case distinct from, and arguably better than, China’s.

A second distinction between China’s and Vietnam’s reform model is the level of central government control over the reform process. Vietnam decided to follow China’s model of local experimentation under central guidance, but in the case of Vietnam, the center lost control of the process and ended up with local policies that were no longer fully subject to Ha Noi’s supervision. As a result, a slogan one can hear in Vietnam when talking about economic performance is "too much competition, not enough coordination." In China, that coordination capacity was never lost, and at times enforced very rigidly by a center that wanted to show just how much it remained in control.

A new biography of the architect of reform, Deng Xiaoping, lays out in detail how Deng wanted local officials to experiment and meet local conditions. But with various factions in Beijing always vying for influence, local leaders continuously had to read the tea leaves as to which side to bandwagon with. Local leaders who went too far in their experimentation, or followed the losing faction, were regularly summoned to Beijing to undergo self-criticism and on occasion were removed. The Central Committee for Discipline Inspection never lost its bite and remained an effective enforcer of central orthodoxy (Vogel 2011).

Another example of Beijing's continued control over the reform process is the limitation of reforms to some designated coastal provinces. Even when inland provinces openly demanded their right to start special enterprise zones as well, Beijing refused. Powerful Shanghai entered the special-enterprise-zone game late because Beijing feared that this financial hub in relatively close proximity to Beijing could cause "spiritual pollution" (Vogel 2011: 402). In Vietnam, by contrast, local leaders in Ho Chi Minh City and adjacent provinces used the privileges that Ha Noi granted them to forge ahead, often in clear violation of central rule. Similar to China, Vietnam prohibited licensing of foreign investment by local officials – in Vietnam, they did it anyway. The more economically successful a province was, the more often and brazenly it engaged in fence breaking (Malesky 2004a). Vietnamese leaders were promoted to central positions of power after – and because of – their success in the province; in China, the center used the nomenklatura system of appointments to stay in control (Turley and Womack 1999).[31] No Chinese province challenged Beijing's decrees openly – Vogel's book lays out in great detail that the main concern for provincial leaders was to support one faction without angering the other too much. It took Deng's famous Southern Tour to break the resistance of the conservatives and allow Shanghai to join the ranks of the provinces with special economic privileges. In spite of their economic power, Shanghai's leaders could not go it alone.

In another piece of evidence, the post- Deng leadership under President Jiang Zemin and Premier Zhu Rongji engaged in a campaign to re-centralize Guangdong. Zhu wanted to reign in Guangdong but felt that the economic success of Guangdong had become admired too widely to reverse Deng's economic policies completely. Instead, beginning in 1998, he planted central institutions in the province to increase Beijing's control and to bind Guangdong to Beijing (Zheng 2007).

In summary, Vietnam tried to emulate China's model, but lost control over the process much more thoroughly. Entrepreneurial local officials in both China and Vietnam were allowed to experiment, but while those in Vietnam rapidly engaged in fence breaking and moved beyond the boundaries the center had set for them, Beijing continued to control the process. Ha Noi also reins them in when they are not successful in their policies, but pragmatically accepts fence breaking where it leads to greater

[31] This point is explained in greater detail in Section 4.3.2.

central revenue. In China, by contrast, local officials must always look toward Beijing and make sure that their preferred policies are acceptable to the dominant group. The reason for this difference may be the different fiscal arrangements. While Ha Noi benefitted from provincial success, fiscal decentralization in China did not initially lead to more tax revenue for the center and caused severe fiscal problems. Vietnam may have learned from China in this regard and structured its fiscal arrangements differently in response. Regardless of the reasons for the variance in process, however, the level of local authority and push-back from the center represents a qualitative difference between the Chinese and Vietnamese model.

The third difference of importance to a study of rent seeking and an argument associated with interest group contestation is migration policy. Freedom to migrate, as is the main argument in the present study, is essential in giving labor the extra margin of bargaining power that we argue – with Tilly and the federalist thinkers – makes the difference. Only where workers can credibly threaten to exercise an exit option and remove themselves from excessively predatory elites will they have a seat at the bargaining table. Where elites can coerce them to move or stay put, as it serves the elite interest, political and economic elites maintain an insurmountable advantage in bargaining power.

Both China and Vietnam started out with a very similar system of household registration, and both systems crumbled when emerging industries needed increased labor concentration in a few industrially advanced areas. Yet it appears that China maintained more of its controls, not to prevent migration, but specifically to keep migrant workers in a legal limbo that reduces their bargaining power. In Vietnam, many migrants remain unregistered at their place of work. Lack of status is an inconvenience accompanied by reduced access to government services, but where a worker obtains housing and health insurance from an employer and is young and childless so that public education privileges are not an issue, it has relatively little bearing on people's lives. In China, by contrast, absence of registration makes a person officially an illegal resident. Such a situation makes it much harder to raise demands or bring formal complaints. And when authorities feel migrants are getting in the way, they can be very obvious and brutal in showing them the limits of their extra-legal existence. In a recent example, Beijing authorities bulldozed schools built by private initiative for the children of illegal migrants who cannot attend public institutions (New York Times 2011).

The message is clear. China experiences the biggest human migration every year when migrant workers return to their home villages for Chinese New Year – a floating population estimated to reach 150 million people (Naughton 2007: 129). They are needed, but when the elite interests need them out of the way, they can use the law to move them. This difference in status – and consequently in bargaining power – represents a difference between China and Vietnam, especially in context of the contestation argument made in this study.

Naughton (2007: 134) points out that with worker shortages in the most industrialized areas on the increase, attitudes are changing. A so-called sunshine policy in which migrants can apply for job training and obtain information on living conditions at popular destinations can be obtained without fear of being persecuted. Yet this policy was only instituted in 2003, many years into the Chinese reforms. In Vietnam, migration of industrial workers (unlike peddlers or unofficial workers, who have been seen as causes of social ills in Vietnam as well) has been liberalized much earlier in the reforms, thus changing the nature of power relations and bargaining much earlier in the game. Plus, as the destruction of schools for migrants shows, even China's sunshine policy is not yet cloud-free.

None of this is to argue that China's reforms are not the model for Vietnam's. But Vietnam is smaller in size and its population is more widely interspersed. Every Vietnamese family has relatives in other parts of the country, and it would be very difficult for the authorities to restrict movement severely. In addition, Vogel has pointed out in his exhaustive biography of Deng Xiaoping and his era, recent history matters. He reminds us that most Chinese know about the heavy hand of the government during campaigns such as the Cultural Revolution or the Great Leap Forward – or heard about it from their parents. This capriciousness associated with millions of deaths has left an indelible mark in people's minds and made people cautious in their dealings with Beijing. In Vietnam, there was a war, which the Party is widely credited with winning. Then there was poverty followed by reform. The Party has worked hard to take credit for the benefits of reform. Vietnam's post-war history does not include episodes of extreme government violence against its citizens (with the exception of re-education of followers of the southern regime immediately after the war). On the contrary, the government is known to have backed down when enough people stood up against it, for example during moments of organized, local opposition against agricultural collectivization in the south. There seems to be less fear among local leaders and ordinary Vietnamese alike that Ha Noi will crack down hard over instances of minor disobedience. These differences push the reforms that started with China's blueprint in mind on a somewhat different path, and make Vietnam a case study in its own right.

4.4. Decreeing Change – *Doi Moi*

It should be clear by now why the Vietnamese government felt a need for reforming its economic policies. Its own legitimacy was at stake, and with it its continued claim to power. In addition to the fear of losing power, Vietnamese leaders, raised in a group-oriented culture where losing face is a serious sanction, genuinely wanted to fulfill their promises. This is evidenced by secret fence breaking. When done in secret, such behavior brings with it all the risks of disobedience, but no benefit. A secret policy rarely leads to promotion, but if found out may cause punishment. Improvements in the local economy can lead to improved rent-seeking opportunities, but while officials at all levels certainly did better than regular people, they did not amass the riches of their African or Latin American counterparts. With power comes the desire for rent, but in the Vietnamese context, rent was a mix between material benefits and recognition for the service performed. The Confucian ethos is based on a grander morale of legitimacy and the Mandate of Heaven, in which any man of higher class must constantly prove his worthiness through proper acts (Mote 1999). The result of this dance between doing well for oneself and right by the people was *doi moi*, a reform that aimed at retaining legitimacy by improving the living standards of all Vietnamese, but within clear limitations: the supremacy of the Party was untouchable. All policies had to maintain, or better still, strengthen the Party's hold on power. Success was to justify the Party's vanguard position in society; failure had to be deflected and attributed elsewhere.

These parameters of *doi moi* are reminiscent of the developmental state model of the early East Asian economic miracle economies, where rent seeking was held in check by fear of imminent overthrow of the regime.[32] Taiwan's and South Korea's regimes feared invasion and determined that only economic success would bind their citizens together strongly enough to meet the geopolitical challenges (Wade 1990; Putzel 2002). In Japan, there was no imminent threat of invasion, but after the disastrous Second World War, the ruling elite had to explain why it should continue to rule. In all cases, the ruling elite could implore its officials and supporters to sacrifice for the greater good in the name of their own survival. Close alignment of socially and individually optimal policies is more likely under such conditions.

4.4.1. Leading up to doi moi *– the post-unification years*

Prior to the reforms, Vietnam was a tightly controlled society. Not only did the government centrally decide a five-year plan, it also tied production and consumption to the local level. Basic food and items of daily need were distributed in a ration system. Ration cards were handed out by the local authorities and were valid only in the jurisdiction where a person was registered. Even after food shortages forced the

32 There are a number of other factors and commonalities, which are of no importance to this study. Here we focus on the issue of rent seeking and contributing variables. We will return to the developmental state model briefly in the conclusion (Chapter 10).

government to allow household farms to produce and sell food in competition with the collective farms, they were still forbidden to transport them beyond local jurisdictions. Only the government could engage in trade beyond the local level. Checkpoints were erected between jurisdictions to prevent all unauthorized, private trade. This limited the market in which peasants could sell their produce at a market price and reduced the incentive to produce more and hurt especially the people in the places where food was scarcest, the urban areas, where little food was produced locally for sale at market prices (Que 1998: 28).

Agricultural goods were sold under a complex multi-pricing system that did not provide an incentive for increased quantity or improved quality. To fulfill local needs (predetermined by the amount of ration cards issued in a district), local food production was sold at a subsidized rate locally first. Surplus production beyond local needs was sold at a "distribution price." On top of that, the government guaranteed a "mandatory price" for all farm output. To make matters worse, the size of a jurisdiction within which a peasant could sell at a market rate, bypassing the much lower government prices, was determined locally. In most cases, the local level was the district, but in some cases the much smaller communes were the limit.[33] Household farms were allowed to make investments to raise output or improve quality, but given the market limitations, they rarely did (Que 1998: 38).

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33 Districts are very small units. Their number is constantly changing, but according to the General Statistics Office, there were 556 districts on December 31, 2009. Because of their small size, they are either urban or rural, and either surplus food producers or food deficient. Allowing trade within a district but not among districts does little to ameliorate food security. The government with its monopoly over food trade among districts thus retained its control over people's basic needs provision and consequently over their lives. Where trade is limited to the commune level, the situation gets even worse. At the end of 2009, Vietnam had 9,121 communes (GSO 2009).

Table 4.1. Per-capita income in Vietnam as % of incomes of selected countries, 1950-98

	1950	1960	1970	1975	1980	1985	1990	1995	1998
Thailand	80.5	74.1	43.4	36.2	29.7	30.4	22.4	21.2	27.0
South Korea	85.5	72.3	37.6	22.5	18.4	16.4	11.9	11.8	13.8
Philippines	61.5	54.2	41.7	35.0	32.0	47.3	47.3	64.2	73.9
Malaysia	42.2	52.2	35.4	26.8	20.7	22.3	20.3	20.2	23.6
Indonesia	78.3	78.4	61.6	47.2	40.5	47.1	41.3	42.1	54.6
China	149.9	118.7	93.9	81.2	71.0	61.0	56.0	52.9	52.8

Source: *Maddison, A.: The World Economy: A Millennial Perspective, OECD, Paris, 2001, in van Arkadie and Mallon 2003: 5.*

Collective agriculture had been implemented in the North during the war. With many young people mobilized for the war effort, the government brought individual farms under the common management of a communal farm enterprise with common input provision, specialized work units, dormitories and mess halls. Economies of scale and scope were supposed to compensate for the absence of many young – and most young male – workers. This collectivist arrangement represented a clean break with a millennia-old tradition of small-scale farming. While families in the North understood the demands of the war effort and resistance to collectivization was minor, the unpopular collective living and working arrangements rapidly led to a steep decline in productivity. But even in the seemingly successful collectivization model in the North, closer analysis shows the shortcomings: the 5% of land that families could retain for personal cultivation produced between 30 and 60% of farmers' incomes (Phong 2004: 41). After unification, southern peasants frequently refused collectivization and it never reached the levels seen in the North. By the mid-1980s, Vietnam depended on Soviet food aid. With conflict over land use and resistance to attempts to collectivize raging, even the rice basket in the southern Mekong Delta region did not export rice to the rest of the country. Socialist allies provided annual aid of 500,000 tons of fertilizer vital to agricultural production. Vietnam also received two million tons of fuel, one million tons of iron and 200,000 tons of cotton worth $1 billion[34] per year (Phong 2004: 21-5).

Table 4.2. Land area and population density of Southeast East Asian countries

Country	Area 1,000 sq.km	Density (pop/sq.km1987-92)	Country	Area 1,000 sq.km	Density (pop/sq.km1987-92)
Brunei	5.77	45.9	Philippines	300.00	209.6
Cambodia	181.04	48.8	Singapore	0.62	4,456.5
Indonesia	1,904.57	95.2	Thailand	513.12	111.4
Laos	236.80	18.0	Vietnam	331.69	204.3
Malaysia	329.75	55.1	East Asia total	16,367.18	101.8
Myanmar	676.55	63.2			

Source: World Bank: Social Indicators of Development 1994

By the time the Party prepared for the Sixth Party Congress to be held in December of 1986, the economy was in free fall. Over 70% of the population were considered living in poverty by already low Vietnamese standards[35] (Dollar et al. 1998: xv). Vietnamese income per capita had steadily declined in comparison to most other Southeast Asian nations (see Table 4.1.). In spite of poverty, inflation reached 700% in 1986. Vietnam's exported of $500 million dollars faced import needs of $1.2 billion (van Arkadie and Mallon 2003: 67).

The government had to tackle two problems: food supplies and off-farm employment. The collective farming project had failed. Not only did collective farms not benefit from scope and scale, a 1979 study on the Red River Delta shows that the larger the cooperative, the lower productivity and income per member (Morley and Nishihara 1997: 74). Household farming had already shown to be a way forward on the issue of food production, but here as well change was needed. Vietnam has extremely

34 This aid was provided at socialist friendship prices. International market value of this aid was much higher.

35 Food poverty is defined as not being able to procure 2,100 calories per day. The lesser poverty level is one where daily food requirements are supplemented with a small basket of required goods (GSO 2000).

low per-capital arable land availability, 0.09 hectares per person. In comparison, India has 0.19 hectares, Thailand 0.3 (van Arkadie and Mallon 2003: 14). The old system of primogeniture – the oldest son taking over the farm while the family helps the younger sons to build another one on virgin lands – had come to an end. Dividing the already small farms up even further was not feasible. Vietnam faced a food crisis as well as a crisis of rural under-employment, which was exacerbated by the people's inability to migrate due to the household registration system. In order to obtain food and basic necessities, people had to stay put in districts where they had no opportunities.

4.4.2. The Sixth Party Congress, 1986

Although the problems that beset Vietnam's economy were obvious, a full reversal of economic policy was not possible as long as Le Duan was in charge. He was a 26-year veteran at the helm of the Communist Party and a personal comrade of the nation's founding father Ho Chi Minh. Le Duan's leadership represented a direct link to that part of the past that created the Party's legitimacy – the wars of independence and unification. Only after his death, the Party felt free to admit serious errors in its economic policies and to strengthen the hand of reformers. A southern reformer, Nguyen Van Linh, took over the leadership of the Party. For the first time, questions were raised not only about mistakes in implementation or party doctrine, but the doctrine itself was challenged (van Arkadie and Mallon 2003: 49). Members of the government were held accountable – 12 ministers were dismissed (Wescott 2006). No longer was the response to a problem tacitly to tolerate some localized experiment, but wholesale reforms were written into law instead. The government now officially recognized a multisectoral economy with a private and a state-owned branch, and foreign investment was welcome. Investment was given preferential treatment in the food, consumer items and export industries, while the focus on heavy industry was abandoned (Phong 2004: 36-7). This policy reflects the twin priorities emerging from the crisis, feeding the country and providing the many under-employed for whom no farmland is available with off-farm job opportunities.

Table 4.3. Major policy changes under *doi moi*

Wages paid on cash basis
Small private enterprises with up to 10 employees allowed
Abolition of internal customs check points
Decollectivization of agriculture
Elimination/reduction of subsidies and price controls
Creation of Export Processing Zones with for 100% foreign owned companies
Increased autonomy of managers in state-owned enterprises
Return of some nationalized businesses to previous owners
Foreign trading monopoly eliminated
Foreign banks allowed
Currency value determined by market rate
Export processing zones created

Source: Turley and Selden (1993)

Reforms began almost immediately in the agriculture sector. Peasants whose land had been collectivized were allowed to return to their household farm and produce for a food market instead of a collective farm or a state trading enterprise. Price controls were rapidly abolished and production rose quickly. Within a decade, Vietnam turned from famine conditions to one of the world's top agricultural exporters, with production primarily coming from small household plots. By 1997, the country was the world's second largest rice exporter (Jandl 1998: 15). Today, Vietnam is the world's number one exporter (in value and quantity) of pepper and cashews, number two in rice and coffee, number five in rubber and seafood, and number five in quantity (number eight in value) in tea (FAO 2011).

The second aim of the reforms was to boost Vietnam's non-farm output, beginning with basic manufacturing of domestic needs but also export processing for hard currency earnings and job creation. Foreign investment was encouraged early on. Not even a year after the Party had decreed change, the government passed a liberal foreign investment law. It foresaw no ceiling shareholding for foreign partners and permitted fully foreign-owned companies, granted tax holidays and unlimited profit repatriation (Beresford 2004: 64). Increasingly investor-friendly investment laws were passed in 1987, 1990, 1992, 1997 and 2000. A Unified Investment Law that puts domestic and foreign investment on equal footing capped the effort in 2005, making Vietnam World-Trade-Organization-ready. The government favored direct over portfolio investment, assuming that foreign ownership and involvement brings with it expertise, technology and foreign market access. State-owned enterprises were recognized as a major part of the problem, and needed to be shaken up by foreign competition, management and production methods. In 1989, 4,600 out of 12,000 state-owned enterprises lost money. They held 75% of the country's asset, but produced only 26% of gross domestic product and employed 30% of the labor force. The reformers therefore decided to reduce these firms' protection, open them up to foreign partners and dissolve 7,000 of them altogether (Rondinelli and Litvack. 1999: 21-2).

Industry reform took longer than agriculture. Vietnam had little experience with the industries the government wanted to focus on, and even the sector it had favored since unification, heavy industry, was doing badly. Expertise was needed, but potential investors first needed to be convinced to enter a desperately poor country like Vietnam. Investment began to enter the country in earnest in 1994, with investors first coming from Taiwan, followed by Southeast Asian countries. Once foreign firms arrived, progress was again rapid. Manufacturing surpassed agriculture as main contributor to gross domestic product in 1995, 30% to 28% (Bloomberg 1996). Starting with close to no foreign capital in 1986, Vietnam attracted $8.6 billion within a decade (World Bank 1997). By 2008, total committed foreign direct investment had reached $98 billion in 9,800 projects (Kieu 2008). Of these, 8,600 are operational (Chinanet 2008). Through tax incentives and preferred infrastructure provision, the government first tried to attract import substituting investment, quickly followed by export processing, and always with emphasis on job creation, human resource improvement and technology transfers (Mai 2004: 22). Export processing zones were an early incentive. Fourteen were built between *doi moi* and 1999 (Ibid: 43), now the Ministry of Trade and Industry lists over 100. The agricultural and industrial reforms which the Sixth Party Congress decided benefited from the absence of opposition.

Although conservatives remained a faction within the Party, they had been sidelined after their leader Le Duan's death by the abysmal economic situation. Provincial leaders had been in the forefront of the new policies, which were modeled after provincial fence breaking as well as authorized experiments in the provinces. The only losers were state-owned enterprises and their employees. Yet managers of these firms saw opportunities for rent creation in joint ventures. Since foreigners could not hold land-use rights, they had to partner with a domestic holder of such rights. State-owned firms had land-use rights for much more land than they needed and could exchange them for excessive leverage in joint ventures.

Table 4.4. Milestones of legal change in the business environment

Law	Passed (enactment generally the following year)
Law on Domestic Investment	Passed 1994 Amended 1998, 2005 (unified Enterprise Law)
Laws on Foreign Investment	Passed 1987 Amended 1990, 1992, 1997, 2000, 2005 (unified Enterprise Law)
Law on Investment	Passed 2005
Private Enterprise Laws	Passed 1990, 2000 Amended 1994, 2005 (unified Enterprise Law)
Enterprise Laws	Passed 1999, 2005 (unified Enterprise Law)
Law on Competition	Passed 2004
Civil Code	Passed 1995 Amended 2005
Law on Financial Institutions	Passed 1997
Law on Insurance Services	Passed 2000
Commercial Code	Passed 1997 Amended 2005
Bankruptcy Law	Passed 1993
Land Law	Passed 1987 Amended 1993, 2001, 2003
Labor Code	Passed 1994
Intellectual Property Law	Passed 2005
Environmental Protection Law	Passed 1993 Amended 2005

Source: Center for Investment and Planning (CIEM)

Workers, on the other hand, did lose their jobs, 1.5 million of them over five years after 1988 (Dollar and Litvack 1998: 12). Unlike other communist countries, however, most households were diversified and earned part of their incomes from the state, part from the market. In Ha Noi, a stronghold of the state economy, a survey in 1991 indicated that 60% of all households earned income from the private sector (Dollar 1999: 38). Across the country, it is estimated that up to 85% of employment comes from the farm and private sectors (Dollar and Litvack 1998: 9). Only 10% of the total workforce worked in state-owned enterprises at the time the Sixth Party Congress debated reforms, compared to 77% in Russia (Rondinelli and Litvack 1999: 3). The rapid growth of the private sector improved the lives of a number of people, especially since the public sector did not offer the most desirable jobs. Organized opposition to the reforms was minimal due to the combination of relatively low proportion of people working state sector and improved working conditions in an expanding private sector.

4.4.3. After reform

In the years following the Sixth Party Congress, Vietnam brought the food crisis under control rapidly. The strategy was simple: Vietnam is a peasant society with 80% of the population working the land (Morley and Nishihara 1997: 68). The government simply let people do what they and their families had done for generations by removing the communist collectivization policies that were supposed to displace the agriculture of old. In industry, opening the country to foreign investment was riskier. Vietnam had no history of industrialization, its heavy-industry emphasis under communism had not created economic growth, and it had never hosted foreign investment at a large scale. Moreover, with the United States still imposing an embargo since the end of the war, Vietnam's products were barred from the world's biggest market.

The first stage of *doi moi* foresaw import substitution. Foreign firms were invited into the country with special benefits in order to increase the availability of scarce products on the domestic market. The government intervened in the economy by picking focus industries and supporting and protecting them accordingly. On one hand, these policy interventions assured that foreign investment did not crowd out domestic firms in the early days of *doi moi*. On the other, it reduced the effectiveness of investment. In the first decade of *doi moi*, relatively little foreign capital went into industries in which Vietnam was deemed to have a comparative advantage. Only 20% of *licensed* capital went into the food, drink and tobacco sector, and 6.5% into the garment and textile sector. Raw materials and minerals received 3% and 6.6% of licensed foreign capital respectively, while 63.8% went into capital-intensive import substitution sectors. When investors had to open their wallets, however, they took a second look. It is common, especially in developing countries, that a large gap exists between committed and implemented investment. Over 50% of actually *implemented* foreign direct investment went into industries where Vietnam is expected to be strong – the labor intensive food, textile and resource extraction sectors (Mai 2004: 81-93). The government wasted resources pushing industries into sectors where, upon closer analysis, they did not obtain the best return on their capital.[36]

The second decade of *doi moi* is associated with a recognition of this inefficiency, after a number of initial investors left Vietnam in the early 1990s. The domestic market they had come to conquer as early entrants was growing rapidly, but from an extremely low base. In the late 1980s, average income was below $200 per person and year (see Table 4.5.). Even at near-double-digit growth rates, cars or household appliances were a long way off for the average Vietnamese household. In order to attract new investors, the government began to focus its incentives policies at

36 Where investors made their own choices, they did not always choose the expected sectors either. At the end of 1994, 29% of foreign direct investment was in real estate and another 18% in construction (Beresford 2004: 88). This real estate boom led directly to the bubble that deflated in 2007.

export processing, regardless of the industry (Mai 2004). (In the third decade of reforms, it gave special incentives to high-tech industries.) The most successful policy in attracting export processors was the cooperative creation of industrial parks and export processing zones. The center approves special tax and tariff regimes, provinces improve the business climate – sometimes through fence breaking, for example Binh Duong's support for migrant worker housing in the 1990s – and create master plans for infrastructure and human capital, and private investors build and manage the zones in coordination with the provincial Department of Planning and Industry, the provincial arms of the line ministry.

The data indicate strong economic growth, food production, trade and investment. Social indicators are also positive. The illiteracy rate declined steadily, and the poverty rate declined from 70% in 1986 (Dollar et al. 1998: xv) to 58% in 1993, 24% in 2000 (Luong 2006) and 19.5% in 2004 (Vietnam News Agency 2007). The Gini coefficient, which measures the concentration of wealth in a society, reveals that inequality has increased by only 0.011 points from a very low 0.269 in the Vietnam Living Standard Survey of 1993 to 0.28 in the next survey published in 1998 (de Brauw and Harigaya 2007). This level of inequality is significantly less than economic theory would assume in similar circumstances, especially with comparable levels of economic growth and consumption increases (Kuznets 1955). Two possible interpretations are possible: either the government's strong social policy interventions have managed to keep inequalities from rising rapidly, or the strong performance of the market economy in creating jobs has allowed more Vietnamese to participate in the formal economy and, paired with the tradition of high remittances, made many families better off.

Table 4.5. Indicators of economic development				
	6th Party Congress 1986	7th Party Congress 1991	8th Party Congress 1996	9th Party Congress 2001
Economic growth (%)	3.4	6.0	9.3	6.8
Illiteracy rate (%)	10.7	9.2	7.7	6.5
Income/cap ($)	180	228	339	410
Food grain production (kg/cap)	301	323	385	433
Budget surplus (% of GDP)	-6.2	-3.8	-0.7	-3.5
Budget revenue (% of GDP)	14.0	13.5	23.6	21.8
Gross dom. savings (% of GDP)	n.a.	13.2	16.7	24.0
Current account (% of GDP)	-2.7	-2.0	-11.1	1.5
Gross dom. invest. (% of GDP)	n.a.	15.1	27.9	26.1
FDI inflows ($ million)	--	229	1,838	1,200
ODA inflows ($ million)	147	229	939	1,700
Exports ($ million)	494	2,042	7,330	15,027
Imports ($ million)	1,121	2,1059	10,481	16,162
Trade (% of GDP)	25.1	63.7	100.0	n.a.
Source: Government Statistics Office, *Statistical Yearbook*, Statistical Publishing House, Ha Noi: various years. IMF, *Vietnam: Recent Economic Developments*, Washington: various years; in van Arkadie and Mallon 2003: 30				

The inefficient state-owned sector was expected to be the main loser in the shift to less government protection and the end to most subsidies. At the time of the Sixth Party Congress, more than one in three state firms lost money. The use of assets was highly inefficient, as they produced one quarter of national output with three quarters of the nation's assets. After *doi moi*, the predicted hardships occurred. Job losses in the state sector were severe, the state industry alone shed over 200,000 workers between 1989 and 1993. In the cooperative sector, the decline in employment was even more severe (Beresford 2004: 78). In 1999, outstanding debt from state-owned enterprises stood at $9 billion, one third of gross domestic product at the time. Yet the state sector did not dissolve; instead it grew in the first decade of *doi moi* (see Table 4.6.). A Joint Donor Report to the Vietnam Consultative Group found that in 2006, state-owned enterprises were profitable, although with a narrow profit margin compared to private industry. In 2006, the state held 46% of equitized companies, while employees held 30% and outside investors only 24% (Joint Donor Report 2006: 60-2). One factor for this discrepancy is the Vietnamese form of privatization called equitization, under which the state may retain a share of an equitized company. The definition of a state-owned company is no longer clear cut, making comparisons between different stages of reform difficult.

Table 4.6. Structural changes in the economy; 1986-2001 (% of GDP at current prices)						
	6th Congress 1986	7th Congress 1991	8th Congress 1996	9th Congress 2001	10th Congress 2006	2009 (prel.)
Agriculture	43.8	40.5	27.8	23.6	20.4	21.0
Industry, construction	25.7	23.8	29.7	37.8	41.5	40.2
Services	30.5	35.7	42.5	38.6	38.1	38.8
Total	100.0	100.0	100.0	100.0	100.00	100.00
State	33.1	33.2	40.0	38.6	37.4	35.1
Non-state	66.9	66.8	60.0	61.4	62.6	64.9
Foreign Invested (part of non-state above)	2000	2004	2005	2006	2007	2009
	13.3	15.1	16.0	17.0	18.0	18.3
Source: Government Statistics Office, *Statistical Yearbook*, Statistical Publishing House, Ha Noi: various years; 2009 data: General Statistics Office, *Statistical Handbook 2009*, Statistical Publishing House, Ha Noi 2009						

The private sector has progressively increased its importance in Vietnam's economy. In 2006, 200,000 private firms accounted for 33% of manufacturing value, 70% of non-oil exports and 65% of all manufacturing production. The foreign-invested sector accounts for 46% of non-oil exports (Joint Donor Report 2006: 72).

Table 4.7.a. Vietnam's total foreign trade as percent of GDP

Year	1986	1989	1992	1993	1994	1995	1996	1997	1998	1999	2000	2008
Total Trade	25%	50.9	51.9	53.9	63.6	65.5	74.7	77.4	76.9	80.5	100	167%

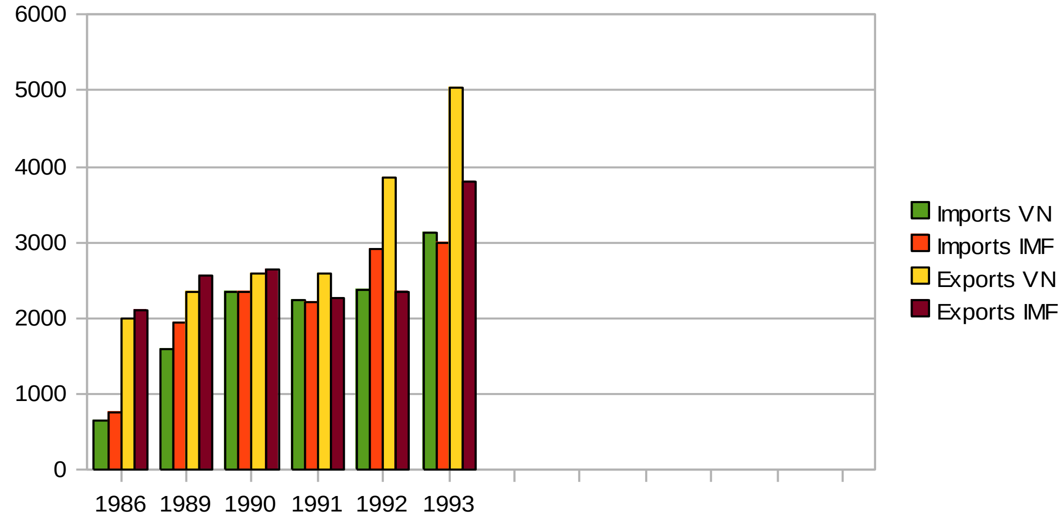
GSO. *Statistical Yearbook*. Hanoi: Statistical Publishing House, 2000; World Bank. *Preparing for Take-Off*. Oxford: Oxford UP, 1999.

Table 4.7.b. Trade/GDP ratio in comparison, 1986-2000 (select countries)			
Country	1986	2000	2008
Malaysia	105%	220%	206.6%
Thailand	50%	105%	151.5%
Vietnam	25%	100%	167.1%
China	25%	30%	68.5%
South Korea			85.7%
Hong Kong			406.6%
Singapore			444.9%
China			85.7%
India			48.4%
Taiwan			134.1%
United States			28.7%

Sources: 1986 and 2002 data: World Development Indicators, World Bank 2002;
2008 data: WTO
http://stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Language=F&Country =VN
(accessed April 8, 2010)

Meanwhile, the rapid success of export processing in export processing zones and industrial parks has turned Vietnam into one of the most trade-open economies in the world. According to the WTO (see Table 4.7.a. and b.), two-way trade accounts for 160% of gross domestic product, more than four times India's ratio and twice China's. In the four years immediately after *doi moi*, exports jumped 3.5 times (Ebashi 1997). When the United Nations Conference on Trade and Development asked multinationals where they planned to invest in 2007 and 2008, Vietnam was placed in the sixth spot, the only Southeast Asian country in the top ten (UNCTAD 2007; Economist.com 2008). The cause can be found in the decision to favor labor-intensive light manufacturing investment in order to absorb surplus labor from the countryside.

Figure 4.1. Trade figures post-*doi moi,* by IMF and government of Vietnam



Initial import-substituting investments were not profitable enough for foreign investors, due largely to the poverty in Vietnam that limited the market for virtually all goods above the level of basic necessities (which were often produced in subsistence households). These manufacturers early on demanded favorable conditions for exporting their production. Vietnam never emerged as a location for market-seeking manufacturing investment,[37] but due to its proximity to the Asian miracle economies, its low labor costs, a willing and relatively well educated work force and the perception of political stability became a location for efficiency-seeking foreign companies.

The major regional export powers, Taiwan, South Korea, Singapore and Japan, were the first to follow the call of the Sixth Party Congress to invest in Vietnam. Their decision to do so is consistent with their interest in a cost-competitive international market and the flying geese model, in which an economic leader outsources low-end production to a second-tier country to focus on a higher-end product, thus letting

37 Foreign investment in real estate is one sector where market seeking was substantial. Investors fill (and by now probably overfill) a need for high-end housing, quality hotels and office space.

industrialization trickle down a newly developing supply chain (see below Section 4.5.). Nonetheless, Vietnam was a high-risk proposition. Why did companies from these countries take an early plunge? The next section responds to that question.

4.5. Location Vietnam: Explaining the High-Risk Choices of Early Investors

Foreign investment around the world occurs under a broad range of conditions. Investors have learned to accept adverse conditions when they seek resources, extracting a risk premium for their efforts. In the case of efficiency-seeking investment, however, investors have a broad range of options. Most importantly, they want to know the rules of the game and that the goalposts will not be moved over the course of the investment. This demand requires assurances of elite self-limitation. Vietnam has developed a system of checks on arbitrary elite action in its reform period. Investors who enter the country today have a good understanding what risks they incur, and how they can be mitigated. Much of this self-limiting incentive structure is based on foreign investors and the benefits they bring the elites. The question remains, however, why did the first investors take the plunge, when prior to their high-risk venture, Vietnam had no experience with self-limiting government, no tradition of rule of law and no history of checks and balances on a strong state, and a record of isolationism and limited international trade integration. In other words, if investment begets more investment by giving political elites an incentive to keep it coming once they have tasted its fruits, what begot the first round? If more investment and better business conditions form a virtuous circle, where and how does such a circle begin?

Van Arkadie and Mallon (2003: 213) find the flying geese model in Vietnam's investment patterns. This model is typically associated with East Asia and explains the pattern of passing production processes for which a local economy is becoming too expensive down to a nearby cheaper economy. That way, the more developed country can stay price-competitive, thanks to low-cost inputs imported from the next tier of producers. In Asia, Japan led the flock, followed by Singapore, Hong Kong, South Korea and Taiwan. As the second-tier economies grew and labor cost increased, they had to outsource the low end of their production chain. Indonesia, Malaysia, Thailand and the Philippines jumped into the breach, followed by China and Vietnam. Based on this model, Vietnam's foreign investors are expected to be first-to-third-tier geese, and indeed, Japan (first tier), Taiwan, South Korea and Singapore (second), and Malaysia and Thailand (third) are among the major investors in Vietnam.

Taiwan has been Vietnam's number one investor since the early stages of *doi moi*. Ebashi asserts that this can be explained by four factors: traditional cultural affinity, existence of a Chinese minority and language skills in Vietnam, geographical proximity useful for as-needed inputs into the production chain and the existence of industries that are suitable for transfer to Vietnam (Ebashi 1997: 52). Another factor, one that Ebashi misses, is the fact that at the time Taiwan started looking for another goose in the formation, the latest export manufacturing hub, China, was closed to Taiwanese firms. This peculiarity of Taiwan's situation explains why Japan and other first- second-tier geese with the same interest as Taiwan – to move low-end production into another cheap production location as Malaysia and Thailand are getting more expensive – are moving into Vietnam with a slight delay and less concentrated than

Taiwanese industry. For Japan, South Korea and Singapore, China was an alternative with a bigger domestic market to justify the risks. Taiwan moves into Vietnam in order to avoid being left out and losing international competitiveness.

In addition to cultural affinity, the East Asian developmental state model has given Taiwan, South Korea and Singapore confidence if not in the Vietnamese government, then in the development model which the Sixth Party Congress has endorsed. The developmental states had gone through a similar period of state-led, growth-based economic reform in order to assure regime survival. They understood the Vietnamese elite's prerogatives and placed sufficient confidence in their ability to navigate the system to take the plunge. The Vietnamese narrative was – just like the Taiwanese had been in the 1950s and 60s – the need to succeed for the sake of regime survival. Taiwanese managers understood the mindset and believed it gave them an opportunity to predict problems and manipulate officials.[38]

Another factor for early East Asian investment was government support. The East Asian business model is characterized by close cooperation between state and businesses. Companies regularly discuss business strategies with government agencies and even cooperate with them on business deals. When Vietnamese officials look for more investment from Japan, South Korea or Taiwan, a government delegation goes to

38 Taiwanese businesspeople are also known as high risk takers. A consultant whose job it is to act as a first point of contact for potential investors in Vietnam told the author that Chinese (including Taiwanese) companies always send people with sole decision-making authority. When they like what they see, they sign on the spot. Japanese firms send managers who have to return and discuss with their superiors, and often lose out on deals to their quicker, more risk-taking and decision-making authorized Chinese competitors. Westerners, the official said, engage in endless studies and discussions and would never be able to succeed in Asia's inter-personal, fast-paced business environment, were it not for their deep pockets and the desire of Asian businesses to access the Western markets through Western partners.

meet Japanese government officials to discuss. The respective governments then issue a statement of support, and investment gains an aura of official bilateral relations. Japan pushed companies to go offshore to reduce its politically damaging trade surplus, with Vietnam as a beneficiary. Singapore financed industrial parks in developing countries, just to make Singaporean companies take the plunge and go offshore. Vietnam-Singapore Industrial Park, known as VSIP, with three large parks is one government-to-government venture serving private firms with official government backing (Phu 2007).

Table 4.8. Foreign investment by country (through October 2004)

Country	Number of Projects	Capital Licensed ($ mio)	Capital Committed ($ mio)
Japan	476	5,088	4,110
Singapore	329	7,921	3,228
South Korea	811	4,675	2,867
Taiwan	1230	7,165	2,787
Netherlands	52	1,790	1,966
Hong Kong	316	3,133	1,893
British Virgin Islands	210	2,364	1,129
France	140	2,158	1,052
Malaysia	160	1,273	800
United States	207	1,253	719

Source: Ministry of Planning and Investment

Note: Due to embargo, many U.S. investments entered Vietnam through third country affiliates, including South Korea, Japan and Taiwan, or through tax havens like the British Virgin Islands. This table uses early data to illustrate the point about early entrants.

Lastly, Vietnam is the first developing country that has its main trade and aid partners guiding it through reforms not in the West, but from East Asia. As the *Economist* wrote in 1995,

> Because America lifted its embargo on trade only recently, Vietnam is the first economy to reach the point of take-off without help from the West. Most of its investment comes from Taiwan, Japan and Hong Kong, not from America or Europe. ... Japan is going to advise the Vietnamese what kind of economy they should have: what should go into their next five-year plan, how they should design their industrial policy and their financial system. ... The Japanese reckon that their experience of planned, copy-cat industrialization may hold more lessons for other late-comers, such as Vietnam, than the models of America and Europe, which experienced

> unplanned development because they industrialized before anybody else (Economist 1995: 33).

Since the early investors in Vietnam come from the same tradition and learned the same lessons, they felt confident about Vietnam. Where Western investors saw high risk and a communist government, Taiwanese saw a later version of their own development model, elites that made very similar rational calculations on their best interest and development cooperation on the government level that mitigated the risk of a radical reversal in Ha Noi.

Once the early investment trailblazers were in place, the incentive structures for the elite changed, self-limitation became the rational thing to do and investment policy was set on a path that instilled confidence in more investors through a mechanism in which investment begets investment through push and pull forces, and success reinforces the system that has created success. That mechanism will be the subject of analysis in the next chapters.

CHAPTER 5: VIETNAM'S DECENTRALIZATION POLICY – FDI AND PROVINCIAL GOVERNANCE

In this chapter, we are testing the first assumption formulated in Chapter 3, which holds that elites exhibit self-restraint with regards to rent seeking when they see it in their interest to attract exogenous benefits – benefits from outside their sphere of coercive power – over skimming off as much as they can in the short run. Elite self-restraint (reduced rent seeking) translates into good governance, which is operationalized in this chapter. After operationalizing the variable, the chapter tests whether the assumption holds that good governance and foreign investment levels are correlated.

The underlying theoretical assumption for Assumption 1 is found in Mancur Olson's famous dictum about roving and stationary bandits. If elites make the decision that they are better served by getting a smaller piece of a larger pie in perpetuity rather than a large chunk of a smaller one for a short while, they turn, in Olson's terms, from roving into stationary bandits (Olson 1993: 567). If the bandit robs and runs, s/he takes what s/he can at once. If the bandit stays put and needs to rob the same person again, s/he will leave enough behind each time to assure that the victims can survive and reconstitute their wealth. Stationary bandits have an interest in the overall benefit of the economy from which they prey, or seek rents.

The outcome of the bandit's actions do not affect the bandit alone, however. The victims make their own calculations. They can invest in defense or in removing the bandit from power, exercise what is called *voice* in political science. Alternatively, they can remove themselves from the reach of the bandit. This *exit* option[39] requires a better place to move to – a state or province where predation is less pronounced. Such a government would be in a contest for citizens' loyalties with the more predatory neighbor. The impact of political and economic contestation was discussed in Chapter 2. In review, the argument is that the need to compete with other, nearby elites reduces the power of each group to engage in excessive rent seeking. An excessively predatory or oppressive elite would have to fear that its citizens, taxpayers, workers and entrepreneurs pick up and leave. As decision-making authority shifts downward from central to provincial elites as a result of economic reforms, provincial elites now need to compete with each other. This offers exit options and, as a consequence, an increase in bargaining power[40] to non-elite groups.

The Vietnamese scenario is a good case to test this assumption for two reasons. First, Vietnam's constitution permits all citizens to reside and work anywhere in the country – no fences and walls are possible. [41] Provincial elites cannot prohibit their residents from seeking better job opportunities, better social services or lower cost of living or taxes. Entrepreneurs are free to invest where they expect a higher return, better government support for their business or simply less harassment. Local elites must make sure that their pastures are at least as green as the neighbors' or else they will lose

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39 See discussion of 'voice' and 'exit' in Litvak et al. (1998) in Chapter 2.

40 Bargaining power is defined as the relative ability of parties in an explicit or implicit negotiating relationship to exert influence over each other's behavior. The term has been applied to any form of negotiations, including labor relations and diplomacy, in the implicit negotiations among levels of government, and in game theory.

41 Some regimes have erected walls and fences against such a possibility. As discussed, Vietnam tried only locally redeemable ration cards and prohibited inter-district trade. The problem with this method is that oppression is an expensive way of assuring compliance, and does not generally help grow the pie. Even if repression works, the amount of rent that can be extracted remains limited.

capital and residents. Second, Vietnam cannot only be compared vertically to other economic systems where such factor mobility does not exist, but also horizontally, across time. Until the *doi moi* reforms, mobility was highly restrained by the ration card system that required people to obtain their daily necessities within their district or commune of residence.[42]

Since the decentralizing reforms, provincial elites have gained broad leeway to regulate their business environment independently, and significant differences among provinces have arisen. Competition among provinces has intensified with the *de facto* and subsequently *de jure* decentralization of economic decision making. Provinces can now attract investment with clear legal rules, reducing the fear that reform policies are overturned by the center or that the leaders may be punished for fence breaking. This increased responsibility for provincial officials means that business climate depends more and more on the quality of local governance, and foreign investors interact with provincial officials for most of their official interactions. In this chapter, we test whether the political logic in Assumption 1 holds for Vietnam.

Assumption 1 assumes that competition for foreign direct investment, a benefit the provincial elite cannot command but must attract, creates a harmony of interest between investors and provincial elites. Investors provide political and economic benefits to political elites. They give the elites the legitimacy they crave by providing

[42] In addition, Vietnam's geography is not conducive to restraining mobility except through extreme measures as those prior to doi moi. Vietnam has two economic growth poles, one in the north and one in the south. (A third one in the center is emerging.) Almost the entire country lies along one long north-south train line. Migration is easy and cheap, and the uprooting of parts of the population during the various wars – French and American – has led to a situation where most families have some distant relatives near one of the development poles, creating a go-to migration network.

material improvements to residents through jobs and salaries. As the elite gets more secure in its hold on power, it has a longer time horizon in seeking economic rents, which are also becoming more plentiful as the economy grows and surpluses for business and workers increase. In return, political elites assure a good business climate, low interference, low predation and active support to assure that capital comes to the province, stays and expands. On their end, entrepreneurs spread the word about the positive conditions in the province where they are active and keep the investment wheel spinning.

The relationship is fully mutual. Political elites cannot reverse course lest they want to lose their reputation and with it future sources of both political legitimacy and rent. Businesses cannot abuse their position either. If businesses were demanding too much, by pushing for excessively low wages, labor protection laws or social regulations (which are funded through taxes and therefore ultimately paid by business), workers would object and the *legitimating effect of high investment* would dwindle. The harmony of interests prevails only as long as each side offers the other what it needs – a good enough business climate with reasonably low wages and regulations to allow business to be profitable, and a good enough political climate with reasonably high wages and protective regulations to make workers feel that they get what they want from the bargain as well. This chapter lays out the variables used for testing Assumption 1: foreign direct investment and low levels of rent seeking (with good governance as a measure for low rent seeking). It concludes by analyzing the evidence.

5.1. Variables

To test Assumption 1, which says that rent seeking is less pronounced where elites try to attract economic benefits they cannot coerce, the focus is on two variables, foreign direct investment and rent seeking. This section discusses the choice and operationalization of these variables. While foreign direct investment is a number that can be drawn from government and donor agency statistics, the level of rent seeking that prevails in a location at a given time must be drawn out of a variety of other data. Rent seeking, as used in the context of this study, is one side of a continuum of good economic governance. Ideally, an economy would function without monopoly rent seeking. At its worst, it is a rentier economy where rent seeking dominates the political economy. Hence, the higher the level of rent seeking, the worse the economic climate. Businesses and workers suffer from excessive intervention by rentiers.[43]

To operationalize rent seeking, we look at good business governance. Where business governance is better, rent seeking is lower. Rent seeking, then, is measured through its effects on business climate. We use the *Provincial Competitiveness Index* (PCI), an annual evaluation of economic governance established in cooperation between the Vietnam Chamber of Commerce and Industry (a think tank linked to the government) and the United States Agency of International Development, as the most widely recognized and often cited measure of economic governance on the provincial level. Since the PCI engages with the business community, it represents a perceptional

[43] The rentier class generally refers to coercive elites. In Assumption 4, we discuss the possibility of a collusion between coercive and commercial elite, to test the race-to-the-bottom hypothesis. For Assumption 4, dominant business elites would also qualify as part of the rentier class.

measure of governance in addition to applying statistical measurements of criteria for good governance.

5.1.1. Foreign direct investment

Statistics on foreign investment in Vietnam are available and disaggregated at the province level. The choice of *foreign* direct investment needs further explanation. A case could be made to use all investment, both foreign and domestic, in a province, since business-friendly climate attracts Nike as well as Bitis, the major Vietnamese shoe maker. Both indeed have factories in Ho Chi Minh City and surrounding provinces. But domestic investment has fewer options. Few Vietnamese companies have the ability to invest abroad, and many cannot compete with foreign investors for the best (and most expensive) pieces of real estate in the top-ranked industrial parks. Some are equitized state-owned firms (partly privatized firms in which the state retains a share) that have inherited their land from the pre-reform custom of governmental land allocation and are bound to that location as a result. Even when companies are not bound to their location by ownership structure, swapping land in a province with very low land value for a plot in an industrial park in Binh Duong is a financial challenge that only the most successful domestic firms can handle. Although some domestic firms choose their location by the same criteria as foreign investors, aggregated data on domestic investment would not allow distinguishing between those independent, successful firms, and the many that make location decisions based on different criteria less connected with business climate, and more with pre-existing conditions and financial limitations.

Foreign firms, by contrast, choose Vietnam first and the province second, among a limitless number of possible locations around the globe.

Table 5.1. FDI projects, number and licensed capital, 1988-2008, 2008

	1988-2008			2008		
Province	# of projects	$mio registered	mio$/project	# of projects	$mio registered	mio$/project
Total Vietnam	10981	163607.2	14.9	1171	64011	54.7
Red River Delta	2790	33627.1	14.9	382	5336	14.0
Ha Noi	1498	20228.2	12.1	218	3151	14.5
Vinh Phuc	182	2215.2	12.2	18	154	8.6
Bac Ninh	133	1933.2	14.5	31	984	31.7
Quang Ninh	158	1743.4	11.0	11	181	16.5
Hai Duong	220	2325.5	10.6	40	367	9.2
Hai Phong	352	3499	9.9	31	311	10.0
Hung Yen	147	729.2	5.0	24	97	4.0
Thai Binh	24	95.1	4.0	n.a.	n.a.	n.a.
Ha Nam	30	203.3	6.8	2	30	15.0
Nam Dinh	24	119.9	5.0	3	22	7.3
Ninh Binh	22	535.1	24.3	4	39	9.8
North. Mountains	325	1823.1	5.6	25	217	8.7
Ha Giang	7	20.4	2.9	n.a.	n.a.	n.a.
Cao Bang	13	25.2	1.9	1	4	4.0
Bac Kan	7	19.4	2.8	0	0	n.a.
Tuyen Quang	5	75.8	15.2	1	20	20.0
Lao Cai	51	322.9	6.3	3	11	3.7
Yen Bai	17	36.8	2.2	1	3	3.0
Thai Nguyen	25	321.2	12.9	n.a.	n.a.	n.a.
Lang Son	49	139.7	2.9	2	31	15.5
Bac Giang	59	282.2	4.8	11	66	6.0
Phu Tho	48	343.7	7.2	n.a.	n.a.	n.a.
Dien Bien	1	0.1	0.1	0	0	n.a.
Lai Chau	4	16.7	4.2	0	0	n.a.
Son La	9	114.5	12.7	n.a.	68	n.a.
Hoa Binh	30	104.6	3.5	6	13	2.2
Central Coast	690	43886.8	63.6	51	32957	646.2
Thanh Hoa	42	6992.9	166.5	5	6211	1242.2
Nghe An	26	335.1	13.7	0	0	n.a.
Ha Tinh	14	7940.8	567.2	1	7870	7870.0
Quang Binh	6	34.7	5.8	n.a.	n.a.	n.a.
Quang Tri	15	67.5	4.5	n.a.	n.a.	n.a.
Thua Thien-Hue	60	1900	31.7	12	1096	91.3
Da Nang	165	3080.3	18.7	17	602	35.4
Quang Nam	57	766.8	13.5	n.a.	n.a.	n.a.
Quang Ngai	22	4651.9	211.5	1	2460	2460.0
Binh Dinh	39	253.2	6.5	1	0.1	0.1
Phu Yen	44	6315.3	143.5	1	4346	4346.0
Khanh Hoa	109	817	7.5	2	127	63.5
Ninh Thuan	16	9952.9	622.1	2	9800	4900.0
Binh Thuan	75	778.4	10.4	9	435	48.3
Central Highlands	147	1334.3	9.1	19	151	8.0
Kon Tum	4	82.1	20.5	1	67	67.0
Gia Lai	7	24	3.4	0	0	n.a.
Dak Lak	5	26.4	4.9	n.a.	n.a.	n.a.

Dak Nong	6	16.4	2.7		n.a.	n.a.	n.a.
Lam Dong	125	1185.4	9.5		18	84	4.7
Southeast	6462	71857.8	11.1		611	21516	35.2
Binh Phuoc	64	200.8	3.1		1	1	1.0
Tay Ninh	173	778.2	4.5		16	113	7.1
Binh Duong	1743	9984.2	5.8		127	1026	8.1
Dong Nai	1031	14752.8	14.3		45	1929	42.9
Ba Ria-Vung Tau	226	16896.1	74.8		4	9376	2344.0
Ho Chi Minh City	3234	29245.8	9.0		418	9072	21.7
Mekong Delta	505	7876.5	15.6		80	3819	47.7
Long An	273	2896.3	10.6		65	929	14.3
Tien Giang	27	294.8	10.9		2	14	7.0
Ben Tre	16	137.4	8.6		2	8	4.0
Tra Vinh	17	80.8	4.6		2	17	8.5
Vinh Long	14	57.3	4.1		n.a.	n.a.	n.a.
Dong Thap	18	44.4	2.5		n.a.	n.a.	n.a.
An Giang	14	29.5	2.1		1	2	0.5
Kien Giang	23	2805	122		2	2304	1152.0
Can Tho	69	799.1	11.6		4	540	135.0
Hau Giang	5	630.8	126		n.a.	n.a.	n.a.
Soc Trang	7	42.3	6.0		1	5	0.2
Bac Lieu	11	37.8	3.4		n.a.	n.a.	n.a.
Ca Mau	11	21	1.9		1	0.1	0.1

Sources: GSO 2009; GSO2010a

Second, *direct* investment is emphasized over portfolio investment, although the flow of the latter is steadily increasing. The reason, again, is connected to the specific questions this study explores. Portfolio investment flows to stock markets. Until recently, there was only one, Ho Chi Minh City, which opened in 2000. In 2005, Ha Noi was added. Following indirect investment flows would not give an indication of the business climate in the 63 provinces in the country.

In general, we use number of projects instead of capital value of projects. The reason is that capitalization can be misleading. Recall the distinction between efficiency-seeking, market-seeking and resource-seeking investment. Only efficiency-seeking investment has the choice of location anywhere in the world where conditions are conducive, because it is not limited to locations where a market is already in place or where resources are located. To test the impact of rent seeking on investment location decisions, only efficiency-seeking investments, mostly manufacturing, is useful. Those tend to be smaller in capital requirements than other types of investments. Provinces with natural resources that attract mining investment could have few projects but very high capital inflows.

Vietnam is still a low-income country where many seek to improve their quality of life primarily through enhanced income. The most developed provinces, however, are already following the trend of wealthier societies by moving in the direction of broader measures of quality of life than income growth alone. Ho Chi Minh City, for example, has a policy of actively reducing the impact of polluting industries within its city limits (Phuoc 2007). Ho Chi Minh City and Binh Duong also no longer license labor-intensive projects with a low level of added value, in order to reduce the impact of mass in-migration of lowly paid workers into a city with already elevated cost of living (Phuoc 2007; Viet 2007). As a result, polluting and highly labor intensive industries no longer make it into these provinces, but are pushed into outlying provinces instead. Ho Chi Minh City even has a policy of actively supporting the move of labor-intensive, low-value-added companies and polluters to nearby provinces (Dung and Thanh 2007). These tend to be highly capitalized – steel or petrochemical plants, for example. Their location decisions increase the total capital invested in outlying provinces significantly, without informing the question about investment and rent seeking. In fact, all a petrochemical investment in Quang Ngai in central Vietnam says is that Vietnam overall is competitive against other developing countries. The location in Quang Ngai is determined not by local rent seeking, but by the availability of a vast, industrial park surrounding the Dung Quat refinery complex that is specifically designated for polluting and heavy industries.

Table 5.1. shows the concentration of foreign direct investment in 2008 and in the period of 1988 to 2008 in terms of capital and number of projects. The Southeast region received 59% of all investment projects over the period spanning two decades, and 52% in 2008. In terms of licensed capital, the Southeast received 44% and 34%, respectively. The average project in the Southeast is capitalized at a lower level than in other regions. Especially the Central Coast region has increasingly attracted vastly above-average sized projects. While the average project size nationally between 1988 and 2008 was $14.9 million, in the Central Coast region, the number was $63.6 million. In 2008 alone, the national average has increased to $54.7 million, but the Central Coast region experienced inflows averaging $646.2 million. In the two regions with most efficiency-seeking light manufacturing, the Southeast and the Red River Delta, the numbers are $11.1 million and $12.1 million respectively (GSO 2009). In comparison, provinces like Ha Tinh have few projects with multiple times the capital value ($567.2 million on average per project for 14 projects, compared to Ho Chi Minh City's average of $9.0 million for 3,234 projects over 20 years). In addition to the heavy industry projects Ho Chi Minh City and Binh Duong will no longer license, these highly capitalized projects are generally aimed at natural resource extraction (resource-seeking investments), which does not represent the question in this study well.[44] Using number

44 On the other hand, real estate projects (market-seeking) can also have a distorting effect due to extremely large scale, and many of them occur in investment magnet provinces. Due to the large overall number of projects there, even a very large project does not give investment capital as large a percentage bounce as in a province with few investors. For example, if $1 billion (the approximate investment by

of projects minimizes distortions. The same is to be said about using data spanning a longer period. In any given year, random distortions can occur. A new tax incentive or the opening of a new special economic zone can influence numbers briefly without reflecting the quality of governance which lies at the heart of this study. By looking at long-term data, these distortions are minimized.

5.1.2. Rent seeking

Rent seeking has to be measured by proxy variables. Multiple measures exist for the rate at which elites self-limit their predatory powers for the sake of attracting business. The World Bank issues an annual *Doing Business* report for world regions and individual countries in which it categorizes criteria for the ease and security of doing business in a jurisdiction. A summary of findings from *Doing Business in Vietnam 2011* is shown in Table 5.2. below. It ranks Vietnam as number 78 globally. Such indicators are not often disaggregated to the sub-national level. In Vietnam, such a break-down exists in the *Provincial Competitiveness Index*.

Table 5.2. Doing Business 2011

Indicator Ease of ...	2011 Rank	2008 Rank		2007 Rank		Change on Rank
Doing Business	78	91		94		+16
Starting a Business – Viet Nam	100	97		90		-10
(Sub-indicators in gray shading)	2011 Vietnam	2008	2011 Region	2008	2011 OECD*	2008
Procedures (number)	9.0	11	7.8	8.7	5.6	6.0
Duration (days)	44.0	50	39.0	46.8	13.8	14.9
Cost (% of income/cap.)	12.1	0.0	27.1	50.0	5.3	32.5
Paid-in Minimum Capital (% of income/cap.)	0.0	0.0	50.6	50.0	15.3	32.5
Dealing with Lincenses – Viet Nam	62(+)	63(+)		62		0
Procedures (number)	13.0	13.0	19.0	19.4	16.0	14.0
Duration (days)	194.0	194.0	167.2	175.3	166.3	153.3
Cost (% of income/cap.)	128.4	373.6	168.7	177.2	62.1	62.2

Intel) were excluded from the Ho Chi Minh City 20-year investment data, the average project size would only decline from \$9.0 million to \$8.7 million.

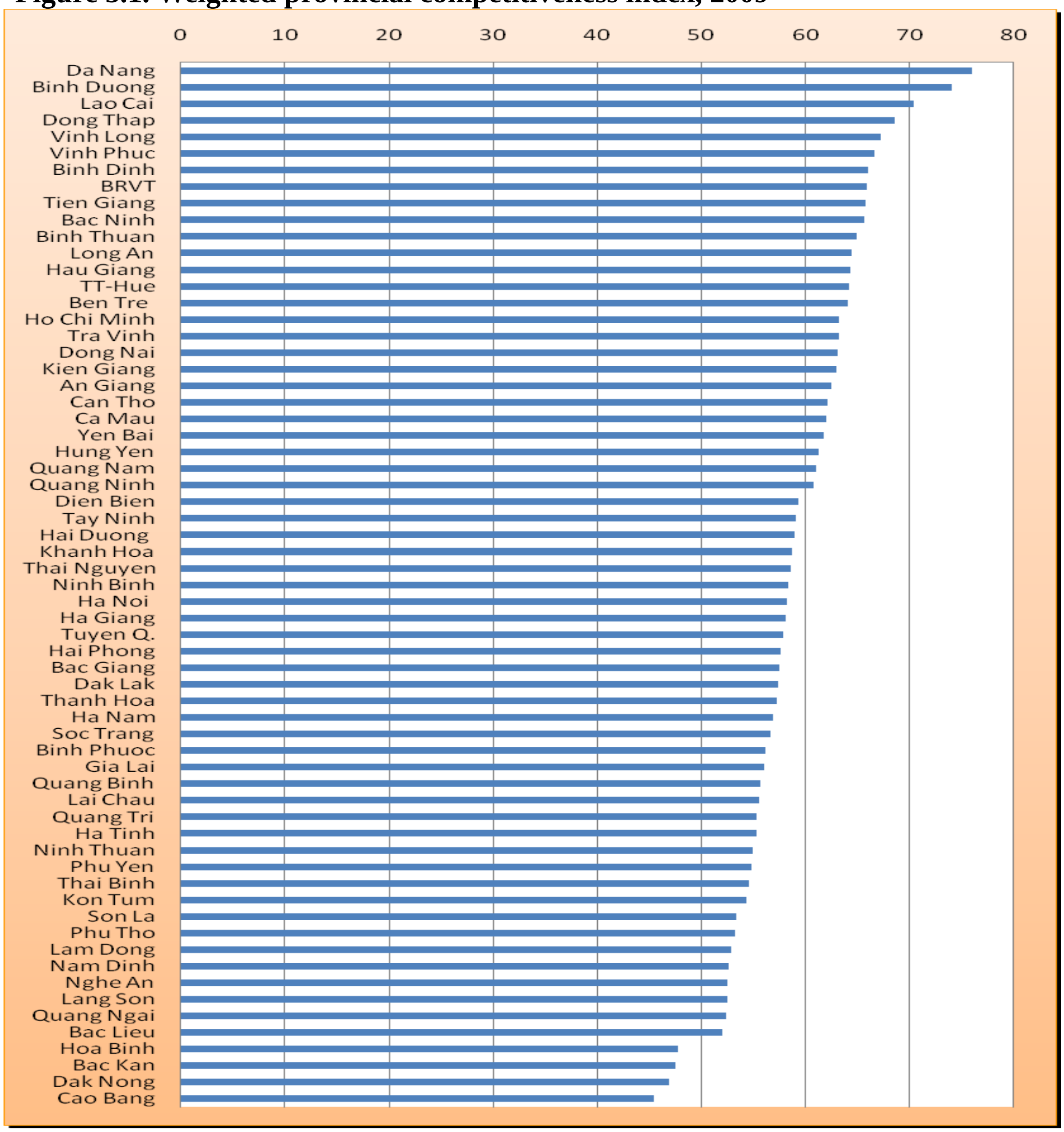
Employing Workers – Viet Nam	n.a.	84		82		n.a.
Difficulty of Hiring Index		0		19.2		25.2
Rigidity of Hours Index		40		20.8		39.2
Difficulty of Firing Index		40		19.2		27.9
Rigidity of Employment Index		27		19.7		30.8
Non-Wage Labor Cost (% of salary)		17		9.4		20.7
Firing Costs (weeks of wages)		87		37.8		25.7
Registering Property – Viet Nam	43$^{(+)}$	38$^{(+)}$		35		-3
Procedures (number)	4.0	4.0	4.7	5.0	4.8	4.9
Duration (days)	57.0	67.0	82.6	98.7	32.7	28.0
Cost (% of property value)	0.6	1.2	3.9	4.9	4.4	4.6
Getting Credit – Viet Nam	15$^{(+)}$	48$^{(+)}$		80		+65
Legal Rights Index (0-10)	8.0	6.0	6.1	4.5	6.9	6.4
Credit Information Index (0-6)	5.0	3.0	2.1	1.9	4.7	4.8
Public Registry Coverage (% adults)	26.4	9.2	n.a.	5.5	n.a.	8.6
Private Bureau Coverage (% adults)	0.0	0	n.a.	10.8	n.a.	59.3
Protecting Investors	173$^{(-)}$	165$^{(-)}$		175		+2
Disclosure Index (0-10)	6.0	6.0	5.2	5.0	6.0	6.4
Director Responsibility Index (0-10)	0.0	0.0	4.5	4.4	5.2	5.1
Shareholder Suits Index (0-10)	2.0	2.0	6.3	6.3	6.8	6.5
Investor Protection Index (0-10)	2.7	2.7	5.3	5.2	6.0	6.0
Paying Taxes	124$^{(-)}$	128$^{(-)}$		128		+4
Payments (number)	32.0	32	24.5	27.4	14.2	15.1
Time (hours)	941.0	1,050	218.2	271.5	199.3	183.3
Profit Tax (%)	33.1	21.5	35.4	18.2	43.0	20
Labor Tax & Contributions (%)	n.a.	19.2	n.a.	10.5	n.a.	22.8
Other taxes (%)	n.a.	0.3	n.a.	9.8	n.a.	3.4
Total Tax Rate (% profits)	n.a.	41.1	n.a.	38.5	n.a.	46.2
Trading Across Borders	63$^{(+)}$	63$^{(+)}$		50		-13
Documents for Export (number)	6.0	6.0		6.9	4.4	4.5
Time for Export (days)	22.0	24.0		24.5	10.9	9.8
Cost of Exports ($/container)	555.0	669.0		885.3	1,058.7	905.0
Documents for Import (number)	8.0	8.0		7.5	n.a.	5
Time for Import (days)	21.0	23.0		25.8	n.a.	10.4
Cost of Import ($/container)	645.0	881		1,014.5	n.a.	986.1
Enforcing Contracts	31$^{(+)}$	40$^{(+)}$		41		+10
Procedures (number)	34.0	34.0	37.3	37.3	31.2	31.3
Duration (days)	295.0	295.0	531.8	549.8	517.5	443.3
Cost (% of claim)	28.5	31.0	48.5	47.8	19.2	17.7
Closing a Business	124$^{(-)}$	121$^{(-)}$		119		-5
Time (years)	5.0	5.0	2.7	2.7	1.7	1.3
Cost (% of estate)	15.0	15.0	23.2	23.3	9.1	7.5
Recovery Rate (cents on the dollar)	18.6	18.0	28.6	28.1	69.1	74.1

Source: World Bank 2010

**OECD = Organization of Economic Cooperation and Development (industrialized nations)*
(+) = top-tier ranking; (-) = bottom-tier ranking (total economies surveyed = 160)
(++) = top-tier ranking; (--) = bottom-tier ranking (total economies surveyed = 183)
Details on indicators at: http://www.doingbusiness.org/ExploreEconomies/?economyid=202

This index measures provinces' quality of governance independent of unalterable characteristics, such as geographic isolation, access to transportation nodes or large urban conglomerations. The PCI establishes criteria of good governance that the provincial government can influence independently of exogenous factors. In testing the impact of governance on economic performance, the PCI measures the impact of changes in governance score on private sector response, through increased or decreased business formation in a province.

Figure 5.1. Weighted provincial competitiveness index, 2009



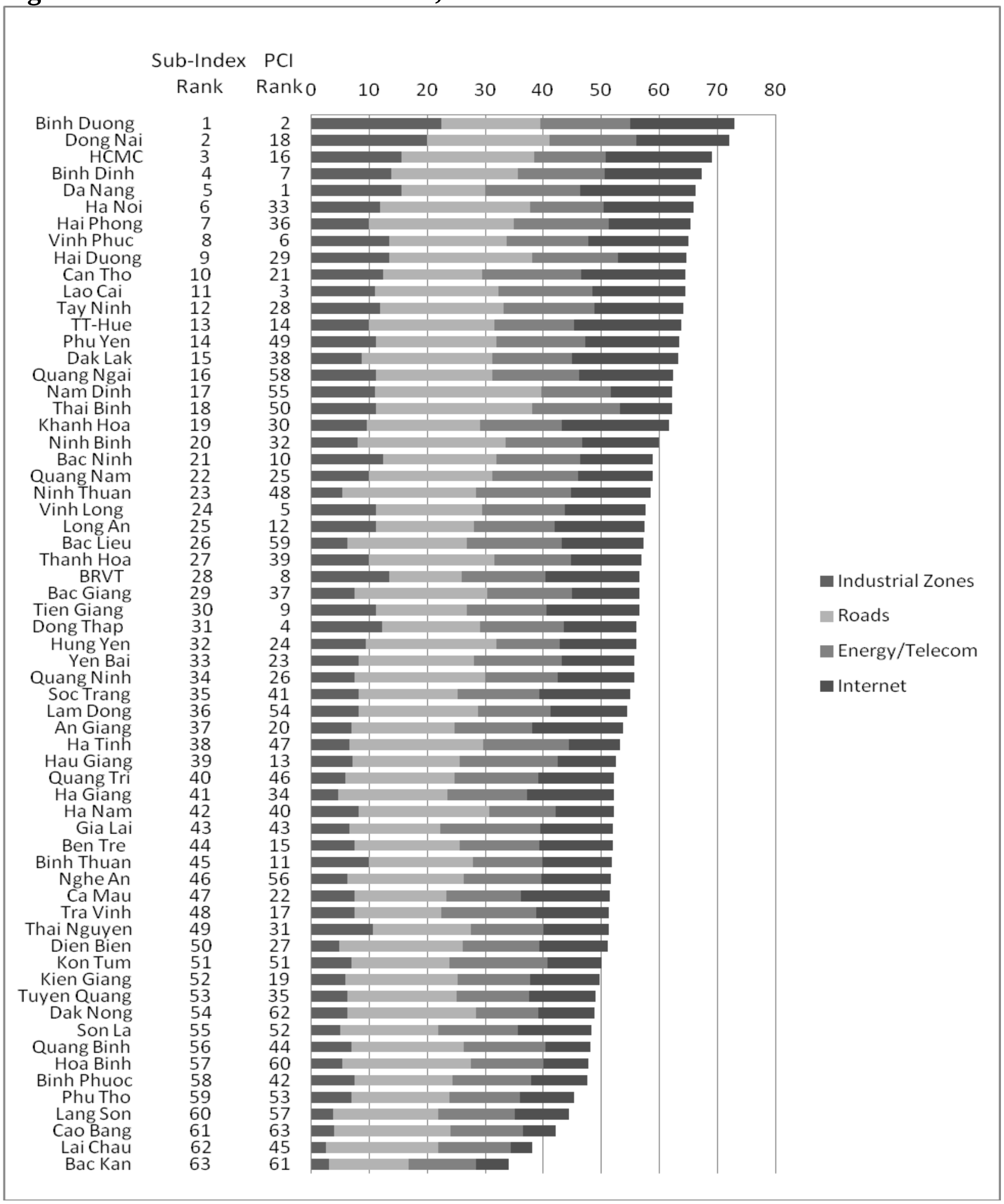
Source: PCI 2009

The PCI is composed of 10 variables, or sub-indices, all associated with good governance (and more or less directly with rent seeking). The sub-indices are weighted based on three outcome criteria that are of critical importance for private sector development: private enterprises per 1,000 citizens, investment per capita and enterprise profits. Regional dummy variables hold cultural, socio-economic and region-specific structural variables constant. The aim is to isolate the relationship between governance score of any given sub-index or the weighted combined index and the outcome variables. The PCI is calculated from a combination of hard data and perceived quality of governance gleaned from a large survey of business owners and managers of all business categories in Vietnam.

5.1.2.1. Infrastructure sub-index

In surveys of investors, quality of infrastructure is regularly ranked as the top decision-making factor. In Vietnam's fiscal arrangement, infrastructure cannot be attributed directly to provincial officials, but "increased fiscal decentralization has, in theory, increased the opportunities for provinces to raise their own resources for infrastructure improvements" (VCCI 2009: xv). The PCI infrastructure index contains four categories, industrial zones, road and transportation network, utilities and communication technology. Confirming the importance of infrastructure, the top four investment recipients by number of projects are in the top six provinces ranked by infrastructure. Only Binh Dinh (ranked #4 in infrastructure) is not a top-15 investment recipient. Da Nang is ranked #11 in investment projects and #5 in infrastructure, but the central province is an emerging growth pole with rapid improvements in most sub-indices and #1 in the overall PCI ranking.

Figure 5.2. Infrastructure sub-index, 2009



Source: PCI 2009

Of the top-15 investment recipients, nine are ranked among the best 15 in infrastructure quality. Of the bottom-13[45] investment recipients, eight rank among the worst 15 in infrastructure quality. With one exception (Dak Lak, #58 in investment/#15 in infrastructure), all of the low investment recipients are ranked #35 and below in infrastructure quality. The relationship between good governance and good infrastructure exists. The bivariate correlation (0.54) does not allow to distinguish whether better government leads to better decisions about infrastructure provision, or whether wealthier provinces are better endowed with infrastructure from the pre-reform period. Some provinces compensate for bad infrastructure with good governance.

Table 5.3. Indicators for infrastructure sub-index

Sub-index	Indicator	Source	Measure	2009 score
Industrial zone quality and coverage	Number of industrial zones and concentration in province	Ministry of Planning and Investment (MPI)	Minimum Median Maximum	0 1 23
	Percentage of total area of industrial zones that have occupants	MPI	Minimum Median Maximum	0.00 30.84 93.55
	Firm rating of provincial industrial zone quality (% good or very good)	PCI 2009 Survey	Minimum Median Maximum	0.00 24.07 79.17
Road quality and transport costs	Assessment of road quality (% good or very good)	PCI 2009 Survey	Minimum Median Maximum	7.95 28.80 80.82
	% of roads paved with asphalt (all roads)	Government Statistics Office (GSO)	Minimum Median Maximum	4.83 51.44 100
	% of provincial roads paved with asphalt	GSO	Minimum Median Maximum	3.00 69.65 100.00
Utilities (Energy and	Hours of telecommunications outages per month	PCI 2009 Survey	Minimum Median Maximum	0 3 8
	Assessment of telecommunications quality (% good or very	PCI 2009 Survey	Minimum Median Maximum	35.59 67.50 84.93
	Telephones, land and cellular, per 1,000 citizens	Ministry of Post and Telecommunications	Minimum Median Maximum	0.4 1.9 20.8

45 At the bottom ranks, too many provinces share the same number of investment projects to allow a cut-off at exactly 15.

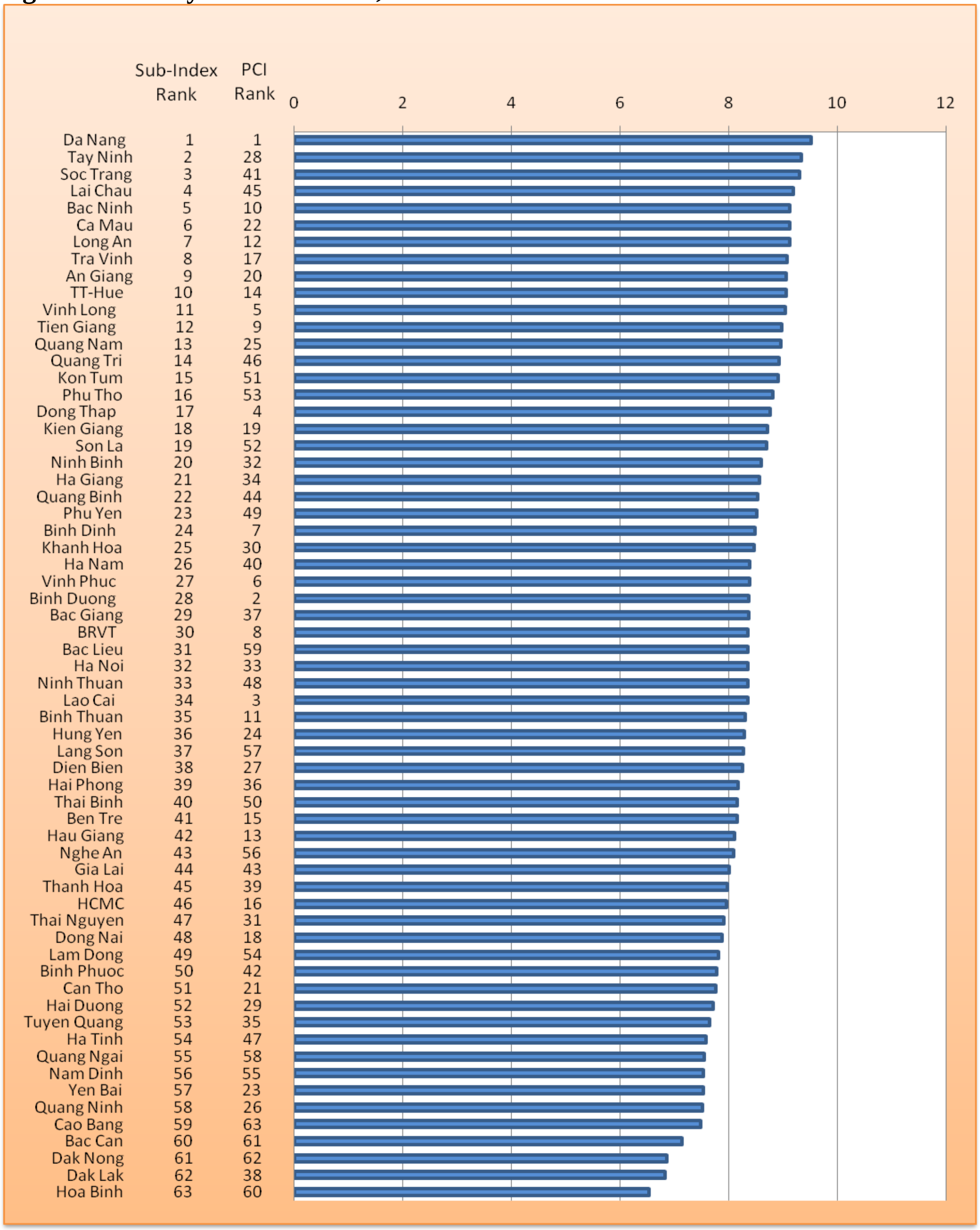
Communications)	Average cost per kilowatt of energy in the province (in VND)	Electricity of Vietnam	Minimum Median Maximum	142.24 796.24 1,231.13
	Hours of electricity outages in the last month	PCI 2009 Survey	Minimum Median Maximum	46.00 50.00 58.00
	Firms informed in advance about power cuts (% of time)	PCI 2009 Survey	Minimum Median Maximum	45.78 50.00 58.38
Internet	% of respondents with email address	PCI 2009 Survey	Minimum Median Maximum	9.6 27.3 69.7
	Assessment of internet quality (% good or very good)	PCI 2009 Survey	Minimum Median Maximum	19.2 46.4 67.4
	% of respondents using online platform for survey	Ministry of Post and Telecommunications	Minimum Median Maximum	0.7% 5.0% 12.0%

Source: PCI 2009: 28-30

5.1.2.2. Entry costs sub-index

Figure 5.3. shows that differences among provinces are relatively small. Consistent with the law of supply and demand, provinces with more investors can charge higher fees for entering than less attractive ones. They generally do. Of the top-15 investment recipients, only Da Nang (#11 in investment projects/#1 in low entry cost), Tay Ninh (10/2) and Long An (6/7) are in the top 25 of the entry cost ranking. Of the bottom-ranked provinces in terms of foreign investment projects, only two keep entrance costs low to compensate for their lower overall attractiveness: Soc Trang (52/3) and Lai Chau (61/4). Investment magnets Ho Chi Minh City (1/46), Binh Duong (2/28), Ha Noi (3/32) and Dong Nai (4/48) charge high entry fees. High fees in the southeastern investment magnets are in line with these provinces' stated policy. They have decided not to accept labor-intensive projects any longer. Their goal is to address the over-population problem and to reduce the impact of migration on social services.

Figure 5.3. Entry cost sub-index, 2009



Source: PCI 2009

Of greater concern are the high entry costs in provinces with very low investment numbers. Dak Lak ranks #58 in number of investment projects while having the second-highest entry costs. Dak Nong is #56 in investment projects, and third highest in entry costs (#63 in the sub-index), and Bac Kan is #52 in investment with the fourth-highest entry costs. Entry cost management was part of the earliest reforms after *doi moi*. Failure to catch up on this index is a strong indicator of high levels of rent seeking in the province. Of the provinces with middling numbers of investment projects, a substantial number keeps their entry costs low.

Entry cost is of less importance to international investors than to more financially strapped small firms. It can be further reduced by locating in an industrial park or, where provincial authorities often take care of licensing and other bureaucratic procedure. Special industrial zones are generally under the authority of the provincial regulatory agency, which reports to both provincial People's Committee and the Ministry of Planning and Investment. The regulator has an interest in avoiding delays and a bad reputation, business enjoys the high-level access to get things done.

Table 5.4. Composition of the entry cost sub-index, 2006-2009

Indicator	Source	Measure	2006	2007	2008	2009
Length of registration (days, median)	PCI 2009 Survey	Minimum	12	7	5	6.5
		Median	20	15	12.25	10
		Maximum	58	22.5	15	15
# of licenses and permits necessary to start ops	PCI 2009 Survey	Minimum	2	1	1	0
		Median	4	2.5	2	1
		Maximum	7.5	5	4	3
Wait for land use rights certificate (days)	PCI 2009 Survey	Median	40	30	30	15
		Medium	121	60	38.5	32.5
		Maximum	338	180	105	180
% of firms waiting more than 1 month to complete all requirements	PCI 2009 Survey	Minimum	3.23	5.18	6.67	3.84
		Median	25.81	27.21	21.91	19.35
		Maximum	44	53.8	39.13	38.46
% of firms waiting		Minimum	0	0	0	0

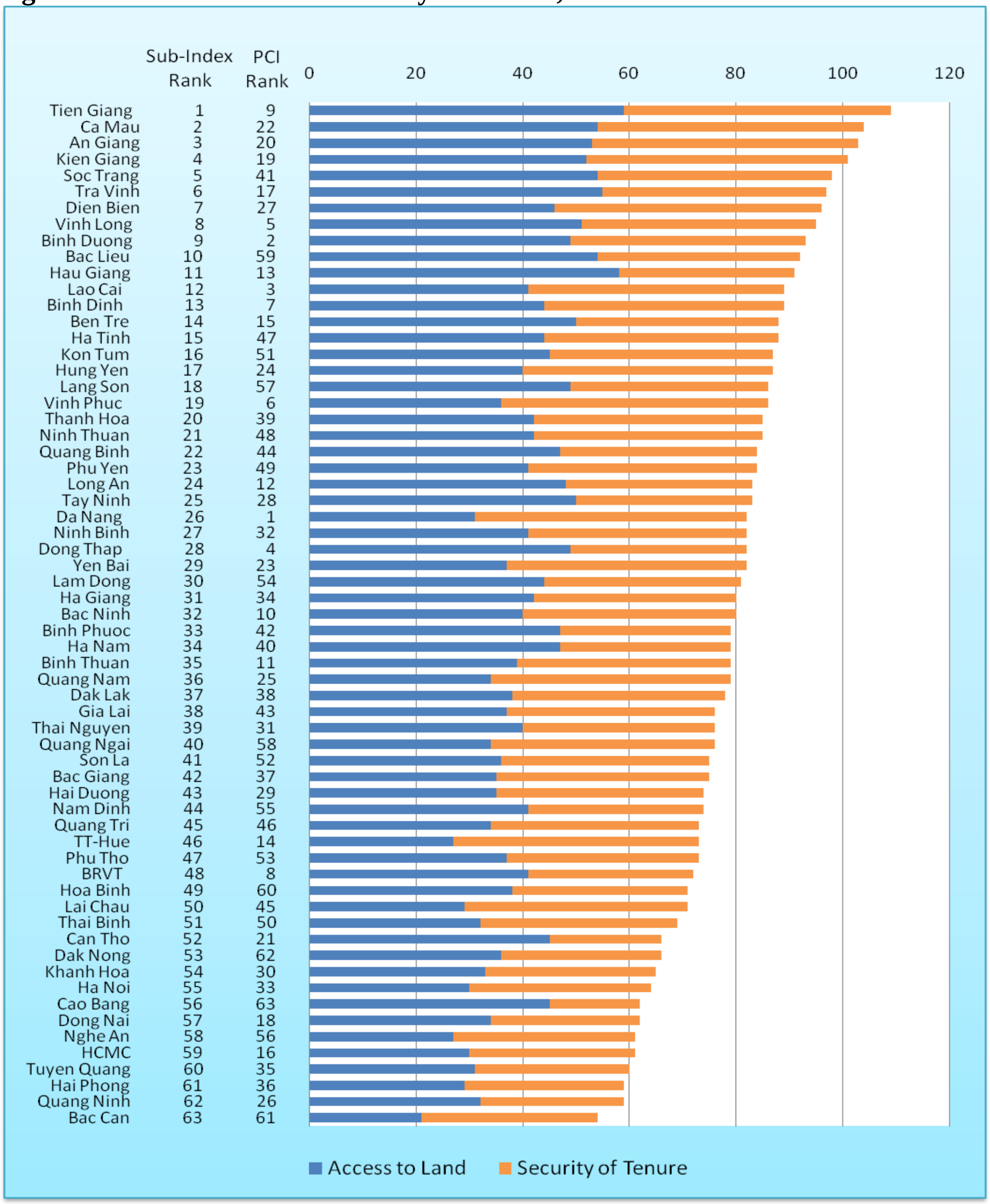
more than 3 months to complete all requirements	PCI 2009 Survey	Median	5.78	6.78	5.72	4.44
		Maximum	25.64	27.27	16	20.72
% of firms having difficulties obtaining all licenses and permits	PCI 2008 Survey	Minimum	0	0	2.08	
		Median	12.4	11.1	10.05	
		Maximum	27.27	36.8	26.92	

Source: PCI 2009: 60-1

5.1.2.3. Land access and security of tenure

The conversion of agricultural land in the vicinity of urban agglomerations to industrial and residential uses has led to intense conflicts. Land manipulation is a major source of rent seeking for the political elite, which can buy land at agricultural rates, re-zone it and sell it at multiple times the purchasing price to investors or real estate developers. In many cases, the original owners of the land have demanded redress after learning about the resale value of their land. On occasions, the government sent them to negotiate with the investor, who already paid a high price to the rentier government officials. Hence, obtaining land use rights for large investments from local governments is fraught with risks. Yet negotiating with the original owners of the land use rights brings with it other complications. One investment project may require the land of dozens of farmers and any one hold-out can sink a project if the government does not step in. The rapid changes in this area of governance are exemplified by two reports written in 2005 and 2009. In 2005, a report authored by PCI main author Edmund Malesky and Dau Anh Tuan considered it best practice that the provincial government set aside land for conversion, then re-zone it and clear it according to pre-set procedures. Using this method, southeastern investment pole Binh Duong cleared 90% of its designated land in one year. Relatively low population density has helped.

Figure 5.4. Land access and security sub-index, 2009



Source: PCI 2009

The successful Red River Delta provinces of Hung Yen (#13 in investment projects between 1988 and 2008) and Vinh Phuc (#9) have replicated one-stop shopping for land-use rights. Investors no longer negotiate with landowners, but with the government. For larger projects, the provincial government is in charge, for smaller ones the district (Malesky and Tuan 2005: 21-3). In the 2009 PCI, the situation has changed significantly. What was considered best practice about to be emulated by other provinces is no longer mainstream.

> Provincial agencies and [local state-owned enterprises] are much less likely to be involved in leasing space to private businesses. If disputes over land rental do arise, the involved parties are most likely to be private individuals. In some cases, one of the disputants may be a government official, but s/he is renting land in a private capacity and not as part of an official responsibility. Although dispute adjudication over business contracts is still a major issue, especially when one of the parties is a government official, these problems should more properly be considered under the Legal Institutions sub-index. (VCCI 2009: 63)

This interpretation misses a broader problem. Many Vietnamese families have one family member in government, another in private business. This combination of political influence, early knowledge of or impact on zoning decisions, paired with political relationships to state bank officials, can bring significant benefits for a third party, a brother, sister, uncle or aunt who is free to engage in land deals that the politically active family member has initiated. If provinces did well with the system of government-managed land clearance, why did this system end in only half a decade? One answer is that the visible corruption embarrassed the Party. By privatizing the rent seeking, political officials still held the strings, but let family members act as fronts. The hand-in-glove connection between Party and courts leaves little hope for the (truly) private claimant in a dispute with a party with government connections. This interpretation reflects Gainsborough's evaluation of the official narrative of the retreat of the state from the economy, but one in which the government continues to hold sway indirectly (Gainsborough 2010).

Table 5.5. Land access and security of tenure sub-index, 2006-2009

Indicator	Source	Measure	2006	2007	2008	2009
% of firms in possession of a land use right certificate	PCI 2009 Survey	Minimum	23.29	51.35	38.36	46.82
		Median	55.28	75.57	81.16	73.68
		Maximum	77.78	92.45	94.74	94.51
Total land in province with official land use right certificate	Min. of Natural Resources; Environment Datasets	Minimum	11.3	13.28	19.52	23.52
		Median	69.20	63.13	77.56	77.89
		Maximum	96.50	97.46	98.75	98.56
Firm rating of expropriation risk (1=very high; 5-very low)	PCI 2009 Survey	Minimum	1.95	1.74	1.63	2.11
		Median	2.49	2.24	2.04	2.55
		Maximum	3.05	2.57	2.49	3.05
If expropriated, the firm receives a fair compensation (%always or usual)	PCI 2009 Survey	Minimum	21.43	22.22	21.25	16.90
		Median	40.00	40.76	38.82	40.54
		Maximum	58.33	57.14	52.75	55.17
Changes in government land price changes reflect market value (% agree)	PCI 2009 Survey	Minimum				53.33
		Median				69.75
		Maximum				81.11
Given a list of possible land problems, respondent checked none (%)	PCI 2009 Survey	Minimum				11.02
		Median				30.72
		Maximum				52.32

Source: PCI 2009: 63-4

Provinces with large stock of foreign investment projects have greater problems making land available than those with few projects; large provinces have more available land than small ones. Urban investment magnet Ho Chi Minh City ranks 59th on the sub-index, Ha Noi is #55, Dong Nai #57. Da Nang, small, but with comparatively few projects, ranks #26. The leader in this category, Tien Giang, is a middling province in terms of both investment projects and size. The best high-investment performer in the land access and security category is Binh Duong at rank #9.

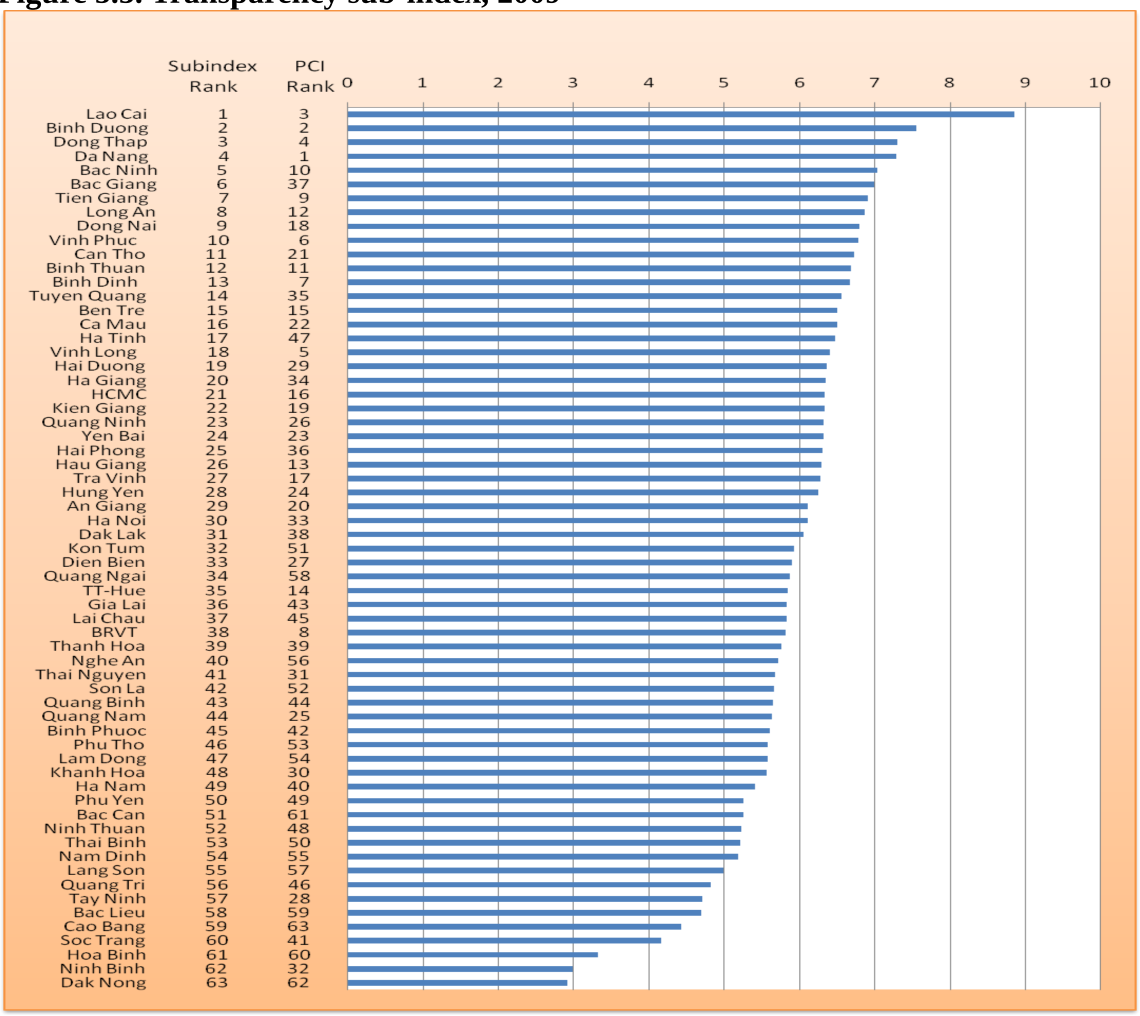
Land access is associated with availability, which itself is a function of province size and number of existing projects. Land security, on the other hand, should be a function of good governance. Figure 5.4. indicates, however, that security is more closely associated with access than with other indicators of good governance, like the PCI overall ranking or the number of investment projects. Top investment provinces lag in this category as well. The rent-seeking behavior of political officials in the context of land conversion has long been the leading reason for protests.[46] Similar to the problem of high entry cost, the more desirable a province, the more rent can be skimmed off without significantly slowing the flow of investment. Provincial leaders make rational decisions about the cost and benefit of high rent seeking. In Da Nang, the province that has become a model of good governance and leads the overall PCI ranking, land security is second to none. The low ranking in the sub-index (#26) stems from low land availability – not surprising for the fourth-smallest jurisdiction in the country with only 1,283 square kilometers, just over half of Ho Chi Minh City's land area. The only high recipient of foreign investment that does relatively well on both availability and security is Binh Duong (#2 in investment, #9 in land access and security).

46 Only since inflation has risen in 2008 have strikes for better pay and better working conditions become the biggest problem.

5.1.2.4. Transparency

The province with the highest level of government transparency is Lao Cai. Given this remote mountain province's outlier score (#3 on the compound PCI), this result is not surprising. Two of the bottom-13 investment recipients score in the top tier of this sub-index, Tuyen Quang (#58 in investment/14 in transparency) and Ha Giang (52/20). Two top-15 investment provinces are ranked in the bottom tier for transparency, Lam Dong (15/47) and Tay Ninh (10/57).

Figure 5.5. Transparency sub-index, 2009



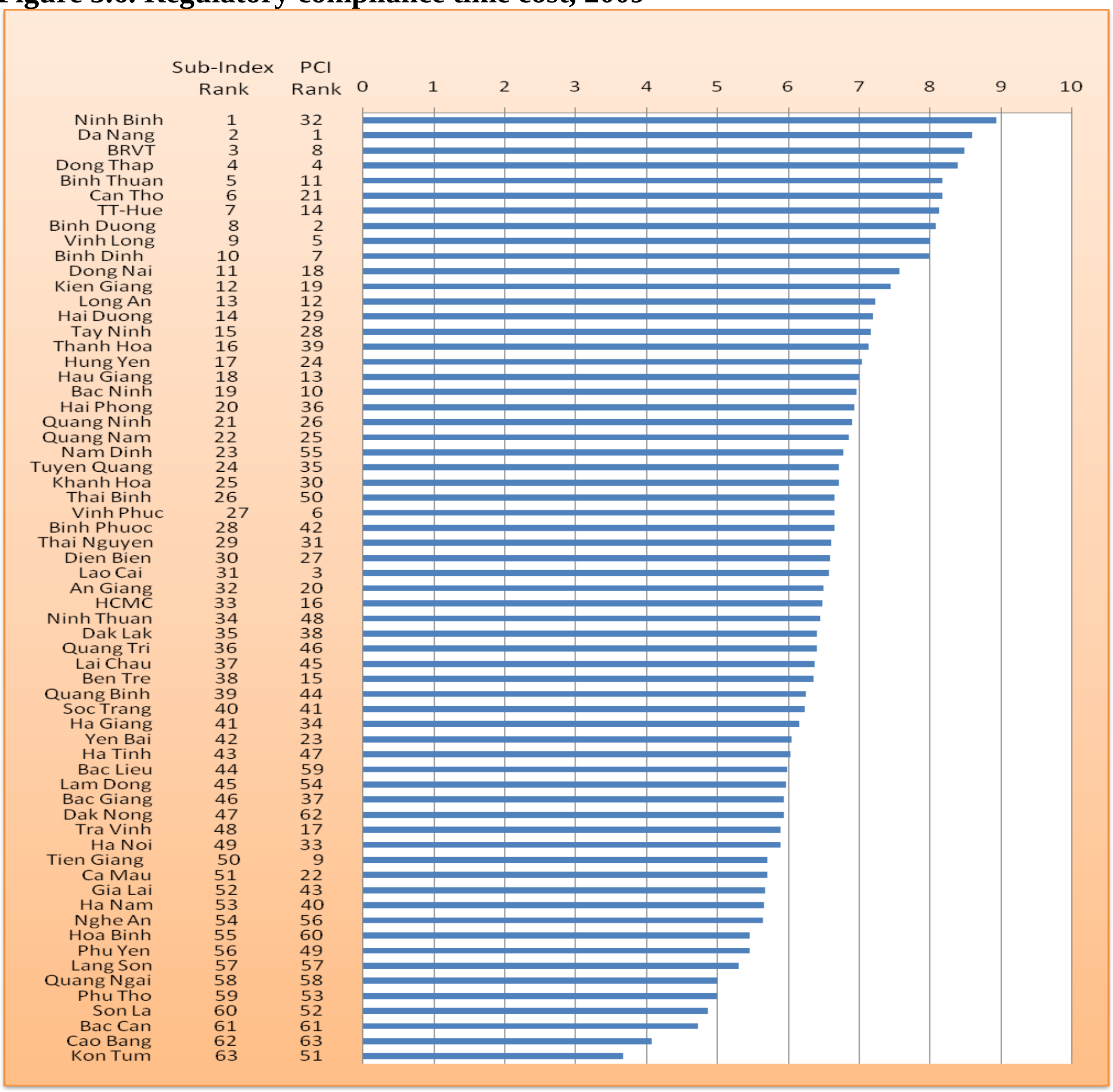
Source: PCI 2009

The transparency sub-index is scored through a complex score card devised by the research team. The indicators are transparency of planning document, transparency of legal decisions and decrees, relationship of important to very important of obtaining access to provincial documents, perception of negotiations with tax authorities as an essential part of doing business, predictability of implementation of central law at the provincial level, openness of provincial web page, and the role of business associations in advising and countering provincial policies.

5.1.2.5. Time cost of regulatory compliance

Regulatory compliance represents a serious concern for international investors, for whom being able to focus on core business functions is of great importance. Regulatory compliance is also a means of gaining rent for officials. Vietnam has a complex system of inspections, which are conducted *ad hoc* and can shut a factory down during the procedure. Different agencies regularly do not coordinate; instead they inspect one part of the factory one day, while the other agency inspects another the following week. Overzealous application of the law is another complaint. Malesky and Tuan (2005: 16) describe the situation of a transportation company that was repeatedly fined for not using the standard canvas on its trucks required for road safety. The company, specializing in high-value transports, used a higher quality of canvas than the one required, but inspectors applied the law by the letter and not by its intent – preventing road accidents from items falling off trucks due to below-minimum quality canvas covers. Another form of selective inspection occurs when officials inspect firms repeatedly in an attempt to favor a competitor. There are multiple reasons for doing so, bribes, a relationship between government officials and firm officials, or that the competitor is a state-owned enterprise. In recent years, privileges for state-owned enterprises have become of such low concern that the Provincial Competitiveness Index has dropped questions about this issue from the survey.

Figure 5.6. Regulatory compliance time cost, 2009



Source: PCI 2009

Provinces with high levels of foreign direct investment perform well on this indicator across the board. Only two fall in the bottom tier of the table, the eternal laggard Lam Dong (#15 in investment projects, #45 in compliance) and Ha Noi (3/49).

Table 5.6. Comparison of Regulatory Compliance Costs

Indicator	Source	Measure	2006	2007	2008	2009
% of firms spending over 10% of time on compliance	PCI 2009 Survey	Minimum	6.52	10.94	13.83	7.27
		Median	21.24	21.87	22.99	15.38
		Maximum	39.39	43.75	42.55	30.36
Median # of inspections by all agencies	PCI 2009 Survey	Minimum	0	1	1	1
		Median	1	1	1	1
		Maximum	2	2	2	2
Median tax inspection hours	PCI 2009 Survey	Minimum	1	2	1	1
		Median	8	8	8	5
		Maximum	40	40	32	40
Gvt officials have become more efficient (% yes)	PCI 2009 Survey	Minimum				28.68
		Median				44.09
		Maximum				55.26
Trips to obtain stamps, signatures reduced (% yes)	PCI 2009 Survey	Minimum				17.69
		Median				30.23
		Maximum				54.95
Paperwork reduced (% yes)	PCI 2009 Survey	Minimum				24.2
		Median				47.89
		Maximum				63.16
Fees reduced (% yes)	PCI 2009 Survey	Minimum				11.38
		Median				24.18
		Maximum				34.04

Source: PCI 2009: 72

Eleven of the top-15 investment recipients are in the top tier of the table. Lower invested provinces are distributed evenly in the bottom half of the table. Only three are in the top half, ranked at #18, #24 and #30, respectively.

5.1.2.6. Informal charges

To be located in a highly desirable province has its price. Where demand is high, officials feel free to demand higher informal charges than in provinces that obtain low rates of investment. This represents a supply-and-demand equation for the cost of doing business in a given jurisdiction. Ho Chi Minh City (#1 in investment, #53 in informal charges), is the lowest-ranked top investment performer, followed immediately by Hai Phong (5/52) and Ha Noi (3/51). With the exception of continuous laggard Lam Dong (15/47), however, all other top investment provinces are in the top half of the ranking, although only two are in the top 10: Tay Ninh (10/5) and Ba Ria-Vung Tau (7/8).

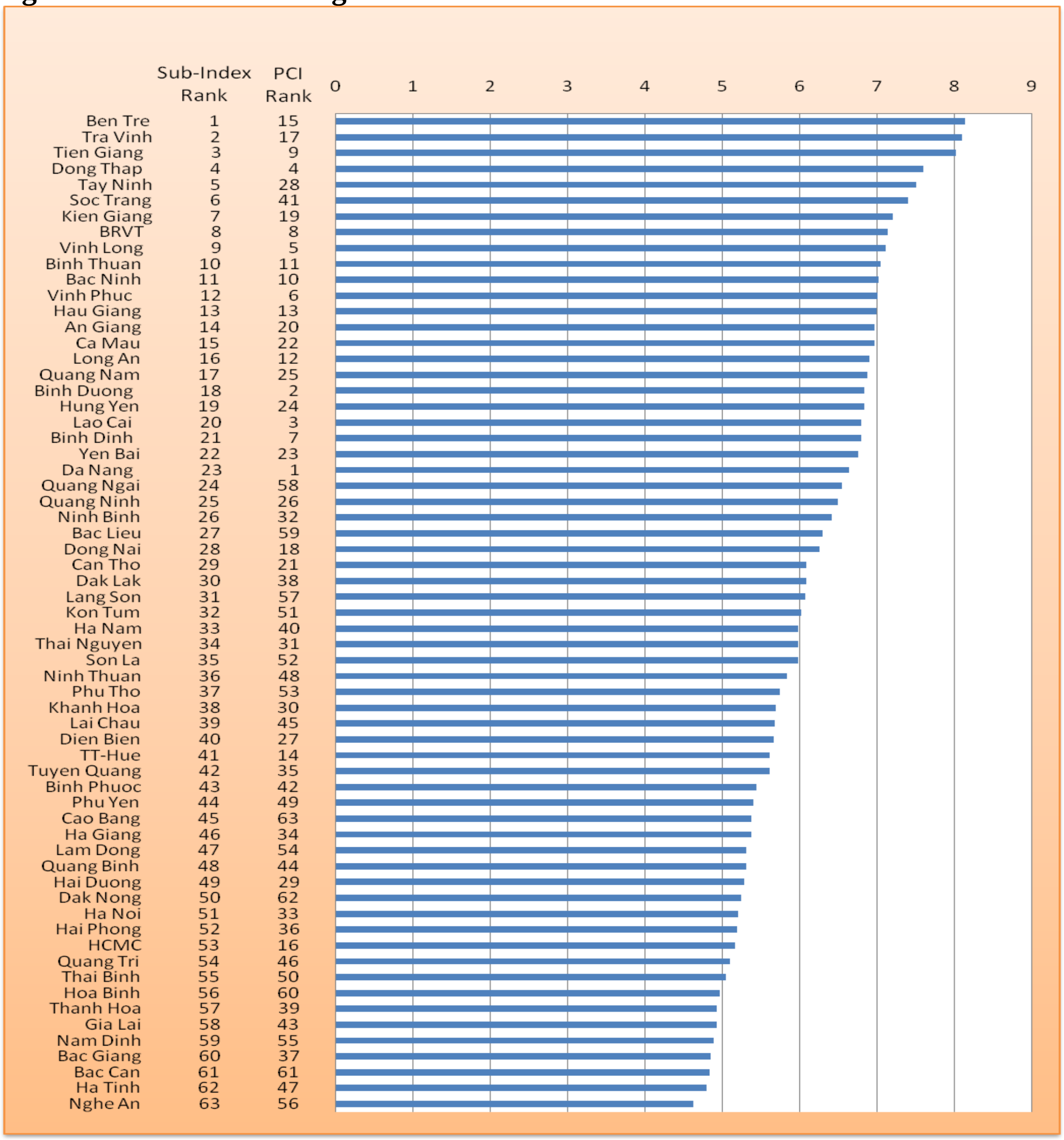
Table 5.7. Informal charges

Indicator	Source	Measure	2006	2007	2008	2009
% of firms that felt that enterprises were subject to bribe requests from provincial authorities	PCI 2009 Survey	Minimum	53.57	40.00	45.54	35.38
		Median	70.00	68.25	65.93	59.40
		Maximum	84.62	82.72	83.59	77.47
% of firms paying over 10% of their revenue in extra payments	PCI 2009 Survey	Minimum	4.35	1.39	2.13	2.61
		Median	12.99	11.54	9.89	8.75
		Maximum	29.41	26.19	22.08	20.78
Government uses compliance with local regulations to extract rents (% strongly agree or agree)	PCI 2009 Survey	Minimum	22.86	17.44	20.00	23.93
		Median	39.76	38.21	37.12	50.35
		Maximum	76.74	79.41	64.54	71.64
Informal payments delivered the expected results (% always or almost always)	PCI 2009 Survey	Minimum	20.83	29.03	27.94	35.42
		Median	47.89	48.28	48.99	51.51
		Maximum	65.93	59.80	62.91	69.01
Firms pay commissions on government contracts (yes)	PCI 2009 Survey	Minimum				22.89
		Median				53.47
		Maximum				74.81

Source: PCI 2009: 74

Less in line with expectations of supply-and-demand logic, only two of the 13 least invested provinces are ranked higher than 30: Soc Trang (52/6) and Hau Giang (58/13). The rest of the less attractive provinces are unwilling or unable to make up for other disadvantages in attracting investment by reducing their informal charges and rank between #30 and the bottom.

Figure 5. 7. Informal charges sub-index



Source: PCI 2009

5.1.2.7. Proactivity

This measure reflects the attitude of provincial governments toward problems investors face while active in the province. Proactive problem solving has been credited with the attractiveness of early mover provinces. Now, especially the southeastern growth poles use the term frequently in describing their competitive advantages over less industrialized provinces where labor and land are cheaper and regulatory frameworks less restricting.

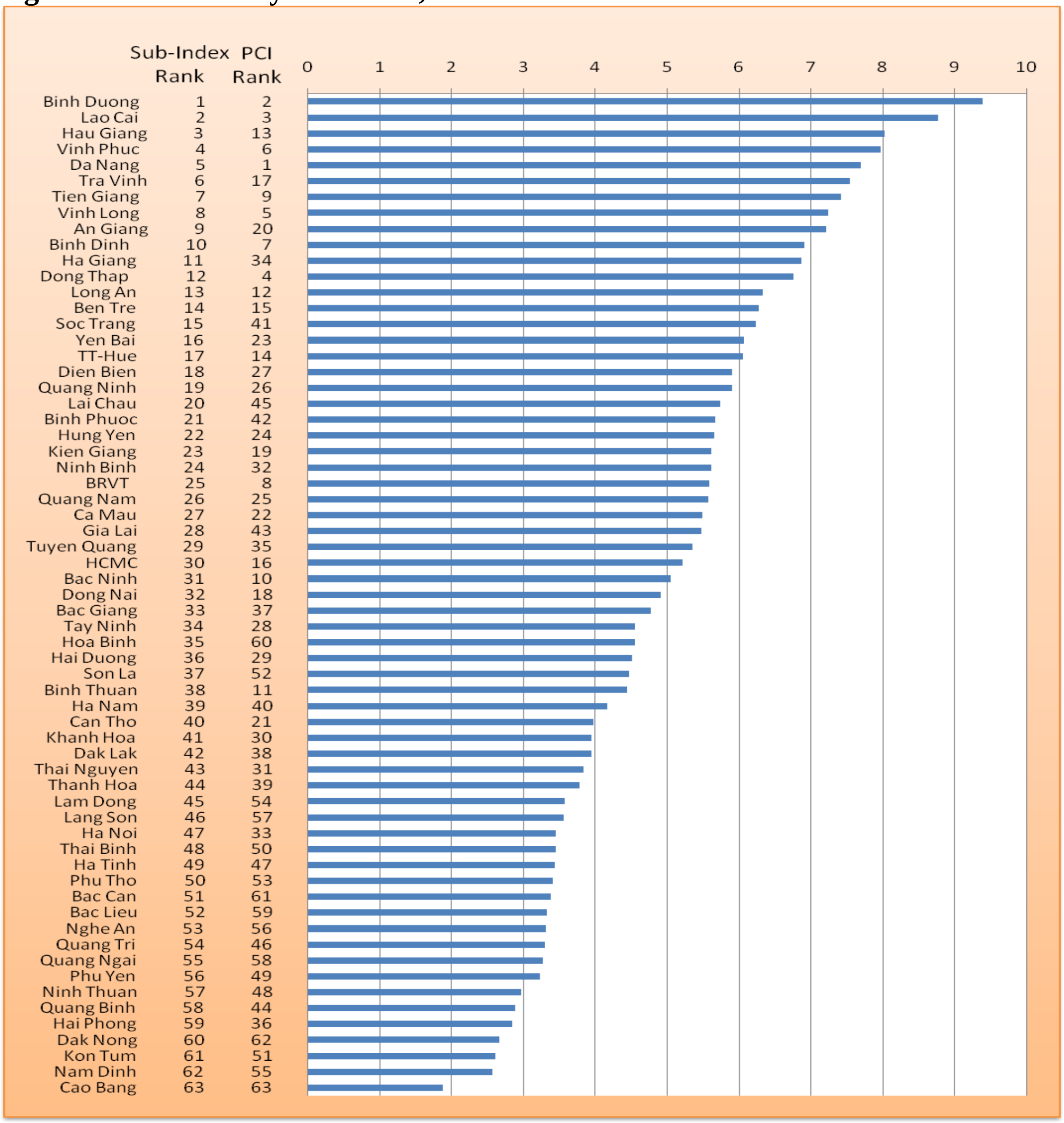
Table 5.8. Proactivity Measures

Indicators	Source	Measure	2006	2007	2008	2009
Provincial officials are knowledgeable enough about nat'l law to find opportunities to solve firm problems (% strongly agree or agree)	PCI 2009 Survey	Minimum	51.61	53.68	57.35	54.67
		Median	74.44	71.74	77.28	72.65
		Maximum	93.48	92.47	91.41	91.72
Provincial officials are creative about working within the national law to solve firm problems (% strongly agree or agree)	PCI 2009 Survey	Minimum	40.00	40.22	40.90	23.94
		Median	61.88	58.12	61.50	42.46
		Maximum	88.64	87.91	85.05	72.59
Perceived attitude of provincial government toward private sector (% very positive or positive)	PCI 2009 Survey	Minimum	30.21	24.50	32.71	28.42
		Median	48.28	44.97	53.40	43.75
		Maximum	71.56	67.37	72.22	71.96

Source: PCI 2009: 75

Binh Duong, the number two investment recipient, tops the list. Binh Duong makes proactivity a key part of their sales pitch. During interviews, government and industry officials have mention proactivity, good governance and the Provincial Competitiveness Index, indicating how seriously Binh Duong takes this aspect of attracting business (Phu 2007; Xuyen 2007; Viet 2007). Ho Chi Minh City and Dong Nai lag behind, while some low-ranking investment attractors perform well, as Figure 5.8. indicates. Among these, some have high informal charges (Ha Giang, Dien Bien, Lai Chau). Two of the three indicators in the proactivity measurement relate only to the question whether provincial officials can get things done. A province can thus be proactive in attracting business by supporting license applications, land clearance and other bureaucratic hurdles, but at a price for its officials.

Figure 5.8. Proactivity sub-index, 2009



Source: PCI 2009

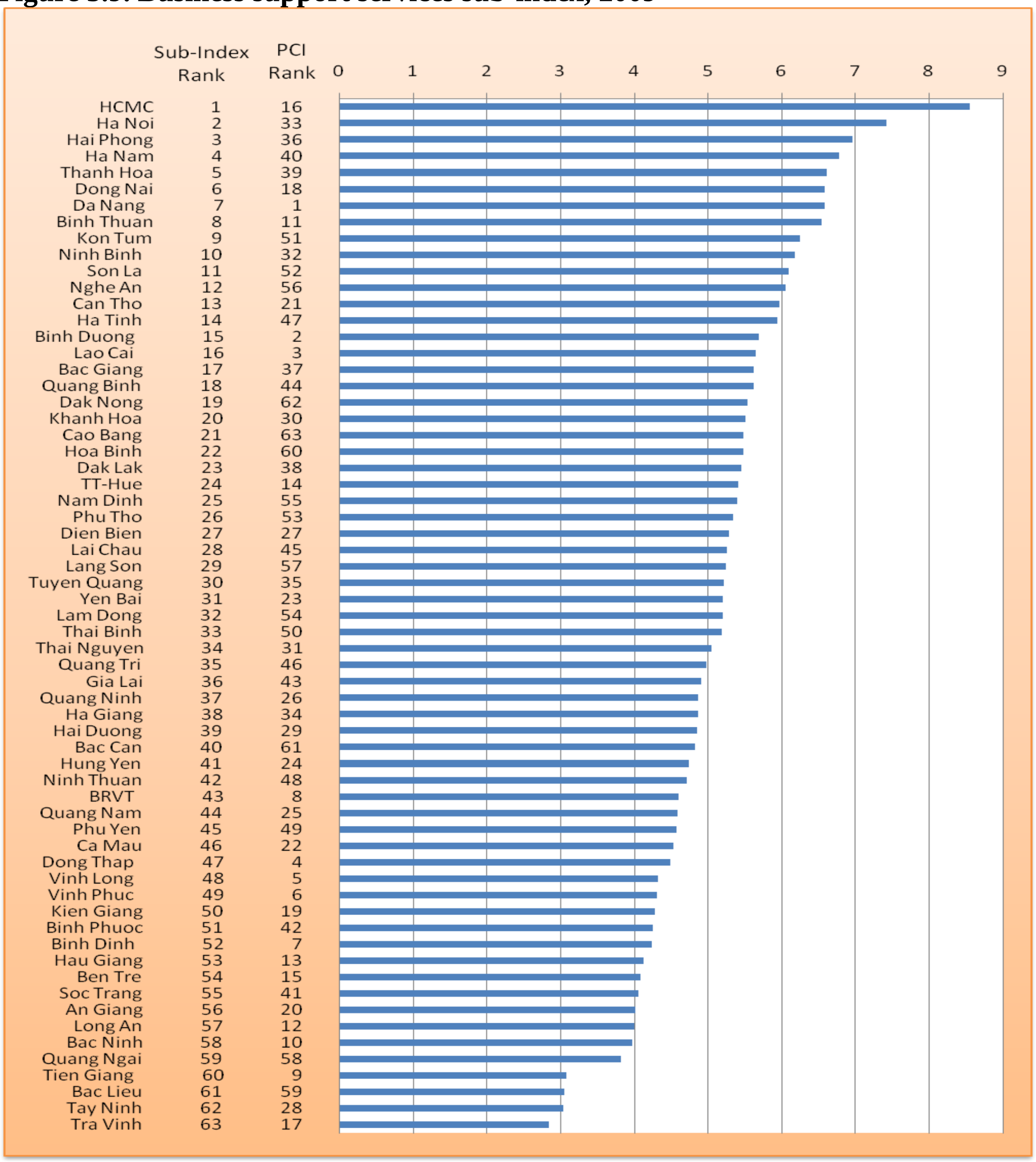
A province can be proactive while engaging in significant rent seeking. Rentier success will depend on how many investors believe their money is well spent. Provinces that have improved their position in the PCI overall ranking or those that are attracting more investment projects lately tend to do well (Lao Cai at #2, Da Nang at #5, Long An at

#13). Proactivity is a policy tool that can be employed with little government effort and with few opponents, because few interests are harmed by proactivity.

5.1.2.8. Business support services

This sub-index has been altered drastically in the last Provincial Competitiveness Index, to provide a better picture of actionable policy decisions rather than a general perception whether a province is supportive of business. Because of these changes, year-to-year comparisons are not available. The sub-index now measures the perception of the usefulness of trade fairs held by the province, how often a firm has used business support services (governmental or private), whether a firm uses trade promotion services and similar questions aiming at providing provincial governments with suggestions what services work best. Top investment provinces rank well in this category, with Ho Chi Minh City leading the sub-index ahead of Ha Noi and Hai Phong. One explanation is that top performers in foreign investment have to 'perform' for their price, which, as other sub-indices show, can be substantial. As this sub-index measures not only attitudes toward government services, wealth and proactivity can become self-reinforcing. The more wealthy firms are active in a province, the better the business opportunities for consulting firms and business support services. The better these services, the better the perception of the province. On this index, it is possible that path dependency sets in for the provinces with large economies and a competitive private market for business services. There are outliers that cannot be explained in this way. Kon Tum, ranked 61st out of 63 provinces in foreign investment projects, is on rank #9 in business support services. In Kon Tum, absent a market for business support services, supply of these services must largely be provided by government.

Figure 5.9. Business support services sub-index, 2009



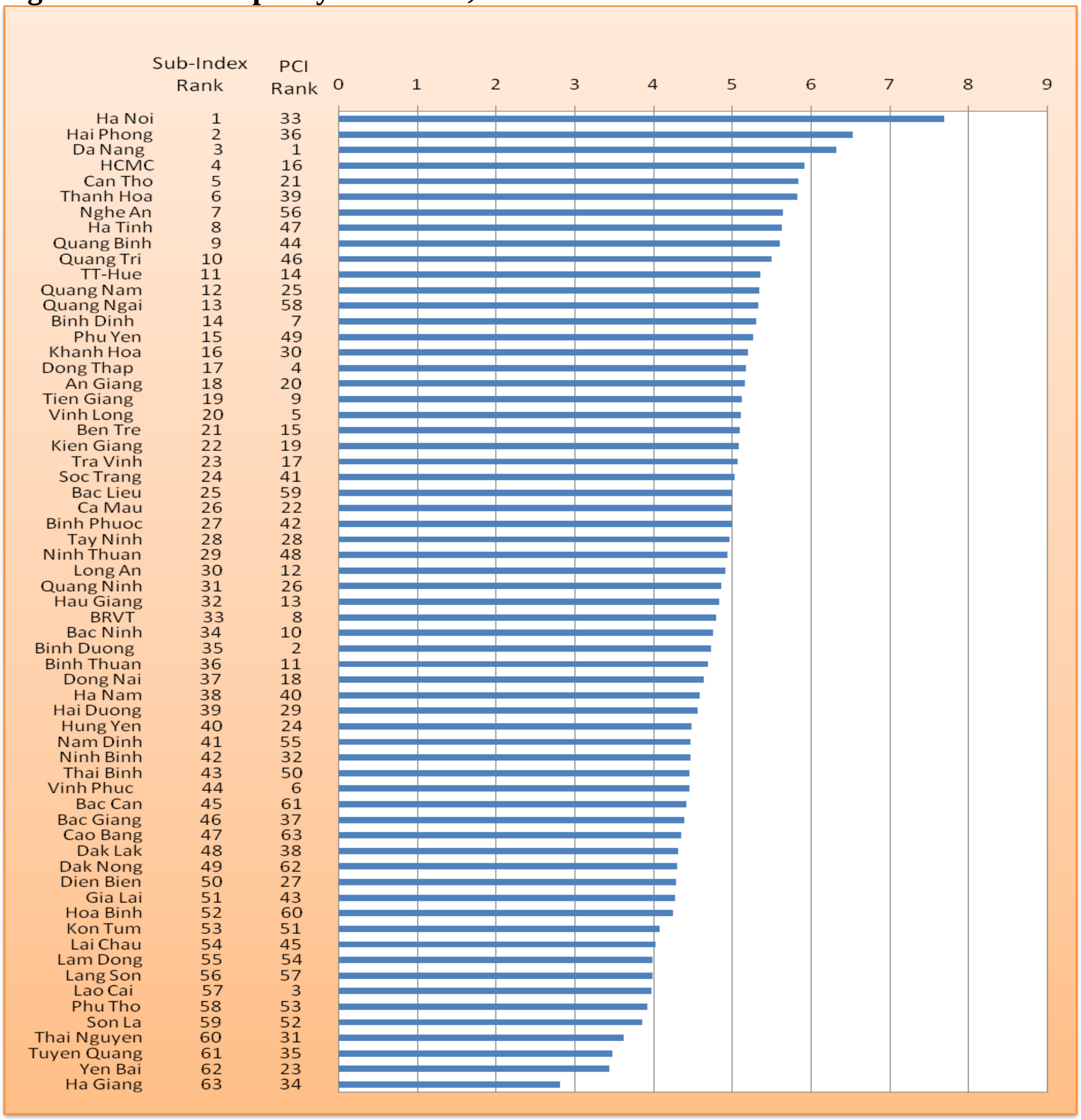
Source: PCI 2009

5.1.2.9. Labor policy

Cost of labor is a decisive factor in making location decisions for efficiency-seeking investment. In the longer run, availability of qualified labor becomes an even bigger issue. For poor countries with low education levels and a large part of the labor force in agriculture, this indicator is of particular importance. Training workers to migrate from farming into industrial work is expensive, yet it has to occur at an early stage of development to bring investors in. Elites must make a choice even before they get the full benefit of foreign investment: either engage in rent seeking or reduce their predation and invest in upgrading the work force for long-term investment growth.

In Vietnam, where investment is concentrated in a small number of provinces, human resource availability, education and training and turnover are major points of competitive advantage. The Provincial Competitiveness Index has added questions about vocational training, universities, and labor exchange services to the survey in 2009 in recognition of the shift in importance away from cheap labor to qualified labor. The inclusion of the total number of post-secondary education facilities per capita is a reflection of Assumption 3, which holds that to retain citizens, especially the most qualified ones, a province must reduce rent seeking and offer a competitive social wages basket. Vocational training reflects Assumption 1, which assumes that the more foreign investment flows into a province, the more the elite will have an incentive to plow money back into the economy to create good business conditions rather than seeking rents for officials in the short run through maximum possible predation.

Figure 5.10. Labor policy sub-index, 2009



Source: PCI 2009

Seven out of the 10 highest-ranked provinces are among the top 15 investment recipients. Of the bottom-13, only one (Dak Lak at #11) is in the top tier. Eight of the 13 are in the bottom tier. Of high investment performers, only two are in the bottom tier. One is Hung Yen at #44. The other is Lam Dong, the 15th highest ranked province in terms of foreign investment, which warrants a separate case study owing to its ranking lowly in virtually all PCI categories in spite of its strong investment performance. Long An, a province that is actively working with Ho Chi Minh City to attract overflow investment in the labor-intensive, low-value-added sectors Ho Chi Minh City no longer wants, is the only other highly invested province ranked in the bottom half of the table (#34). Long An is consistently doing well on indices that can be managed by provincial governmental performance. Its low performance on labor issues is evidence of how difficult labor issues are to address by policy alone, without the pull of an already existing, well-performing market. Five low investment-attracting provinces are ranked ahead of Long An, but four of them barely so (ranks #29 through #32). The one outlier, Dak Lak on #11, requires further study to evaluate how a poor, agricultural province with very little investment could perform so well on the labor policy front.

Table 5.9. What goes into the labor policy sub-index

Indicator	Source (2009)	Measure	2006	2007	2008	2009
Perception of services provided by provincial agencies in general education (% very good or good)	PCI 2009 Survey	Minimum	7.43	51.51	17.71	22.08
		Median	19.16	73.29	35.20	45.45
		Maximum	35.52	87.34	58.90	68.93
Perception of services provided by provincial agencies in vocational training (% very good or good)	PCI 2009 Survey	Minimum	31.25	24.00	6.25	10.25
		Median	55.43	55.90	19.81	27.11
		Maximum	73.17	79.49	46.28	48.51
# of labor exchange bureaus per 100,000 inhabitants	Min. of Labor, Invalids and Social Affairs	Minimum		0	0	0
		Median		0.14	0.17	0.17
		Maximum		0.68	0.62	0.70
% of firms that have used labor exchange services	PCI 2009 Survey	Minimum				15.65
		Median				33.33
		Maximum				47.13
% of firms that used private provider for above labor exchange services	PCI 2009 Survey	Minimum				25.53
		Median				40.43
		Maximum				75.61

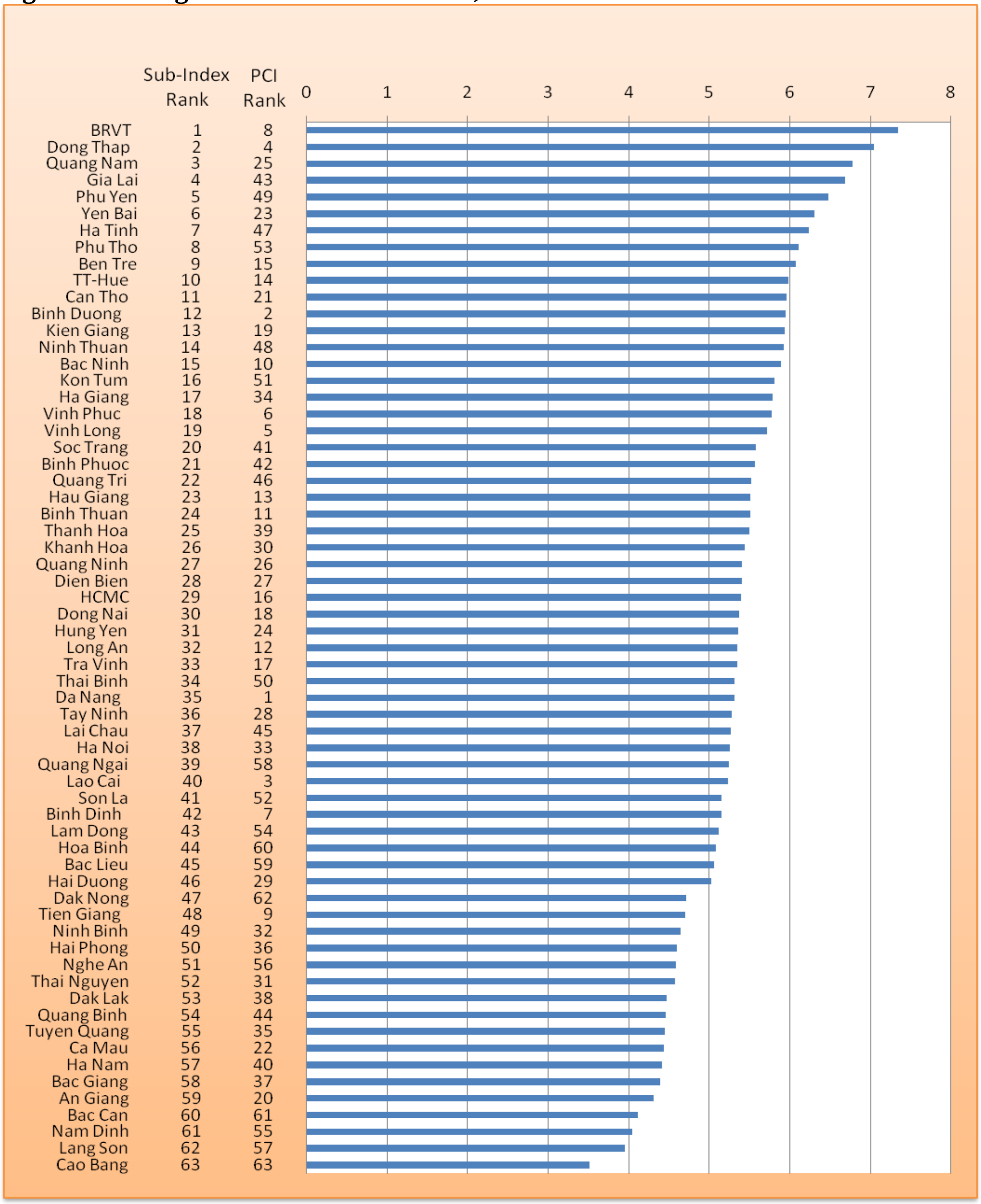
% of firms that intend to use above services for labor exchange	PCI 2009 Survey	Minimum				8.51
		Median				27.78
		Maximum				42.86
% of total business costs spent on labor training	PCI 2009 Survey	Minimum				0.00
		Median				1.00
		Maximum				2.50
Total training institutions (university secondary, vocational) per 100,000 inhabitants	Min. of Labor, Invalids and Social Affairs	Minimum				0.76
		Median				1.97
		Maximum				5.99
# of district-level vocational training centers per district in province	General Dept. of Vocational Training	Minimum				0.00
		Median				0.36
		Maximum				1.17
% of vocational training institutes in the province run by private entities	General Dept. of Vocational Training	Minimum				0.00
		Median				16.67
		Maximum				62.50
Ration of vocational training school graduates to untrained laborers	Min. of Labor, Invalids and Social Affairs	Minimum				1.42
		Median				5.45
		Maximum				29.02
% of workforce with secondary school degree	General Statistics Office	Minimum				4.40
		Median				10.30
		Maximum				30.20

Source: PCI 2009: 83-5

5.1.2.10. Legal institutions

This index measures businesses' faith in the People's Court system through perception survey questions and hard data. The top of the sub-index is dominated by middling provinces in terms of investment. Only #1 Ba Ria-Vung Tau and #4 Gia Lai are exceptions, one from the top end of the investment ranking (Ba Ria-Vung Tau is #7), and one from the low end (Gia Lai is #52). Investment poles are concentrated around the middle of the table.

Figure 5.11. Legal institutions sub-index, 2009



Source: PCI 2009

Table 5.10. The legal institutions sub-index over time

Indicator	Source	Measure	2006	2007	2008	2009
Legal system provided mechanism for firms to appeal officials' corrupt behavior (% always or usually)	PCI 2009 Survey	Minimum	7.44	17.70	17.22	13.04
		Median	19.16	28.80	27.31	25.17
		Maximum	35.53	41.41	42.53	43.94
Firm confident that legal system will uphold property rights and contracts (% strongly agree or agree)	PCI 2009 Survey	Minimum	50.00	53.57	55.05	45.63
		Median	69.42	66.11	67.00	62.32
		Maximum	82.14	77.55	78.23	75.76
Cases filed by non-state entities at Provincial Economic Court per 100 firms	People's Supreme Court	Minimum	0	0	0	0
		Median	0.41	0.58	1.29	3.05
		Maximum	9.49	8.12	6.97	35.64
Non-state claimants as a percentage of claimants at Provincial Economic Court	People's Supreme Court	Minimum	0	0	0	0
		Median	50.00	50.00	65.48	72.41
		Maximum	100.00	100.00	100.00	100.00
Business used courts or other legal institutions to resolve disputes	General Dept. of Vocational Training	Minimum				4.76
		Median				23.33
		Maximum				44.83
Median days to resolve court cases	Min. of Labor, Invalids and Social Affairs	Minimum				1.00
		Median				6.00
		Maximum				19.71
Median formal and informal costs as a percentage of dispute value	General Statistics Office	Minimum				3.09
		Median				12.21
		Maximum				60.00

Source: PCI 2009: 87-8

5.1.2.11. The Provincial Competitiveness Index as a proxy for rent seeking

The Provincial Competitiveness Index is designed as a measure of good economic governance. For Assumption 1, it does measure exactly the rent-seeking aspect of governance. Assumption 1 concerns itself with the relationship between investors and provincial governing elites, assuming that elites will reduce their rent seeking if they expect in return a better business climate and a growing economic pie. To measure this assumption, rent seeking is defined as skimming off surpluses versus re-investing them into the economy for further attractiveness to investors and continued growth. All ten sub-indices respond to this question. They measure either active re-investment (as in infrastructure construction or active involvement in clearance and re-zoning of agricultural land for commercial uses) or reduced predation (as in reduced entry cost or informal charges).

In some cases, the line between these two categories is in flux. Transparency requires active change by government; at the same time it represents a significant reduction in the predatory power of officials. Every step in the licensing process represents an opportunity for extra-legal payments (or legally required payments). Cutting red tape (reducing entry costs) and increasing transparency are therefore government actions as well as reductions in predatory power – a concomitant stepping up and stepping back. To test other assumptions, we measure additional forms of reduced rent seeking, such as the level of social wages and government services. For those assumptions, additional data about government performance are required. But to test for the hypothesized harmony of interest between provincial coercive elites and investors, the PCI covers all bases and is a near-perfect proxy for rent seeking. The detailed analysis of sub-indices allows to broaden the hypothesis beyond the original inquiry and ask why some provinces do very well in some aspects of providing a better business climate than in other aspects of the same variable. Such question can help understand the impact of good governance and specific aspects thereof on corporate location decisions.

5.2. The Constraining Effects of Foreign Investment on Rent Seeking

Rent seeking is always a disincentive to invest in a jurisdiction. It is therefore reasonable to assume that provinces that attract a large amount of investment do so because they have limited their levels of rent seeking. This section investigates whether the data support this assumption. The number of investment projects should be positively associated with the quality of governance, measured by the compound score on the Provincial Competitiveness Index that weights the sub-indices. The relationship is not expected to be perfectly linear,[47] because a province that has excellent infrastructure, access to a deep-water port, good human resources and the social infrastructure to satisfy foreign expatriate managers can get away with higher levels of corruption and more red tape than a province that has little going for it other than good, efficient and honest government. Natural advantages do matter alongside governance. Governance is really *one factor* in the cost-benefit analysis conducted by investors – albeit the most important one, according to the regression analysis conducted by the PCI. This is why similarly endowed jurisdictions exhibit very different outcomes due to different quality of governance.[48]

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47 If governance *alone* mattered, we would expect a winner-take-all situation and the best-governed province would get all the investment. No efficiency-seeking investor would have any reason to go anywhere else.

48 That is, in the end, what the PCI measures, investment climate independent of natural endowment. Obvious examples of the importance of governance on the international level are the dramatic difference in economic performance between North and South Korea, which can hardly be blamed on natural

Equally importantly, after a good start, success builds on success in a path-dependent process. Provinces with a large investor pool are likely to attract investment with less effort and may even engage in more rent seeking; latecomers must show more initiative.

Table 5.11. Number of projects and capital licensed by region and province; PCI ranking

Region shaded	FDI licensed 1988-2008			FDI licensed in 2008	
Province	# of projects	Rank (project #)	US$ million	# of projects	(Rank (project #)
Total	10981		163607.2	1167	
Red River Delta	2790	2	33627.1	382	
Ha Noi	1498	3	20228.2	218	2
Vinh Phuc	182	9	2215.2	18	10
Bac Ninh	133	14	1933.2	31	7
Quang Ninh	158	12	1743.4	11	15
Hai Duong	220	8	2325.5	40	6
Hai Phong	352	5	3499	31	7
Hung Yen	147	13	729.2	24	9
Thai Binh	24	34	95.1	0	44
Ha Nam	30	29	203.3	2	25
Nam Dinh	24	34	119.9	3	23
Ninh Binh	22	37	535.1	4	20
Northern Mountains	325	5	1823.1	25	
Ha Giang	7	52	20.4	0	44
Cao Bang	13	48	25.2	1	33
Bac Kan	7	52	19.4	0	44
Tuyen Quang	5	58	75.8	1	33
Lao Cai	51	23	322.9	3	23
Yen Bai	17	40	36.8	1	33
Thai Nguyen	25	33	321.2	0	44
Lang Son	49	24	139.7	2	25
Bac Giang	59	21	282.2	11	15
Phu Tho	48	25	343.7	0	44
Dien Bien	1	63	0.1	0	44
Lai Chau	4	61	16.7	0	44
Son La	9	51	114.5	0	44
Hoa Binh	30	29	104.6	6	18
Central Coast	690	3	43886.8	51	
Thanh Hoa	42	27	6992.9	5	19
Nghe An	26	32	335.1	0	44

endowments or on cultural or historical differences. In Vietnam itself, think of the vast gap in economic performance before and after *doi moi*, without any marked change in resources.

Ha Tinh	14	45	7940.8	1	33
Quang Binh	6	56	34.7	0	44
Quang Tri	15	44	67.5	0	44
Thua Thien-Hue	60	20	1900	12	14
Da Nang	165	11	3080.3	17	12
Quang Nam	57	22	766.8	0	44
Quang Ngai	22	37	4651.9	1	33
Binh Dinh	39	28	253.2	1	33
Phu Yen	44	26	6315.3	1	33
Khanh Hoa	109	16	817	2	25
Ninh Thuan	16	42	9952.9	2	25
Binh Thuan	75	17	778.4	9	17
Central Highlands	147	6	1334.3	19	
Kon Tum	4	61	82.1	1	33
Gia Lai	7	52	24	0	44
Dak Lak	5	58	26.4	0	44
Dak Nong	6	56	16.4	0	44
Lam Dong	125	15	1185.4	18	10
Southeast	6462	1	71857.8	611	
Binh Phuoc	64	19	200.8	1	33
Tay Ninh	173	10	778.2	16	13
Binh Duong	1743	2	9984.2	127	3
Dong Nai	1031	4	14752.8	45	5
Ba Ria-Vung Tau	226	7	16896.1	4	20
Ho Chi Minh City	3234	1	29245.8	418	1
Mekong Delta	505	4	7876.5	79	
Long An	273	6	2896.3	65	4
Tien Giang	27	31	294.8	2	25
Ben Tre	16	42	137.4	2	25
Tra Vinh	17	40	80.8	2	25
Vinh Long	14	45	57.3	0	44
Dong Thap	18	39	44.4	0	44
An Giang	14	45	29.5	1	33
Kien Giang	23	36	2805	2	25
Can Tho	69	18	799.1	4	20
Hau Giang	5	58	630.8	0	44
Soc Trang	7	52	42.3	1	33
Bac Lieu	11	49	37.8	0	44
Ca Mau	11	49	21	0	44

Source: GSO various

In either case, investors get what they want (or what they pay for). In one case they pay a little more for an established province with infrastructure, companies with complementary skill sets nearby, a track record and other benefits worth the extra cost. In the other case, they pay less and get less in return. Investment should thus not be a linear function of good governance, but be positively correlated with it.

Figure 5.12.a. and 5.12.b. represent a direct relationship between foreign direct investment and rent seeking. Provinces are ranked by number of foreign investment projects in 2008 and for the 1988-2008 period, respectively, on the x-axis, and their weighted compound Provincial Competitiveness Index 2009 score on the y-axis. We use number of projects instead of licensed capital to avoid distortion by extremely highly invested projects that are not reflective of efficiency-seeking manufacturing projects. We also refrain from using licensed capital because firms have an incentive to apply for the biggest possible project and implement only parts of it, rather than re-applying at every expansion. The amount of implemented capital varies greatly from the licensed amount. The 2008 investment data are reflective of the current investment climate because foreign investment soared after Vietnam was admitted to the World Trade Organization. New investors who had been preparing their investment in expectation of Vietnam's admission were aware of the performance of provinces at the time of investment as well as their progress or regress over the years leading up to 2008. They could make an informed decision taking natural endowment, infrastructure and governance at a point in time and changes in governance over time into consideration. The long-term investment data (1988-2008) represent a check on the possibility of 2008 being an outlier year for any individual province or Vietnam overall, and to check whether investors changed their behavior over time as some provinces improved their

investment climate while that of others deteriorated.

Figure 5.12.a. Number of 2008 FDI projects and 2009 PCI score

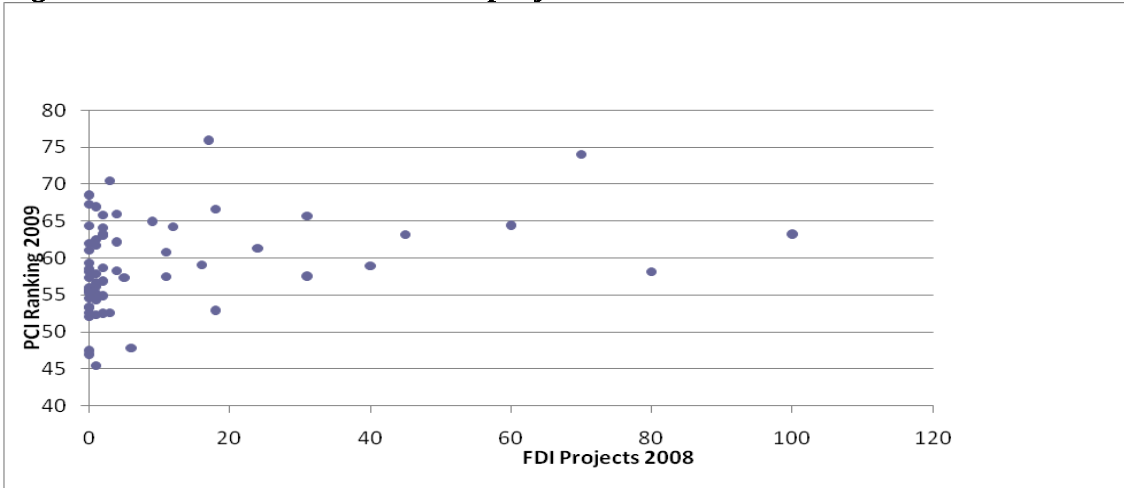
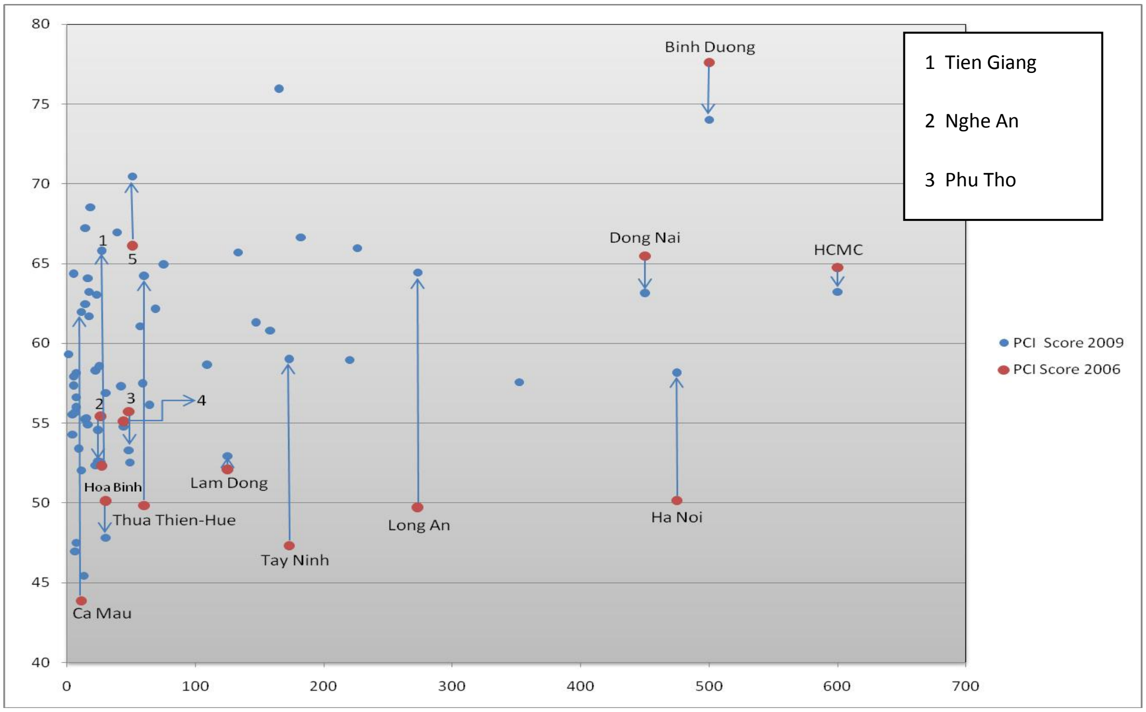


Figure 5.12.b. Number of 1988-2008 FDI projects; Changes in PCI 2006-2009



Sources: PCI, GSO 2010a

Figure 5.12.b. also shows the change in the PCI performance of some select provinces.

It indicates the relative decline of the top investment attractors, and the major improvers and decliners. The data confirm that governance is of significant importance in the choice of investment location. For a province to obtain more than 10 foreign direct investment projects in 2008, it needs a PCI score of at least 57 points. The same PCI score of 57 also represents a clean dividing line for long-term investment: provinces with 75 projects or more need to score above 57. Lam Dong, the perpetual exception on all PCI sub-indices, represents the lone outlier in both cases again. The graphs show that a high PCI score is a necessary, not a sufficient condition for investment. Several provinces with PCI scores above 57 receive few investment projects. The prime examples are Lao Cai and Dong Thap, whose scores puts them into the category "excellent" with only four other provinces, while their investment numbers remain low. Lack of infrastructure, distance to markets and low availability of qualified workers cannot be compensated entirely by quality of governance. By contrast, low quality of governance always pushes a province into the low ranks of foreign investment recipients, even if they have immediate access to deep water ports, the main national railway and highway, natural resources or a large underemployed population. The lone exception, Lam Dong, is a mountainous inland province that has neither good governance nor any natural endowment advantages.[49]

A multivariate correlation in the Provincial Competitiveness Index tests for a number of variables as selection criteria for the location of investment projects. The

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49 No good explanation for Lam Dong could be found. Edmund Malesky, the main author of the PCI, suggested in an email to the author that the hill station of Da Lat might attract tourism-related investment. But Da Lat is off the path of international tourism and attracts mostly Vietnamese honeymooners and backpackers. One major investment project is the conversion of the palace of the last emperor, Bao Dai, into a hotel. Aside from this project, Da Lat remains a destination for lower end tourism built on small family hotels, not foreign-invested ventures. Lam Dong requires a case study for itself.

result shows that the most important is governance as measured by the PCI. Second is wealth as measured by gross domestic product. Third is surface area, possibly because larger provinces can more easily overcome the pressing issue of land clearance and zoning for industrial purposes. Fourth, road quality as measured by percentage of asphalted all-weather roads. Governance, however, has ten times the impact of paved roads – for each percentage point in improvement in the PCI score, three more investors were likely to invest in a province. To achieve the same result, a province would have to pave 10% more roads (VCCI 2009: 6).

Figure 5.13. Factors for investment location decisions

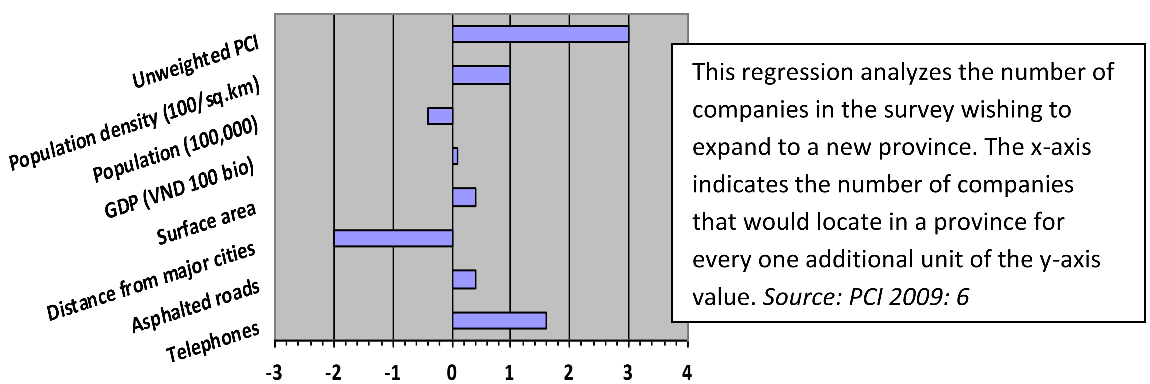

Figure 5.13. depicts the results of the 2009 survey. Because of the range of responses, only the four above-mentioned variables can be considered statistically significant. For the others, it is not certain that they will continue to have the same positive relationship in future iterations of the survey.

5.2.1. Outliers and the harmony-of-interest assumption

Provinces whose PCI score and ranking in the number of investment projects diverge widely warrant further analysis in light of the above data. While outliers should not simply be explained away (in what Imre Lakatos (1970) called a degenerative problem shift), it is useful to investigate what we can learn from data points that do not fit the hypothesized outcomes. In every statistical analysis, these outliers are numerous and should be evaluated, for a richer analysis than a mere regression provides.

Lao Cai and Dong Thap are the two most remarkable outliers, because of their high PCI and low investment rankings. Lao Cai's PCI rank was #3 in 2009 and #5 in 2006. Its investment performance was three projects in 2008 and 51 over the two decades between 1988 and 2008. Lao Cai is a mountainous province with a high proportion of ethnic minorities in its population. It is distant from growth poles, has a small and geographically dispersed population and given the bad infrastructure into the Northern Highlands, its remoteness is more pronounced than the physical distance from Ha Noi suggests.[50] In spite of this lack of natural advantages, its leadership provides excellent governance. Governance makes up partly for other disadvantages, including distance and low population. With Lao Cai's excellent governance score and very good infrastructure sub-score (#11), the province has the seventh-best overall investment environment with regards to variables that can be controlled by provincial government.

[50] Physical distance is not the only factor. If, due to infrastructure weakness, a province is reachable only with great difficulty, a company will be less likely to locate there than in an equidistant province with better roads, an airport and a main train line. Moreover, as we will see later, Vietnamese migrants follow networks of family and acquaintances. The fewer individuals from an area have already migrated to another province, the fewer will follow through this network. Ethnic minority status creates an additional level of social remoteness, since minorities are reluctant to move to the lowlands and as a result, networks remain small and options limited.

As a result, Lao Cai ranks 23rd in the number of investment projects received out of 63 provinces. Based on geography and demography, the province should be among the lowest recipients of foreign investment.

Table 5.12. Lao Cai and Dong Thap: Two excellent performers with low natural endowments

	Distance to growth pole	Population 2009	Pop. Density 2009	Land area in sq.km	PCI score 2006/2009	PCI rank 2006/2009
Lao Cai	274km/2h04min	614,900	96	6,384	66.13/70.47	5/3
Dong Thap	188km/3h07min	1,667,700	494	3,375	57.65/68.54	11/4

Sources: Statistical Handbook 2009, Statistical Yearbook 2008, Provincial Competitiveness Index 2006, 2009. Distances calculated by the author with Googlemaps.

Dong Thap, the other low-investment-receiving province with an "excellent" PCI score, exhibits different characteristics. Its geographical center is three hours driving from the center of the southeastern growth pole. Its infrastructure ranking, one of the most important criteria for investment decisions, is only #31. In addition to lagging infrastructure, Dong Thap is far from the ocean and, unlike Lao Cai, is not located along the national north-south train line. Lao Cai may also benefit from its proximity to the emerging trade partner China, while Dong Thap is an inland province close to – but badly connected with – Cambodia and Laos.

Importantly, Dong Thap is a climber in the governance ranking. While Lao Cai has been a top PCI performer from the beginning of this ranking, Dong Thap was only in the "mid-high" category in 2006. Lao Cai's better performance can be attributed to its longer history of good governance. In 2006, when Lao Cai was already ranked "high" and #5, Dong Thap was a respectable – yet in terms of PCI score a distant – #11. This may explain why Dong Thap has not registered many investment projects over the long run, but leaves unexplained why it has not licensed a single investment project in 2008.

One must assume that its continuous lag in investment performance is largely geography-based. Ho Chi Minh City's strategic partnership with neighboring Long An (to the south) to locate labor-intensive industries there may also be holding more remote Dong Thap back.

Table 5.13. Difference in PCI 2009 rank vs. rank in number of projects, 1988-2008

Province	# of projects (ranking)	PCI 2009 (ranking)	Difference PCI vs. project ranking
1 Lam Dong	15	54	39
2 Lang Son	24	57	33
3 Hai Phong	5	36	31
3 Hoa Binh	29	60	31
5 Ha Noi	3	33	30
6 Phu Tho	25	53	28
7 Nghe An	32	56	24
8 Phu Yen	26	49	23
8 Binh Phuoc	19	42	23
10 Hai Duong	8	29	21
10 Nam Dinh	34	55	21
10 Quang Ngai	37	58	21
Tay Ninh	10	28	18
Thai Binh	34	50	16
Bac Giang	21	37	16
Cao Bang	48	63	15
Ho Chi Minh City	1	16	15
Quang Ninh	12	26	14
Khanh Hoa	16	30	14
Dong Nai	4	18	14
Thanh Hoa	27	39	12
Hung Yen	13	24	11
Ha Nam	29	40	11
Bac Lieu	49	59	10
Bac Kan	52	61	9
Ninh Thuan	42	48	6
Dak Nong	56	62	6
Long An	6	12	6

Quang Nam	22	25	3
Can Tho	18	21	3
Ha Tinh	45	47	2
Quang Tri	44	46	2
Son La	51	52	1
Ba Ria-Vung Tau	7	8	1
Binh Duong	2	2	0
Thai Nguyen	33	31	-2
Vinh Phuc	9	6	-3
Bac Ninh	14	10	-4
Ninh Binh	37	32	-5
Thua Thien-Hue	20	14	-6
Binh Thuan	17	11	-6
Gia Lai	52	43	-9
Da Nang	11	1	-10
Kon Tum	61	51	-10
Soc Trang	52	41	-11
Quang Binh	56	44	-12
Lai Chau	61	45	-16
Yen Bai	40	23	-17
Kien Giang	36	19	-17
Ha Giang	52	34	-18
Lao Cai	23	3	-20
Dak Lak	58	38	-20
Binh Dinh	28	7	-21
54 Tien Giang	31	9	-22
55 Tuyen Quang	58	35	-23
56 Tra Vinh	40	16	-24
57 An Giang	45	20	-25
58 Ben Tre	42	15	-27
58 Ca Mau	49	22	-27
60 Dong Thap	39	4	-35
61 Dien Bien	63	27	-36
62 Vinh Long	45	5	-40
63 Hau Giang	58	13	-45

Sources: PCI 2009, GSO 2010a

Investors would have to cross Long An province by road to get to Dong Thap, which is deep in the Mekong where river crossings are frequent and rainy season flooding is more pronounced. Given Ho Chi Minh City's strategic alliance with Long An, investors probably see no reason to go farther afield. Long An itself was ranked #12 in the PCI in 2009. Lao Cai and Dong Thap stand out as the two provinces ranked as "excellent" on the PCI index while receiving middling (Lao Cai) and low (Dong Thap) numbers of foreign investment projects. Other provinces also have significantly diverging PCI and investment ranking scores. Whether this divergence challenges the harmony-of-interest assumption needs investigating. In Table 5.13., provinces are ranked according to the divergence of their PCI 2009 rank and their rank in number of investment projects received between 1988 and 2008. The top 10 (n=12, since three provinces share rank #10) are those whose ranking in number of investment projects exceeds their PCI score by the largest number; the bottom 10 those with the highest PCI score in relation to their investment ranking.

We compare these outliers across a number of variables used to explain location decisions used the PCI survey: distance to major cities, population and population density, surface area and infrastructure. The PCI finds that governance is correlated most closely with investment location (see Figure 5.13.) followed at a distance by remoteness and various other factors. The PCI, however, does not have a focus on export-oriented foreign investors. To adjust to the foreign investment focus, access to infrastructure and port access must be emphasized as key criteria for location decisions. Table 5.14. lists criteria of importance to foreign investors as they search for an investment location. Since foreign investors are concerned with availability of workers and land access, population and surface are listed, although it is likely that export-oriented foreign investors with higher capital reserves and higher salary levels are less limited by land access and labor scarcity than poorer domestic companies.

Table 5.14. Divergence of PCI and FDI ranks: some explanatory factors

Province	Distance (km/time)	Distance to	Population	Pop. density	Surface sq.km	Port access[3]
1 Lam Dong	282 / 4h57min	Bien Hoa[2]	1,189,300	122	9,772	6h10min
2 Lang Son	152 / 2h24min	Ha Noi	733,100	88	8,324	2h45min
3 Hai Phong	130 / 2h05min	Ha Noi	1,841,700	1,210	1,522	0h00min
3 Hoa Binh	85 / 1h26min	Ha Noi	789,000	172	4,595	3h10min
5 Ha Noi[1]	0 / 0h00min	Ha Noi	6,472,200	1,935	3,345	1h55min
6 Phu Tho	102 / 1h34min	Ha Noi	1,316,700	373	3,533	3h26min
7 Nghe An	392 / 5h34min	Ha Noi	2,919,200	177	16,491	6h03min
8 Phu Yen	374 / 6h08min	Da Nang	863,000	171	5,061	3h00min
8 Binh Phuoc	213 / 3h53min	Bien Hoa	877,500	128	6,874	3h57min
10 Hai Duong	83 / 1h23min	Ha Noi	1,706,800	1,034	1,650	0h43min
10 Nam Dinh	93 / 1h34 min	Ha Noi	1,826,300	1,105	1,653	1h38min
10 Quang Ngai	131 / 2h20min	Da Nang	1,219,200	237	5,153	2h27min
Averages top 12	170 / 2h47min		1,812,800	320	5,664	2h56min
54 Tien Giang	109 / 2h04min	Bien Hoa	1,673,900	674	2,484	1h20min
55 Tuyen Quang	135 / 2h03min	Ha Noi	727,500	124	5,870	3h47min
56 Tra Vinh	251 / 4h10min	Bien Hoar	1,004,400	438	2,295	3h23min
57 An Giang	322 / 5h15min	Bien Hoa	2,149,200	608	3,537	4h16min
58 Ben Tre	119 / 2h10min	Bien Hoa	1,255,800	532	2,360	1h25min
58 Ca Mau	382 / 6h00min	Bien Hoa	1,207,000	226	5,332	5h13min
60 Dong Thap	188 / 3h07min	Bien Hoa	1,667,700	494	3,375	2h21min
61 Dien Bien	481 / 6h42min	Ha Noi	493,000	52	9,563	8h35min
62 Vinh Long	193 / 3h24min	Bien Hoa	1,029,800	696	1,479	2h37min
63 Hau Giang	240 / 4h06min	Bien Hoa	758,000	473	1,601	3h19min
Averages bottom 10	242 / 3h54min		1,196,600	316	3,790	3h38min

Sources: Distances calculated by the author with Googlemaps, other data Statistical Handbook 2009
1 Ha Noi annexed the larger province of Ha Tay in 2008. As a result, population and surface area increased, paved roads, telephone and GDP per capita declined.
2 Bien Hoa is the geographical center of the Ho Chi Minh City/Binh Duong/Doing Nai growth pole.
3 Major ports are Hai Phong, Da Nang, Quy Nhonh, Ba Ria-Vung Tau and Sai Gon.

Capital can overcome these obstacles, as money can buy land even where it is scarce, and higher salaries lead to migration and to qualified workers changing from companies with lower salary levels to those with higher pay. Foreign investment in the manufacturing sector tends to import most of its inputs and materials, and re-export them after adding value or assembling them. For such a process, access to ports is of key importance, since origin of inputs and destination of the product are both abroad and shipping the parts or products over the bad Vietnamese road or train network represents lost time and profit.

The data in Table 5.14. support the suggest that provinces that do significantly better or worse in attracting foreign direct investment than their PCI score would suggest can largely blame or credit the vagaries of geography for their situation. The 12 provinces that attract less investment than their PCI ranking would account for are located at a driving distance of almost one-and-half times farther than the most over-performing provinces; driving distance to the nearest port is approximately 25% longer. (Without the unexplained eternal outlier Lam Dong, the numbers would be even more pronounced.) Over-performing provinces have significantly higher population and surface area, as the PCI regression analysis suggested. Higher population leads to a broader labor pool and surface area implies that there is more, and therefore cheaper, land. Population density is comparable between over- and under-performing provinces.

One novel insight from the table, which does not emerge from the statistical correlation of the data that the PCI performed, is that eight of 10 under-performing provinces are located in the South, eight of 12 over-performing ones in the North. One possible explanation is construction cost. Land in the Mekong region is sandy and unstable, and requires significantly more expensive construction for large buildings like factories. As a result, population density is not the only factor for the cost of building new infrastructure. In the south, construction cost is higher even after land clearance, acquisition and zoning have been completed.

Another important question is whether a province is indeed over- or under-performing, or whether investment projects over the 20-year time frame do not reflect recent changes in governance. Phu Tho appears to be over-performing in investment projects compared to its PCI score. In reality, investors match the expectations. Phu Tho was a good performer in the 2006 PCI (ranked #18), but experienced the most spectacular drop of all provinces between 2006 and 2009, when it ranked only #53. Investors recognized the decline in performance and acted in accordance with the theory, by eschewing the province in spite of its favorable geography.

Table 5.15. Over- and underperformers

Over-performers	Change in PCI rank 2006-9	FDI rank 1988-2008	FDI rank 2008	Under-performers	Change in PCI rank 2006-9	FDI rank 1988-2008	FDI rank 2008
Lam Dong	-19	15	11	Tien Giang	+24	31	26
Lang Son	-12	24	26	Tuyen Quang	+12	58	34*
Hai Phong	+5	5	8	Tra Vinh	-3	40	26
Hoa Binh	-21	29	19	An Giang	-11	45	34*
Ha Noi	+5	3	2	Ben Tre	+10	42	26
Phu Tho	-35	25	45*	Ca Mau	+34	49	45*
Nghe An	-33	32	45*	Dong Thap	+7	39	45*
Phu Yen	-28	26	34*	Dien Bien	+31	63	35*
Binh Phuoc	+12	19	34*	Vinh Long	-1	45	45*
Hai Duong	+1	8	7	Hau Giang	+15	58	45*
Nam Dinh	-11	34	24				
Quang Ngai	-1	37	34				
Av. Change	-11.4				+11.8		

** In the 2008 rankings, multiple provinces at the lower end have the same number of projects. As a result, ranks #45 and 34 are shared by a number of provinces. Rank #45 represents zero projects, rank #34 means 1 project.*

In 2008, Phu Tho ranked last in received investment projects, with zero investors seeking a license in the province, consistent with its declining quality of governance. Its seeming over-performance is due merely to the lag time for data to percolate down into long-term statistics. Table 5.15. confirms this explanation. The average drop in rank between the first PCI and its most recent edition among investment over-performers is 11.4 ranks. Under-performers rose by an average of 11.8 ranks. This suggests that investors indeed follow a good investment climate due to good governance, but rapid decline in investment climate makes long-term numbers look better, rapid improvement makes them look worse. The top risers in the PCI, Ca Mau and Dien Bien, are among the 10 most under-performing investment recipients, while the five provinces with the steepest decline are among the 12 most over-performing provinces.

Quantitative analysis is naturally limited in capturing the nuances of any individual case. Hai Phong and Hai Duong over-perform due to their excellent access to a direct shipping route to Japan. Japanese investors declare that they are interested in the Ha Noi-Hai Duong-Hai Phong corridor that runs along one of Vietnam's very few multi-lane freeways ending in the country's second port of Hai Phong, because they can save significant transportation time and cost from Hai Phong to Japan when compared to other major ports in the region. As for Ha Noi, the city benefits from its status as the political capital. Especially investors in the service and financial industries seek proximity to regulators.

Among the under-performers, some have experienced recent improvements in governance and investment is lagging due to the past low quality of governance. In other cases, the difficult transportation system in the Mekong delta with many river crossings and soils that make it hard to build heavy structures on play a role. Proximity to Ho Chi Minh City can be beneficial as a spill-over location, but as Long An is actively cooperating with the Ho Chi Minh City government to build highways and business parks for investors, Long An is gaining an advantage that is likely to come at the expense of other nearby provinces.

Interesting case studies can be conducted for the outliers. Lam Dong warrants a case study due to its unexplained consistent outlier status. A province like Tien Giang, adjacent to Ho Chi Minh City, enjoying good road connections to the Sai Gon port and a network of canals for river transport, should be rising faster in the investment ranking than it does. Yet overall, the data indicate that low rent seeking – expressed through the PCI's governance index – is positively associated with higher amounts of foreign investment. Figures 5.12.a. and b. show that good governance is a necessary condition for high levels of FDI, both for the one-year and 20-year time frame. Even in cases where natural factors act against a province, extremely good governance can in some cases make up for a large part of the endowment deficit. The case of Lao Cai is a case in point.

5.3. Discussion of Data

The data in this chapter support the assumption that provincial elites voluntarily limit their rent-seeking powers to bring in investment. Investors follow good governance, and *ceteris paribus* invest where they can expect predictable, proactive, supportive governments with low levels of predation. Since all other things are never equal, however, factors beyond the control of local elites, such as natural resource endowment or geography, also play an important role in firms' location decisions. Naturally, no government is perfect on all counts, and investors constantly undertake cost-benefit analyses how much performance in one area of governance (as reflected in the sub-indices) they are willing to trade off for another. Many of the investor preferences are predictable and consistent with findings in settings other than Vietnam. Willingness to pay higher taxes (or informal payments) in return for a supportive government, political stability, good infrastructure, high-quality human capital, access to markets or existence of industry clusters has been found in studies around the world. Most markedly, this is evidenced by the fact that the majority of foreign investment goes to industrialized countries where labor costs, taxes and welfare benefit payments are significantly higher than in the developing world.

The 10 sub-indices (infrastructure, entry cost, land access and security, transparency, regulatory compliance cost, informal charges, proactivity, business support, labor policy and legal institutions) paint a picture of provincial leaders making decisions based on careful deliberations. The early top performers recognize that due to their desirability, be it for reasons of geographical advantages, availability of human capital, proximity to markets or path dependence (suppliers, customers, up- and downstream industries and infrastructure already in place), they can engage in more rent seeking than less advantaged provinces. Ho Chi Minh City, for example, leads in one single sub-index (business support services), and is ranked relatively low in several others. As expected, it ranks highly in infrastructure (#3), as relatively good infrastructure was a key reason for placing investment projects into Ho Chi Minh City in the early stages of *doi moi*. Now, the local government lobbies the center for more infrastructure funding. It does so both to retain its leading edge, especially with the top-end firms like Intel, but also because big construction projects remain a means of obtaining power, prestige and, not least, rents from corruption that goes hand in hand with such projects.[51] Ho Chi Minh City ranks #4 in the quality of labor policy. Again, this is not surprising, given the large number of factories with their strong need for labor. As a result, in-migration has increased the cost of housing in particular and cost of living in general, pushing workers out of the city. Return migration leads to a scarcity of labor in Ho Chi Minh City, which in turn reduces its attractiveness as a factory location. The local leaders are aware of this threat to their province's medium- and long-term locational advantage and work hard to provide human capital to enterprises. Less intuitively, Ho Chi Minh City leads in the category for business support services. Given the number of investors already in place and the path dependency that comes with the early mover advantage, this is surprising. Based on the law of supply and demand we discussed earlier, Ho Chi Minh City could be expected to reduce its support for businesses, since they are coming to the province in large numbers anyhow. Of course, business support could be a legacy of the times when fence-breaking officials worked hard to make the city the must-go-to destination in Vietnam. It could also be a result of city leaders' decision to attract a new kind of companies, those in the high-tech field. For them, support services are crucial in overcoming a reluctance to take a risk with a low-tech work force.

[51] One of the most serious corruption scandals in the *doi moi* era erupted in 2006, when officials at the Ministry of Transportation, in charge of infrastructure development, embezzled millions to bet on European soccer matches. Arrests reached all the way up to the Minister's office. The Transportation Minister had to resign, while others in his immediate orbit were handed jail sentences. The scandal became famous under the name PMU 18, after the designation of the ministry's sub-unit. For an in-depth discussion see Gainsborough (2010).

On the other hand, Ho Chi Minh City performs rather badly in other sub-indices, as would be expected for a province already as successful as this economic capital. Entry cost is high (the province ranks #46). In an urban province with little land but thousands of factories, high entry cost may be a reasonable way of weeding out the less desirable projects. Those that really should be in this growth pole are more likely willing to pay a little extra in time and money to get their license. The same logic applies for time cost of regulatory compliance (#33) and informal charges (#53). In short, Ho Chi Minh City has succeeded in attracting so much investment that it no longer needs to perform at top levels in all categories, and officials engage in significant – yet still tolerable – amounts of rent seeking. This outcome is compatible with the initial theoretical assumption that under conditions of contestation, officials will limit their rent seeking as a rational choice: they want to gain smaller, long-term rents in return for giving up excessive predation in the short run; they do *not* want to eliminate rents altogether.

Another interesting case is the central, urban province of Da Nang. Located in a poor part of the country far from both economic poles of the country, the Southeast and the Red River Delta, its leaders decided that they need to work extremely hard on their governance to overcome their geographical and demographic disadvantages. Da Nang ranks in the top tier of all but three categories (informal charges, land access and legal institutions), in the top ten in the other seven, and ranks #1 in the weighted overall index. Interestingly, one of only three weak categories is that on corruption (the informal charges sub-index). This is a governance measure that can be directly affected by political leadership, and given Da Nang's success on that front, a better performance on this measure was to be expected. One possible explanation parallels that of Ho Chi Minh City: Da Nang has been such a stellar performer that officials begin to take their pay-off for their work. Checking for past performance, however, we find that Da Nang started out on rank #40 in the first report in 2006 (while already being ranked #2 overall). Da Nang's improvement suggests that it is indeed addressing corruption, but that this problem is entrenched and takes time. Another weak category is land access and security (#26). For one of the smallest, purely urban provinces, it is not surprising that access to land is problematic. The sub-index shows that security is relatively high, and that the low ranking is based on access problems. This is a case where even good governance cannot overcome natural limitations. The third weak index concerns legal institutions, in which Da Nang ranks #35. This ranking remains unexplained, since legal institutions are part and parcel of good governance and not subject to natural disadvantages. A separate study needs to address this question.

Lao Cai represents an interesting case. A remote mountainous province with all the disadvantages of geography and demography, it ranks among the best-governed provinces (#3). Lao Cai is a good example of a province whose natural disadvantages cannot be overcome by good governance. Lao Cai may be doing better in terms of investment than other provinces with similar natural conditions, but remains a laggard nonetheless. Lao Cai ranks badly in entry cost (#34), time cost of regulation (#31), labor policy (#57) and legal institutions (#40). It is not surprising that a remote province with a large percentage of ethnic minorities, who are not well integrated into mainstream society, would not get high grades on providing high-quality human capital. Regulatory cost and legal institutions are more surprising. Since the quality of legal institutions runs counter to overall good governance in many cases (see the Figure 5.11.), there may be issues with the local control over legal institutions that are beyond the scope of this study to discover.

Another angle of analysis is to look not at individual provinces, but at categories of provinces and their performance in various sub-indices. This method has the advantage that it smoothes over idiosyncrasies that invariably emerge when looking at individual provinces to try to explain their performance. Looking at categories, the assumption that leaders seek success not for the greater good, but for their own benefit, is confirmed in the finding that already successful provinces use their attractiveness to engage in some level of rent seeking. With the notable exception of Da Nang (#1), which is only starting to draw large numbers of projects, the top performers in the entry-cost category are provinces that rank in the middle or low in the PCI and in investment projects. The top provinces in overall PCI performance rank in the middle to lower middle on entry cost (Ho Chi Minh City ranks #46, Dong Nai #48). This pattern allows the conclusion that elites in provinces with low investment try to get what they can from the few investors who move there (maybe because they have no choice, be it that they are resource seekers or pushed into the location by political forces). Leaders in provinces with more investment see it in their interest to limit their predation in return for a bigger pie to skim off from. The middling provinces in terms of investment have low entry costs, potentially in an attempt by reformist politicians to overcome other disadvantages. The lowest ranked provinces in this category also rank at the bottom of the PCI and investment ranking, reflecting the lack of reform in these provinces overall.

A similar picture manifests itself on informal charges. The top performers include some high-ranking PCI performers (Tien Giang #9, Dong Thap #4), but no top investment recipients. Ba Ria-VungTau is ranked #8, but this province receives fewer, yet highly capitalized projects which often have *umbrellas* (protective support) from the highest levels of government. The highest-invested provinces rank middling to low. The reasons for their performance conform to the explanation given for Ho Chi Minh City earlier in this section. While most investment recipients rank in the upper half of the informal charges table, few rank very highly, and the first, fifth and third ranking investment recipients (Ho Chi Minh City, Hai Phong and Ha Noi) rank in the bottom tier on informal charges. Not to be expected is that only two of the bottom investment recipients make a good effort in limiting their side payments and rank highly in this category. The others seem to have given up hope that reducing predation will grow the pie for them.

On business support, provinces with less investment have to work harder to attract the few they do get. Kon Tum, for example, ranked #61 in foreign investment projects and #51 in the PCI, ranks #9 in business support. By contrast, Ba Ria-Vung Tau, which attracts mostly large scale heavy industry projects that are often pushed and approved by the central government, has little incentive to work hard and ranks #43. Interestingly, in this category, the top investment attractors rank highly overall. Ho Chi Minh City even tops this category. Interviews with Ho Chi Minh City, Binh Duong and

Dong Nai officials allow the conclusion that these very successful provinces are aware of their limitations in terms of space and human capital and as a result actively select the industries they consider important for the future of their province, especially higher-value-added industries. This policy can explain their ranking in this category, which is largely based on surveys of entrepreneurs. Those who are located in these provinces feel welcome and well supported.

Overall, the infrastructure sub-index shows a clear correlation between high PCI, investment performance and good infrastructure. The top-four investment recipients (in numbers of projects) rank in the top six in the infrastructure index. Of the bottom-13 investment recipients, eight rank in the bottom 15 in infrastructure. This is explained by the self-reinforcing nature of infrastructure and investment. Good infrastructure attracts investors. Investors push for more infrastructure and have the lobbying power to get it.

On transparency, two of the bottom 13 investment recipients rank in the top tier. One is Lao Cai, which is number three in the overall PCI, based on its excellent governance in spite of its natural disadvantages. The related category of legal institutions shows the middling investment provinces on top. One reason could be that foreign investors who set up their factories in industrial parks can largely bypass the legal system and deal directly with the provincial regulatory authorities (the Department of Planning and Investment). Domestic businesses have to deal with the court system and give low ratings in this category, which is largely survey-based.

Seven of the top 10 provinces in the category of labor policy are among the top

15 investment recipients. There is a clear connection between the need for providing quality labor and business environment in the provinces where labor is scarce. Where surplus labor exists and most investment is in low-end production, there is less need for proactive labor policies. Hence, provinces with low investment levels are unlikely to suffer from ranking low on this score. Top invested provinces also do well on proactivity in dealing with concerns of investors. Bottom-ranked PCI and investment provinces tend to rank lowly in the proactivity category as well. Similarly, in time cost for compliance, higher invested provinces do generally well, although top provinces can afford to demand more. Ho Chi Minh City, for example, actively dissuades low-tech, labor-intensive industries from setting up shop in the overcrowded urban province. As a result of such selectivity, regulations are more tenuous and compliance time increases. A similar logic may be at work in Ha Noi, which ranks very low in this category (#49).

Finally, in the important category of land access, it is not surprising that small and largely urban provinces have problems with land access, regardless of their level of investment. In addition, the more investment there already is, the more complicated it becomes to clear additional land for more business parks or urbanization. Ho Chi Minh City ranks #59, Dong Nai #57 and Ha Noi #55. It will be interesting to see what impact the physical growth of Ha Noi province (which absorbed Ha Tay in 2008) will have on land access. Some of the less invested and larger provinces have good land access, but lower levels of land security (assurances that land right titles will not be challenged or subject to additional payment requests later). One interesting cases is Binh Duong province. This growth pole pioneered land zoning and clearance procedures by making the provincial authorities the sole go-to contact. Investors no longer negotiate land rights purchases with the title holders, but apply to the province, which then takes care of re-zoning, purchase, compensation and transfer (Malesky and Thuan 2005). This procedure puts land-scarce Binh Duong into ninth place in this index, with high scores in the land access as well as land security categories.

Looking across sub-indices, the picture is mixed, but supportive of the assertion made in the theory: elites self-limit their predatory powers out of self-interest. They want to obtain rent from their behavior, hence, when the situation is conducive, they will engage in rent seeking. Governing elites always want a pay-off. They make choices as to how to obtain it, and whether they feel better served by long-term or short-term predation. Grindle's "good enough governance" (Grindle 2004) is a good representation of Vietnam's reforms. The model provinces are models of enlightened, pro-business policies only in comparison to their own past and to other jurisdictions. The success of Vietnam's model is that it has reduced rent seeking enough to keep all parties happy, as evidenced by the self-limitation of powerful coercive elites on one hand, and the willingness of investors to keep putting their money into certain locations on the other.

An interesting aspect of the sub-indices is that at the bottom end of each index, we find almost invariably provinces with the lowest overall PCI and extremely low investment levels. These provinces seem to have given up on overcoming natural disadvantages. Instead, they accept the fiscal transfers from the rich provinces (via the central government) as their share in Vietnam's economic success. The PCI measures governance only, above and beyond natural obstacles to economic growth. This is why disadvantaged Lao Cai ranks so highly, yet still attracts little investment. The fact that some provinces clearly make no effort to imitate Lao Cai in mitigating the disadvantages of geography, demography or history supports the harmony-of-interest theory advanced in this study. These provinces have made their choices and picked the cards they wish to play. Their elites do not believe that they can gain from better governance, and instead take what they can under the current conditions.

5.4. Conclusion

Assumption 1 is intuitive and its confirmation by the data in itself is not particularly insightful. Few would dispute that investors, when they have a choice, will go where they feel welcome. In connection with other assumptions about harmony of interest of various actors, however, showing the importance for *mutual* limitations can inform government policy as well as business strategy. Moreover, given assumptions in the literature that doubt that elites will engage in self-limitation as long as they can avoid it, showing the progress of Vietnamese provincial elites on that count is meaningful – providing indications as to *why* they would do so adds to our understanding of foreign investment decisions and how investment climate can be improved.

The findings in this chapter also add to our understanding of “good enough governance” (Grindle 2004), since clearly no province is top in all aspects of reducing rent seeking. Coercive elites welcome investors for their own benefit, and under conditions of continuous contestation they learn rapidly to optimize the benefit they can get from improving the attractiveness of their province as an investment location. We need to recall that this does not mean that elites welcome investors for the investors' sake, but because the elites perceive high investment to be in their interest. This implies that they will *increase* their rent seeking as long as they can do so *without slaying the goose that lays the golden eggs,* but also that they will limit it as soon as they see such a strategy as being in their interest. As long as investment streams into Ho Chi Minh City, it is reasonable for the elite there to assume that the business climate is good enough and that some forms of rent seeking are acceptable and in the elite's benefit. The harmony of interest assumption permits for an elevated level of corruption, as long as supply (good governance) and demand (for investment licenses) are in balance. The harmony-of-interest assumption predicts, though, that Ho Chi Minh City officials learn to find their balance and limit their rent seeking to acceptable levels, precisely because they have learned that their interest is directly connected with the interest of investors.

This learning is the subject of the next chapter. Assumption 2 holds that proximity forces elites to learn the same lesson rapidly or suffer painful consequences. The closer a highly developed province, the more likely will nearby provinces emulate the development success policies. This reflects a test of the rationality of political actors. Chapter 6 will show whether political actors respond to the incentive structures provided by the structural forces of contestation and alter their rent-seeking behavior depending on the predictable (or already measurable) consequences. The chapter thus tests a different harmony of interest, one that pits provincial elites against neighboring elites, bolstering the bargaining power of their own residents in the process.

CHAPTER 6: PROXIMITY AND CONTESTATION

Chapter 5 has shown how incentives and a harmony of interest between provincial political elites and investors turn roving bandits into stationary bandits; in other words, how the long-term benefits of more investment override the short-term interest in immediate predation. Later, Chapter 9 will discuss how political elites in poor and rich provinces as well as the political leaders in the central government benefit from each other, and all gain a stake in the economic success of the economically reformed[52] provinces. These harmonies of interest – the one between rich province's political leaders and investors, the other among political elites at different levels of government and in rich and poor provinces – beg the question, *by what mechanism(s) does reform spread in Vietnam*? If the leaders in the poor provinces are content with fiscal transfers from the wealthier ones, why do they not simply sit back and let the money roll in? And why does the central government reward more reforms when it could take the fiscal transfers from the rich provinces, pass them on to the poor and bask in its popularity?

In an attempt to answer this question, this chapter tests Assumption 2, which explains why poor provinces could not be satisfied with merely letting the early winners of economic opening pay their bills through fiscal transfers. We assume a *harmony of interest between elites in poor provinces and their citizens* insofar as elites do not want to see their citizens migrate to richer provinces. The elites see it in their interest not to lose taxpayers, workers and consumers, nor do they like to see provincial population

[52] A reformed province is one with better governance as measured through lower levels of government predation (rent seeking). Chapter 5 discusses the *Provincial Competitiveness Index as* the measure for good governance. Improved governance represents reform in a province.

numbers drop, on which central fiscal transfers depend. Since workers primarily move where the jobs are and factories move where business conditions are best, poor provinces whose citizens are migrating away are best advised to engage in catch-up reforms to attract investment capital themselves.

Assumption 2 states that *proximity between a poor province (one with low investment levels) and a wealthy one results in a higher likelihood that the poor province will engage in reforms itself, owing to the threat of out-migration.* As a result, we expect clusters of provinces with improving governance ratings, with the growth poles of Ho Chi Minh City-Binh Duong-Dong Nai in the south and Ha Noi in the north at the center of concentric circles of reforming provinces. We expect proximity to rich provinces to be positively correlated with reform efforts, because migration is associated with transaction costs which increase with distance. The closer to home a growth pole is located, the more the cost-benefit analysis is tilted in favor of migration.

Assumption 2 depends on personal mobility and voluntariness of migration. The ability of regular citizens to make choices about residence alters the bargaining power between elite and non-elite groups. Where people can be prevented from leaving, or are forced to leave, the cost-benefit calculations change and Assumption 2 no longer holds. Chapter 3 has laid out federalist theory (Tiebout 1956) and the theory of political contestation (Tilly 1985; 1990; Jones 1987). It laid out how exit options allow citizens to make credible claims that they will remove themselves from their present elite unless the latter provides more opportunities and a better public goods basket at a reasonable price. Since political leaders face negative repercussions from losing residents, workers, taxpayers and consumers, they have an interest to stymie the flow.[53] Since migration carries costs, Assumption 2 states that *proximity breeds contestation*. The closer a successful province to a less successful one, the less costly will migration be and the higher the risk of mass out-migration. We therefore assume that proximity to a reformed, wealthy province is positively correlated with reforms in the poor province. The closer a poor province is located to an economic success story, the more likely that province will reform its own governance, which is measured by the *Provincial Competitiveness Index* (see Chapter 5). Thus, proximity to a well governed province with better income-earning opportunities increases the bargaining power of subordinate groups, here generally equated with the working class. They can more credibly claim that they will leave if governance in their home province does not improve. Since mass emigration hurts the elite's rent-seeking capabilities and political career opportunities, this is an outcome the elite has a rational interest in avoiding.

We test the assumption that elites in poor provinces will engage in catch-up reforms in order to avoid outflows of their citizens by

- showing migration data to indicate whether migration does follow the expected patterns, from poorer to richer provinces, with proximity as a factor for decisions on destination;
- providing evidence that migration is indeed a choice based on the pull of better opportunity and not a forced decision based on exogenous factors;

53 The two main problems with out-migration are (a) reduced political power as shrinking province loses influence in Ha Noi and the leaders lose career advancement opportunities, in addition to reduced fiscal transfers, which are based on population levels); and (b) reduced rent-seeking opportunities as capital follows consumers into reformed, wealthier provinces.

- exhibiting a time series of change in governance scores to investigate whether clusters of good governance arise around early reformers; and
- discuss the data in light of Assumption 2, including the cases of outliers – provinces with strong improvements in governance score located at a great distance from growth poles.

All these factors depend on one underlying reality – uneven economic development. Section 6.1. introduces Vietnam's development policies and outcomes as a foundation for the assumptions of this chapter. Section 6.2. then gives an overview of migration in Vietnam. The section provides the legal, demographic and historical framework to understand migration patterns. It also discusses research on the conditions and motivations of migrants. This is important for the harmony-of-interest assumption. Only where migrants make decisions based on pull forces (the pull of the receiving province) rather than push forces (landlessness, extreme poverty, being pushed off the land by force) can we see a harmony of interest at work. Harmony of interest, by definition, depends on free calculations of costs and benefits. Following this overview over the regulatory framework and general migration data, Section 6.3. investigates the hypothesized correlation between migration, reform patterns and proximity between reformed and laggard[54] provinces. It discusses the problem of multicollinearity, insofar as poor provinces are often poor *because* they are far away from the early growth poles. Any analysis of distance and reform data is complicated by the associated correlation

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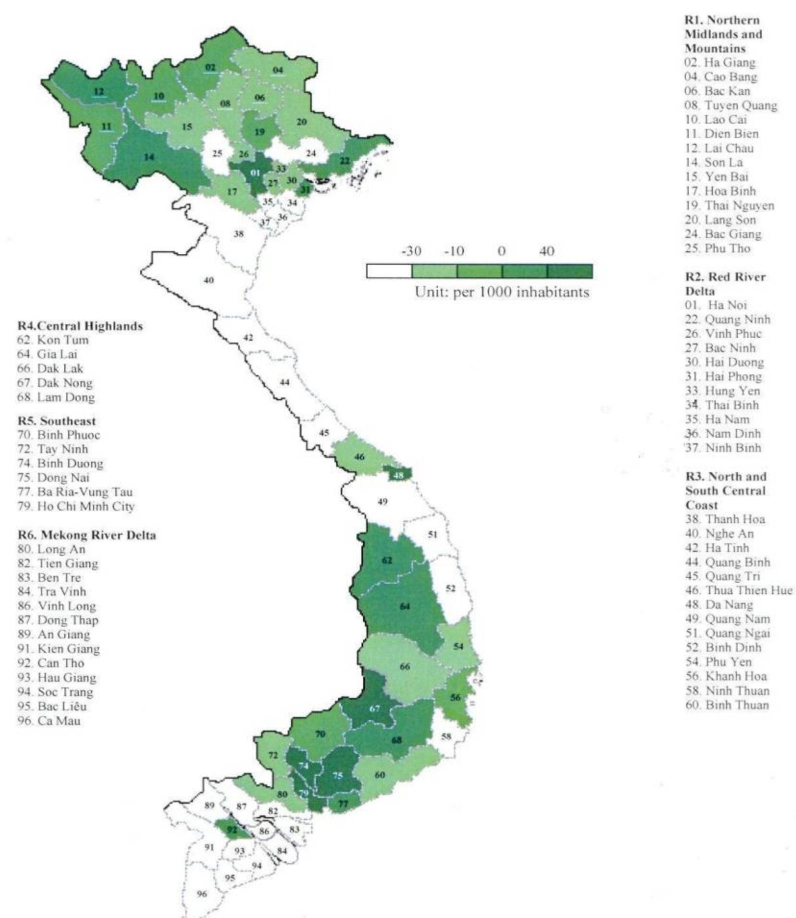
[54] Less well governed provinces can be considered laggards – especially in the context of attempts of catching up with the others. Yet Chapter 5 has shown that in some cases of disadvantages, even excellent governance will not lead to high investment levels. The term laggard therefore is correct in many cases and describes the issue of this chapter, but one must keep the nuances in mind.

between distance and poverty, with poverty itself correlated with lower likelihood of governance reforms. Section 6.4., finally, analyzes the data in light of the hypothesis, Section 6.5. draws conclusions and links this chapter to the following.

Figure 6.1. Net domestic migration, census 2009



Source: Census 2009

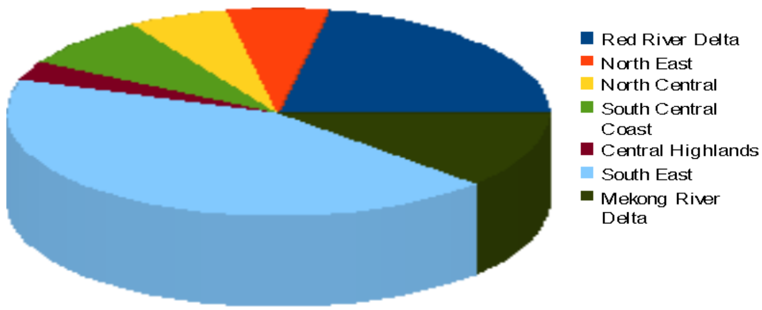
6.1. Uneven Development

Vietnam followed the Chinese model in limiting economic reforms to a small part of the country, in Vietnam's case Ho Chi Minh City. In China, for example, only 11% of the national territory were granted favorable conditions for foreign investment and external trade (Lu 2000: 35). The reasons for this decision are political and economic. Politically, the Party was concerned about this radical change from doctrinaire communism to market opening and foreign capitalist infiltration, and wanted to limit the experiment to the South. A failure could be blamed on the reactionary history of the capital of the former South Vietnam. Economically, the uneven development model recognizes that a poor country lacks the means to give all regions the same support. Those that are favored are expected to return their gains and share them with the rest of the country through the fiscal transfer system (Litwack and Qian 1998: 117-8). Studies of industry location have shown that market forces tend to lead to geographical concentration of investment (Williamson 1965; Myrdal 1957). Krugman explains this phenomenon by a preference of firms to locate near markets and seek strategic complementarity (Krugman 1995). This is even more important where human capital is low and clustering can provide access to better trained workers. Jurisdictions with a first-mover advantage benefit from the virtuous cycle that follows clustering and subsequent preference of investors for a location nearby existing industries (Yang 1997: 7). Once clusters of investors are established, they feed upon themselves. Factories spring up because there are others that make upstream or downstream products. Knowledge used in one production process is often also relevant in another, bringing companies with similar skill set requirements together. And workers have more interest in investing in skill enhancement when there already are more skilled workers around than where there are few. The industrial geography literature discusses this phenomenon of clustering (for example Cantwell 2004). Firms seek each other's proximity to gain the benefits from spillovers, rather than fearing the loss of their intellectual property. Economic sectors congregate for three reasons: a greater pool for skilled labor, the availability of specialized inputs provided by local suppliers, and the easy transmission of new ideas and processes, which leads to productivity increases for all.

This means that Vietnam's leadership had three good reasons to undertake an uneven development policy. First, it contained the political risk from failure in the 'reactionary' South, where capitalism had been practiced until 1975, when the country was unified under the Communist banner. Failure of the experiments could be blamed in a capitalist mindset that had not yet fully absorbed Marxist doctrine. Second, it concentrated its limited resources in a few model areas instead of spreading them thin across the large nation. Third, it benefited from the clustering of vanguard industries. Based on these policy decisions, the central government allotted most early investment licenses to the southern provinces of Dong Nai and Ho Chi Minh City. Because of their success with earlier fence-breaking experiments to get food into the starving cities, the leaders of these two provinces were familiar with the power of the market and with ways to circumvent central government authority. They also knew that as long as they were successful, they could push the envelope and take additional liberties on top of those they were initially granted, and could even improve their career chances in the process (Kerkvliet 2001; Porter 1993). Soon, these two provinces began to lobby investors actively to ask the central authorities to be placed in the south. In the first decade of *doi moi*, three provinces, Ho Chi Minh City, Ha Noi and Hai Phong, received 55% of all committed foreign direct investment capital (Mai 2004: 101). Ho Chi Minh City and Dong Nai received 59.5% of all approved projects (Malesky 2004a: 287). As a consequence, regional income differences are stark. The average difference between the richest region (the Southeast) and the poorest (Northwest) grew from 2.1 times in 1996 to 2.5 times in 1999 and 3.1 times in 2002 (GSO and UNFPA 2006: 10).

The uneven development strategy was successful. Preferential policies allowed the area around Ho Chi Minh City to grow rapidly through the attraction of international investment in the manufacturing sector. The concentration of the economic upswing in a few areas is best demonstrated by the number of provinces that had surpluses to pay into the central treasury: in 2004, six provinces (out of then 64) had a surplus (Malesky 2004b: 290). The idea of allowing the benefits to spread out also succeeded: in 2008, the number of net contributors to the central budget had increased to 11 (Ministry of Finance 2007). In addition, the growth poles attract millions of workers, whose remittances add to the distribution of wealth between the early success provinces and the rest of the country. Figures 6.2. indicates the concentration of foreign investment by showing the distribution of industrial parks (where most foreign investment is located) by province and by land area covered. The Southeast region receives the lion's share, 43% of the number of parks, 53% of land area covered by them. This indicates that the Southeast not only gets most parks, but that they are also larger than the average.

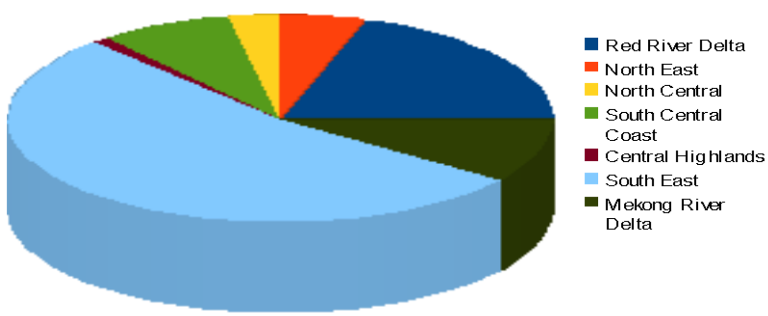
Figure 6.2.a. Distribution of industrial parks by region



Red River Delta	22%	Central Highlands	3%
North East	6%	South East	43%
North Central	6%	Mekong River Delta	12%
South Central Coast	8%		

Source: Ministry of Planning and Investment 2007

Figure 6.2.b. Distribution of industrial parks by land area covered per province



Red River Delta	6,101 ha (20%)	Central Highlands	463 ha (1%)
North East	1,594 ha (5%)	South East	16,308 ha (53%)
North Central	791 ha (3%)	Mekong River Delta	3,073 ha (10%)
South Central Coast	2,596 ha (8%)		

Source: Ministry of Planning and Investment 2007

The uneven distribution of the benefits of reform changed the bargaining power among provinces. Malesky describes a cycle of pull, push and reinforcement forces. First investors are attracted to a province by good infrastructure, human capital, a history of capitalism, large urban areas, a supportive local government and tax incentives. Second, investors improve the fortunes of the local economy and as a side effect increase the political clout of the local political elite, which in turn can engage in fence breaking and improve business conditions further. Third, the more of the money flowing into the national treasury comes from a small number of investment-rich provinces, the more the interest of the central government converges with the interest of local governments and with investors. The center permits more experimentation by the successful provinces and they, in turn, become even more business-friendly. This provides provincial governments with increased bargaining power *vis-à-vis* the center, which is unwilling to cut off its own main revenue source. Moreover, the revenue from foreign investment allows the successful provinces to emancipate themselves from the influence of large state-owned enterprises. These big employers and budget contributors had held outsized influence (Malesky 2004a: 291-2). Malesky's account supports our assumption that foreign investment represents a form of bargaining power for the sub-national government. It works as a bargaining chip for sub-national jurisdictions when a convergence of interests exists between the higher and lower levels of administration.

6.2. Migration in Vietnam

Following unification after the end of what is known in Vietnam as the American War in 1975, the government wanted to build a communist society in the whole country. What had been reasonably successful in the North during the war – large scale nationalization of productive assets and collective farming – proved more elusive in the South, where people were still used to a more traditional, individualistic form of working their land and businesses. The government established full control over society by limiting all kinds of travel and commerce. Most goods could be traded across district lines only by government trading houses in an extremely complicated system of state-managed production, distribution and allocation quotas. Since people depended on ration cards to obtain the basic necessities of life, and since these cards were redeemable only in the district[55] were a person was registered, people were effectively tied to their district of official residence. Spontaneous migration was made impossible simply through the inability to obtain food outside one's district.

To avoid that people can change districts officially, a complicated household registration system (*ho khau*) was put in place. The *ho khau* system divided people and families into four categories:

- KT1 residents are registered where they actually reside permanently;
- KT2 residents reside in the same province, but not in the same district where they are permanently registered;
- KT3 residents are registered temporarily, for a period exceeding six months; and
- KT4 residents are registered for a period of up to six months (Deshingkar 2006: 10).

With the end of the 'subsidized economy' as a result of the *doi moi* market reforms, the ration cards gave way to cash payments for food and other items of daily use. The

[55] See Chapter 4 for a description of the system. Note that the number of administrative units is constantly changing. The number of provinces, for example, increased from 38 in 1978 to 64 in 2007 and 63 today. The number of districts in 2008 was 586 (GSO 2008a), a year later 556 (GSO 2009). The key point is that food distribution was administered by very small units of the state.

control of the government over the movement of its citizens diminished instantly. People were (relatively) free to move into urban areas or industrial zones to find work and income. As long as they earned enough money to pay for their needs in the free market, registration lost much of its meaning.

Demand for labor grew highly unevenly, as foreign investment was licensed in Ho Chi Minh City and adjacent provinces, while the rest of the country remained almost entirely rural in character. In the aftermath of *doi moi*, some 80% of the population were farmers (Morely and Nishihara 1997: 68). Owing to significant scarcity of arable land,[56] rural surplus labor was available for industrialization. The pull of the emerging industrial zones was strong from the earliest stages on, given the income differential between rural underemployment and factory labor (CIEM 2005). Recognizing the need for labor migration into the new economic growth poles, the government amended the labor code to assure workers "the right to work for any employer and in any location that the new law does not prohibit" (Art. 16 of the Labor Code from July 5, 1994, cited in CIEM 2005).

6.2.1. Inter-regional migration

As a result of legal changes and arising opportunities, Vietnamese began to migrate in large numbers. In the period[57] between 1994 and 1999, 6.5% of the population moved between districts. Half of these migrants also changed province in the process. Net

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56 With 205 people per square kilometer, Vietnam has the highest population density in Southeast Asia together with the Philippines (with the obvious exception of city state Singapore).

57 Because of the definition of migration as having a different place of residence from five years prior, the 1999 census measures the early *doi moi*-related migration flows.

migration contributed over one-third of urban population growth in that period. For the economic and political centers, Ho Chi Minh City and Ha Noi respectively, immigration accounted for 50% of population growth (GSO and UNFPA 2005: 10-11). In the same period, the population of 40 provinces declined. Most pronounced declines occurred in the Red River Delta provinces of Hai Duong, Thai Binh and Nam Dinh (all within 2 hours traveling time from Ha Noi) and in the agriculturally unfavorable Central Coast region (GSO and UNFPA 2006: 9).

In the mid-1990s, the post-war generation began to enter the workforce in large numbers. An estimated one-and-half million young people reach working age per year. The age pyramid is heavily skewed; one in four Vietnamese is in the 15-24 age group, and another 30% are 26-30 years old. While few young people are unemployed (under 5%), more than one in four are under-employed in the rural economy (Deshingkar 2006: 7). Detailed migration data are collected in the decadal census, last undertaken in 1999 and 2009. The census collects migration data across administrative boundaries (but excludes people who have changed administrative unit because of change in borders or re-naming of units). Following international norms, a person is considered a migrant if that person at the time of the census resides in an administrative unit other than the unit of residence at the same date five years earlier. Therefore, the migration statistics encompass the five-year period prior to the census, 1994-1999 and 2004-2009. Tables 6.1. summarizes inter-regional migration data.

Table 6.1. Inter-regional migration 1994-1999, 2004-2009 (in 1,000 individuals)						
Region[1]	In-migrants		Out-migrants		Net population loss/gain	
	1994-9	2004-9	1994-9	2004-9	1994-9	2004-9
Country Total	1,334	2,361	1,334	2,361	0	0
Red River Delta	163	289	333	331	-170	-42
Northern Mountains	84	91	180	271	-96	-180
Central Coast	114	110	425	775	-311	-665
Central Highlands	326	166	60	125	+266	+41
Southeast	580	1,635	125	125	+455	+1,510
Mekong River Delta	67	70	211	734	-664	-664

Source: Census 2009

1 Data from the 1999 census were re-calculated to reflect the altered boundaries of the socio-economic regions. Calculations by the Government Statistics Office.

A comparison between migration data of 1999 and 2009 shows that only two regions exhibit a positive net migration rate, the Central Highlands and the Southeast. The analysis in the census points out that in-migration to the Central Highlands in 1994-9 is based largely on a government-sponsored scheme and is thus not comparable to other provinces where migration was spontaneous (GSO 2010b). In the 2004-9 time frame, organized migration has largely ceased, but low population density still attracts migrant peasants who cannot find land in the densely populated rest of the country. By 2009, the intensity of in-migration into Ho Chi Minh City had slowed to15% of 1999 levels, from 76/1,000 to 9/1,000. At the same time the migration rate to the Southeast had increased from 49/1,000 to 117/1,000. Of the four out-migration regions, in three absolute levels of migration have increased, while the Red River Delta has seen a decline in net rates. The Red River Delta benefits from in-migration into Ha Noi, largely compensating for out-migration elsewhere.

Table 6.2. shows where migrants move. The data show that the most important

determinant for migration is availability of remunerated labor. The second factor is proximity to the home province. The Southeast draws migrants from all parts of the country, near or far. Only Northern Mountains residents do not favor the Southeast over other regions, but migrated to the adjacent Red River Delta instead. The number of Mekong River Delta migrants into the Southeast is staggering, yet not surprising. Slightly more than 97% migrate to the Southeast, which combines ample job opportunities in industry with proximity to home.

Table 6.2.a. Inter-regional patterns of movement, 2004-2009

moving from/ moving to	North. Mountains	Red River Delta	Central Coast	Central Highlands	South -east	Mekong River	In-migrants	Out-migrants	Net Migration
Totals	*270*	*331*	*775*	*125*	*125*	*734*	*2,316*	*2,316*	*0*
N. Mountains	--	70	13	3	4	1	91	271	-180
Red River	160	--	98	9	19	4	289	331	-42
Central Coast	8	29	--	29	36	9	110	775	-665
Central High.	27	29	79	--	23	7	166	125	41
Southeast	73	195	570	83	--	713	1,635	125	1,510
Mekong River	2	9	15	2	43	--		734	-664

Source: Census 2009

More than 1.5 million people migrated to the Southeast in the five-year period prior to the 2009 census. About half of them came from the adjacent Mekong River Delta (713,000), and another 570,000 from the adjacent Central Coast. Even from the far-away Red River Delta, 195,000 people found their way to the Southeast. In 2004 alone, 118,000 people left the South Central Coast, representing 3.78% of total employed labor force of that region. At the same time, 91,000 people left the Mekong Delta region, approximately 1.27% of the regional labor force. The region around Ho Chi Minh City received 261,000 people, or 67% of the migrant workforce nationally (CIEM 2005). In addition to the official numbers, the census fails to capture those temporary migrants who do not register in the receiving province where they work. As a result, the census underestimates population movements between poor and rich provinces.

Since the census office re-calculates the data from the 1999 census to reflect the adjusted geographical regions,[58] some nuance gets lost. To re-gain some perspective on proximity as a factor impacting migration decisions, we are taking a look at the 1994-9 numbers, which are calculated for the eight geographical regions in use at that time (and reduced to six in 2008). Most interesting for the determination of the impact of proximity are the effects of separating the Central Coast into North Central Coast and South Central Coast, because in this old division, one region was located much closer to the Red River Delta, the other to the Southeast. By merging the two regions into one, the nuance gets lost.

Table 6.2.b. Gross Migration Flows 1994-1999

Region of residence, 1994	Red River Delta	North East	North West	North Central Coast	South Central Coast	Central High-lands	South East	Mekong River Delta	Ha Noi	HCMC	Other Urban	Total out-migration
Red River	47,553	59,284	16,305	8,051	9,261	76,398	53,543	11,191	108,717	47,605	23,209	461,117
NE	39,536	51,261	6,507	6,191	2,524	52,494	18,832	1,005	35,631	7,631	6,852	228,469
NW	10,691	4,093	2,043	1,782	407	4,772	888	287	6,359	685	310	32,317
NC Coast	12,521	6,466	25,147	30,301	14,109	88,410	61,520	7,756	26,995	48,199	21,621	343,045
SC Coast	1,836	745	123	5,191	15,308	50,431	15,409	2,347	1,478	50,615	24,591	168,074
Central Hi	6,458	1,903	375	8,457	10,150	17,016	9,552	1,283	1,453	16,247	4,250	77,144
SE	4,246	1,300	178	5,679	5,023	26,832	45,792	10,178	849	73,972	10,721	184,770
Mekong	2,440	920	78	2,266	2,036	9,370	49,466	167,417	965	153,292	8,334	396,584
Hanoi	20,277	8,548	1,423	6,977	1,267	1,661	2,184	1,241	--	8,709	3,039	55,326
HCMC	4,820	1,119	103	5,480	6,990	6,535	30,930	30,588	3,393	--	7,441	97,399
O. Urban	6,758	6,166	282	5,420	7,451	8,988	12,633	3,516	10,793	26,707	2,015	90,729
Total in-migration	157136	141805	52564	85800	74526	342907	300749	236809	196633	433662	112383	

Source: Population and Housing Census1999

Migration to the Central Highlands in the 1994-9 period was caused largely by a government land distribution scheme and therefore is of no particular interest for the present research question. With regards to whether proximity to one of the growth poles impacts migration, we see that migrants from both North Central Coast and South Central Coast prefer to move to the South, but at significantly differing rates. South Central Coast residents prefer the Southeast over the Red River Delta by a factor of 8.6;

[58] The regions serve statistical purposes only.

migrants from the North Central Coast by a factor of 5. Northeast and Northwest residents (now subsumed under Northern Mountains) clearly prefer the Red River Delta over the Southeast, as they did in the 2004-9 time frame. Residents of all other regions prefer the Southeast over the Red River Delta.

6.2.2. Inter-provincial migration in the most recent census period

Figure 6.1. above graphically indicates migration flows in the five-year period prior to the 2009 census. In approximately one quarter of the provinces (15 of 63), the number of in-migrants exceeded the number of out-migrants. Those with a positive net migration rate included the economic power houses Binh Duong (+340/1,000), Ho Chi Minh City (+136/1,000), Dong Nai (+66/1,000) and Ha Noi (+50/1,000). Dak Nong in the Central Highlands falls in the top category with a net in-migration rate of 66/1,000.[59] This means that one in three Binh Duong residents lived elsewhere five years prior to the census. In Ho Chi Minh City, 10% of residents as per April 1, 2009, had resided elsewhere at the same date in 2004. On the other end of the spectrum, the highest net out-migration rates occur in Thanh Hoa (-68/1,000), Ben Tre (-67/1,000), Ha Thinh (-65/1,000), Tra Vinh (-61 /1,000), Ca Mau (-57/1,000), Thai Binh (-57/1,000), Ha Nam (-54/1,000), Nam Dinh (-53/1,000) and Vinh Long (-52/1,000). In the Southeast, all but two provinces, Binh Phuoc and Tay Ninh, had positive net migration rates (GSO 2010b: 82). Of the other provinces, the Red River Delta economic engines

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[59] Dak Nong's rate is due to the division of two provinces. Government officials moved to Dak Nong, the new province, to form a new government. In return, Dak Lak, the other part of the new province, shows a negative migration rate.

of Ha Noi, Hai Phong and Quang Ninh had positive migration rates (although the region overall had a negative one).

Table 6.3. Inter-provincial migration

Province	Net migration (persons)	PCI 2009		Province	Net migration (persons)	PCI 2009
Ha Noi	49,500	58.18		Quang Nam	-40,200	61.08
Vinh Phuc	-28,500	66.65		Quang Ngai	-49,800	52.34
Bac Ninh	-12,600	65.7		Binh Dinh	-40,200	65.97
Quang Ninh	4,000	60.81		Phu Yen	-27,200	54.77
Hai Duong	-21,600	58.96		Khanh Hoa	-7,500	58.66
Hai Phong	9,000	57.57		Ninh Thuan	-33,100	54.91
Hung Yen	-19,800	61.31		Binh Thuan	-23,200	64.96
Thai Binh	-56,800	54.58		Kon Tum	26,900	54.28
Ha Nam	-53,500	56.89		Gia Lai	10,500	56.01
Nam Dinh	-53,200	52.6		Dak Lak	-11,000	57.37
Ninh Binh	-45,100	58.31		Dak Nong	65,800	46.96
Ha Giang	-4,400	58.16		Lam Dong	7,200	52.93
Cao Bang	-13,900	45.53		Binh Phuoc	-700	56.15
Bac Kan	-12,000	47.5		Tay Ninh	-19,400	59.03
Tuyen Quang	-29,300	57.92		Binh Duong	340,400	74.01
Lao Cai	-2,900	70.47		Dong Nai	66,100	63.16
Yen Bai	-20,600	61.71		Ba Ria-VT	21,300	65.96
Thai Nguyen	-9,400	58.58		Ho Chi Minh	135,700	63.22
Lang Son	-23,500	52.52		Long An	-19,700	64.44
Bac Giang	-43,500	57.5		Tien Giang	-42,800	65.81
Phu Tho	-36,600	53.3		Ben Tre	-66,800	64.09
Dien Bien	-3,100	59.32		Tra Vinh	-60,700	63.22
Lai Chau	34,400	55.55		Vinh Long	-51,800	67.24
Son La	2,500	53.4		Dong Thap	-45,400	68.54
Hoa Binh	-16,500	47.82		An Giang	-45,900	62.47
Thanh Hoa	-67,900	57.32		Kien Giang	-33,600	63.04
Nghe An	-46,400	52.56		Can Tho	3,200	62.17
Ha Tinh	-64,500	55.26		Hau Giang	-37,500	64.38
Quang Binh	-48,000	55.68		Soc Trang	-47,500	56.63
Quang Tri	-39,200	55.32		Bac Lieu	-46,500	52.04
Thua Thien-Hue	-22,700	64.23		Ca Mau	-57,000	61.96
Da Nang	76,700	75.96				

Source: Census 2009 (migration data); PCI 2009 (PCI coefficients)

In the Northern Midlands and Mountains, all provinces experienced net outflows, except for Lai Chau, which like Dak Nong (see footnote) underwent a provincial division, and Son La, where the construction of a large hydroelectric dam created temporary job opportunities (GSO 2010b: 84). Table 6.3. reflects the migration patterns in Vietnam. With the exception of Son La and its construction-related in-migration, two pathways exist to create conditions conducive to in-migration. One is not subject to economic policy: the availability of land. All Central Highland provinces (with the already discussed exception of Dak Lak) exhibit a moderate level of in-migration. The other is high investment, which, as we have seen, is strongly correlated to good performance on the Provincial Competitiveness Index. Since we are discussing catch-up governmental *reforms*, we compare migration and PCI performance (which is a proxy for good – or reformed – governance), rather than migration and investment directly. We see that the minimum PCI level for a non-Central-Highlands province to attract migrants is 57.57 (Hai Phong). This also happens to be the cut-off PCI score for obtaining more than 10 investment projects in 2008, or for more than 75 projects in the decade between 1988 and 2008. Of the 15 provinces with positive net-migration levels, three are located in the Red River Delta, four in the Central Highlands, four in the Southeast, one on the Central Coast area, one in the Mekong Delta, and two in the Northern Mountains (Son La with the hydropower project and Lai Chau, which has been restructured). The Central Coast in-migration province is Da Nang, the top PCI performer and an urban province. The one in the Mekong Delta is Can Tho, an urban province with a PCI score of 62.17 (ranked ‘high’). These data show that jobs attract migrants, with good governance an intermediary variable that supports job growth, although other factors, such as remoteness, cannot always be overcome.

6.2.3. Push versus pull factors

While migration has been liberalized and, as the numbers show, is a fact of life in post-*doi moi* Vietnam, legal restrictions still exist, making unregistered migrants vulnerable to extortion by officials, but mostly by private sector actors who overcharge for housing or for acting as intermediaries in setting up public utilities. A study found that unregistered migrants as well as KT3 and KT4 migrants pay higher health care and education costs, pay more for housing and utilities (GSO and UNFPA 2005: 10), and are more vulnerable to abuse due to the fact that they are reluctant to report problems to the authorities (ILO 2003: 188). These are problems associated with another harmony of interest, however, which will be discussed in Chapter 7. For the purpose of testing Assumption 2, we need to show that migration is voluntary and thus reversible, if local governments manage to create conducive conditions. In other words, for migration to support the harmony of interest of Assumption 2, it needs to be “instrumental behavior” (Anh 2001: 3).

Three features of *doi moi* account for the increase in migration, according to Nguyen Anh Dang and James McNally (in Phan and Coxhead 2007). First, collective agriculture was much less efficient than private family farms. As farmland reverted to private use, underemployment in rural areas increased, and with it incentives to leave. Vietnam’s tradition of primogeniture ran up against the exhaustion of unclaimed farmland. Traditionally, the first-born son kept the family farm and the rest of the family helped younger sons to transform virgin land into a farm. Daughters married away. As land ran out (except in the Central Highlands), this system reached its environmental limits. Moreover, due to population pressure on the land – Vietnam's population density is 11 people per hectare (Deshingkar 2006: 6) – splitting the family farm among sons was not a viable option either. Non-farm jobs were rapidly becoming a necessity. Second sons and daughters married to second sons had to find off-farm employment, which is scarce in most rural provinces. This land pressure could indicate push forces, with young people unable to make a living in agriculture due to land scarcity, a condition that does not respond to policy intervention. On the other hand, rapid increases in farm productivity caused an explosion in farm output which in turn increased rural family incomes even in the face of growing under-employment. Farming families were in many cases better off in spite of increased under-employment. Vietnam's stellar performance in transforming itself from a food-deficient country into one of the world's top agricultural exporters shows that even with small farms and increasing underemployment, farming was still viable and people were not driven off the land to work in cities at all cost.

Second, the already discussed abolition of the ration card system ended the government's control over people's movements. When lacking household registration was a threat to basic food security before *doi moi*, it turned into a mere transaction cost in the reform economy. Hence, families could make rational decisions about the best way of managing overall income, often sending one child to the factory to remit home cash while the other(s)[60] stayed on the farm to assist parents and grandparents with farm work.

Third, due to small size and a good public information system, both physical and information cost about migration was relatively minor. Vietnamese migrate in networks, where family members of fellow villagers send home information about opportunities and hardships, and act as a first point of assistance for new migrants while they adapt to the new environment (Dang and McNally, in Phan and Coxhead 2007:5). This is a reason why minorities, although the poorest group in Vietnam, rarely migrate. Due to their social distance from the majority *kinh*, they did not migrate from their ancestral lands in the mountains and the Mekong delta. As a result, they now lack the networks in the industrialized areas which new migrants could use as a stepping stone.

This analysis indicates that migration decisions are made largely as a result of family consultation and strategizing about costs and benefits. The most comprehensive migration study to date supports this position. A large-N study by the Vietnamese government and United Nations Population Fund (UNFPA, for its former name Fund for Population Action) found that most migrants into urban industrial areas are young and single. In the industrial zones in the Southeast region, 56% of female in-migrants are between 15 and 29 years of age. There are only 65 male in-migrants in these zones for every 100 females (GSO and UNFPA 2005: 10). This is consistent with Dang and McNally's claim that families prefer to send daughters to the city while keeping sons on the farm. The majority of the migrants indicated that while their life in the receiving

[60] Vietnam has been very successful with its voluntary two-child policy. Ethnic *kinh* (the majority group) tend to follow the policy, so that nowadays, many families have only two children.

province was not easy, they had been made aware of the problems and faced few surprises. All these findings support the claim that migration is indeed caused by pull from wealthier provinces with better opportunities, rather than push factors that may be outside the control of policy makers.

The most direct indicator that sending provinces can enact policies to avoid out-migration is return migration. If migrants move back to their home province as conditions warrant, migration is a choice, and policy and conditions in both sending and receiving provinces can influence migration decisions. Migrants in Vietnam indeed return to their home provinces in large numbers, generally based on changing life events. Especially starting a family alters the cost-benefit analysis of living away from the extended family, with the associated cost of maintaining a household in the expensive urban areas of the rich provinces. Table 6.4. shows the cost of living differential between regions, which is directly linked to the amount of foreign investment and employment in the region. To compare over time, the pre-2008 regional division of eight regions was chosen.

The *Vietnam Living Standards Survey* (GSO 2008b) tracks quality-of-live indicators over time. It is obvious that the Southeast has the highest income levels, but also the highest cost of living (as measured in household living expenses[61]), by a wide margin. Increases of expenditures in the period between 2002 and 2007 are remarkably stable. Total household expenditures grew by a factor of 2.5 to 2.7 in all regions with one exception, the Central Highlands (3.1). Increases in necessary living expenditures

61 These living expenses are necessities of life. The survey contains another category, ‘other expenses,’ which were not considered here.

(categories eating, drinking, housing and other living) increased 2.4-fold to 2.6-fold; in the Central Highlands the increase amounted to a factor of 3.0 (calculations by the author, based on GSO 2008b data). The decline in poverty rates was most impressive in the Red River Delta and the Southeast, where household poverty was cut in half. Inequality rose in all regions, but surprisingly barely at all in the industrialized Southeast (by 0.003 points) – albeit from an already higher level.

Table 6.4. Income and household expenses by region (in VND 1,000); poverty rate in %

	Total household income		Total household expenditure		Of which eating & drinking		Of which housing and other living		Poverty rate		Gini coefficient	
Region // Year	2002	2008	2002	2008	2002	2008	2002	2008	2002	2008	2002	2008
Red River Delta	353.1	1048.5	300.2	813.9	146.0	380.8	125.2	332.5	22.4	12.1	.390	.411
Northeast	268.8	768.0	240.8	630.8	134.8	327.0	85.5	237.7	38.4	29.4	.360	.415
Northwest	197.0	549.6	192.4	496.8	115.0	270.4	64.0	181.2	68.0	58.6	.370	.403
N. Central Coast	235.4	641.1	210.2	560.2	112.4	284.4	80.4	217.5	43.9	31.9	.360	.371
S. Central Coast	305.8	843.3	267.0	706.5	139.7	339.8	107.9	288.5	25.2	19.0	.350	.380
Central Highlands	244.0	794.6	216.3	670.9	118.3	325.4	83.6	280.7	51.8	33.1	.370	.405
Southeast	619.7	1649.2	482.1	1292.6	235.7	546.9	211.9	615.0	10.6	5.4	.420	.423
Mekong River	371.3	939.3	284.8	709.3	156.4	347.7	102.0	275.9	23.4	19.5	.390	.395

Source: GSO 2008b

Note: Until 2008, Vietnam was divided into eight socio-economic regions. These have no administrative functions and serve statistical purposes only. The General Statistics Office recalculates the numbers for pre- versus post-2008 comparisons.

The numbers indicate that while salaries are significantly higher in the industrialized regions, so are living expenses. In all provinces, average incomes cover average expenses, but the *Vietnam Living Standard Survey* takes unofficial income, such as intra-family transfers, into account. Migrants remit home an average of VND1,000,000 (in 2005, approximately $60), and two in three migrants remit (GSO and UNFPA 2005: 72).

Given the wider income gap in the industrialized Southeast, the cost of living hits low-income workers harder, but they compensate with low-cost living arrangements in dormitories or worker housing with multiple persons per room. Such living arrangements are suitable for single migrants without family attachment. As a result, many migrants reverse course and return home after a while in the industrial regions, especially when they are ready to start a family. In Ha Noi, one in four indicated to the *2004 Vietnam Living Standard Survey* that they would like to move back, in Ho Chi Minh City one in three did (GSO and UNFPA 2005; 2006).

In industrialized regions, return migration has become a worrisome trend and provincial officials and factory managers are beginning to investigate how to reduce employee turnover. During interviews in 2007, several provincial investment officials voiced concern about the acceleration of the trend. One official in Binh Duong said turnover after the Tet holidays[62] amounts to 25% to 30% of factory workforce. This represents a significant business cost and production interruptions. Recruitment agencies do brisk business and many factories request new workers even before Tet, to keep interruptions to a minimum. Recruitment fees amount to VND50,000 to 100,000 per hired worker, plus cost of training (Viet 2007). In 2007, monthly salaries were VND1,200,000 to 1,500,000 (approximately $70 to $90, at the exchange rate of the time); finders fees represented a significant additional wage cost.

Since workers move as a function of family needs and based on family decisions, they do not simply pack up and leave. The reason for higher mobility lies in the increasing availability of job opportunities in other parts of the country. Industrial parks are spreading throughout the country – by the end of 2007, 96 were in operation, 53 under construction and 108 in the planning stages in 62 provinces.[63] This expansion

[62] Companies pay a traditional significant Tet bonus. Workers stay on the job until Tet, the Vietnamese New Year and most significant holiday, to obtain the bonus, and then simply do not return after the end of the week-long holiday.

[63] Calculations by the author from Ministry of Planning and Investment sources. The number of industrial parks, export processing zones and special economic zones vary by source, mostly because they are managed and licensed by different entities – provinces, central government, private entities.

of job opportunities creates incentives to move back home, using the job experiences acquired in the economic model provinces to get a job in a similar factory while living with the family or at least at a significantly reduced cost of living. A well-trained worker from a factory in the Southeast has improved job opportunities and bargaining power in the poorer provinces were skilled labor is scarce. An official from the central province of Quang Nam was reported saying that in 2000, 45,000 young workers left, mostly for the southern industrial zones, but half of them had returned home even though they had to accept jobs at lower salary levels (Tuoi 2010). After the global economic crisis of 2008, industrial parks in the Ho Chi Minh City-Binh Duong-Dong Nai growth pole complained about a labor shortage. An executive at a Dong Nai garment factory claimed the recruiters could only find a few hundred applicants for 1,700 open jobs, while an official at the Ho Chi Minh City industrial park and export processing zone authority HEPZA said the province was looking for at least 37,000 additional workers between June and December of 2010 to avoid a serious shortfall. Overall, in 2010 the industrial zones needed 150,000 new recruits but could only meet approximately half the demand (Tuoi Tre 2010).

The vice chairman of the Industrial Zone Management Board of Ha Nam, a province with ambitions to draw away investment from adjacent Ha Noi, said that a worker can live on the equivalent of $80 a month in Ha Nam, while in Ha Noi a minimum of $150 would be required. As for rent, a place that goes for VND100,000 in Ha Nam would cost two to three times that price in Ha Noi (Han 2007). At the time of

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Another source (ActionAid 2005: 8-9) counts 104 industrial parks and export processing zones in 2005. In late 2009, a business news source found that 228 parks were licensed and 145 had become operational (lookatvietnam.com 2010).

the interview, Ha Nam had one operational industrial park of 110 hectares, which was being expanded to 190 hectares. A second 250 hectare park is being readied as well. Other industrial park managers interviewed echoed the position. To provide qualified labor for their new ventures, they want to lure out-migrants back with the promise of lower cost of living and proximity to family. Workers who live in the province of their KT1 registration also save on social services, like education, health care and public utility provision.

Both the strategies of the sending provinces that try to lure out-migrants back home as anchors for their new factory work force, and that of the receiving provinces that work harder to retain them provide evidence that workers in Vietnam are pulled by opportunity, not pushed by adversity. As conditions change, they reverse course to match their preferences. This premise of migration as a choice rather than an absolute need is a condition for the test of Assumption 2, which holds that due to competition among provinces and instrumental migration choices, mobility gives non-elite groups bargaining power, which in turn forces out-migration provinces to reform. Assumption 2 further claims that proximity pushes laggard provinces to reform faster, because proximity reduces transaction cost of migration and enhances the bargaining power of workers further. In the following section, we investigate the importance of distance on both migration and changes in quality of governance, to test the claim of Assumption 2.

6.2.4. Proximity

Proximity reduces the cost of acquiring information about opportunity (information cost) and the cost of physical relocation. The closer a province is to an early growth and investment pole, the more people are likely to pick up and move to obtain the benefits associated with living in the wealthier jurisdiction. The farther away a poorer province is located, the higher is the cost of migrating. Increased transaction costs reduce the net benefit of moving. Cost of transportation increases with physical distance. The road network has been improved significantly over the past decade. Before the construction of a number of bridges over the many arms of the Mekong and prior to major road improvements beginning in the late 1990s, 200 kilometers in the Mekong delta could have taken eight hours to travel even in the dry season, with multiple ferry crossings and dirt roads. A large number of provinces in the Mekong delta were without paved road access to their provincial capital. Distance did not relate directly to travel time. Buses, the only means of transportation into many areas of Vietnam, generally travelled only during daylight hours. For longer distances, they left in the morning hours for arrival by sunset. A traveler wishing to go from Can Tho, the so-called capital of the Mekong, to Ho Chi Minh City had to take a bus by mid-morning or be stranded until the next day. This is no longer the case to the same extent, but infrastructure remains unevenly distributed and is still a factor.

To investigate the impact of proximity on reform, we must first establish parameters. The provinces that should be driving reform – based on their foreign investment numbers and potential for migrants – are the southern growth trio Ho Chi

Minh City, Binh Duong and Dong Nai, and Ha Noi in the North. These four provinces are the top investment magnets by orders of magnitude. Da Nang, which is emerging as a growth pole in central Vietnam and could be attractive to migrants from the poor central region, is a later starter, does not offer the vast number of jobs yet that would make it a full-fledged alternative to the northern and southern magnets.

Both being adjacent and travel time are used as measures for proximity. Having a common border in itself is of no particular importance, but in cases of large provinces or those with particularly bad transportation infrastructure, measuring the travel time between provincial centers does not explain migration numbers. Residents near the provincial borders may move at a high rate while those far away are less likely to take the risk; residents along a major road or river may be in a better position than those in a mountainous area. A common border, therefore, does have an impact on migration decisions, even if not for all residents of the province equally.

In addition to being adjacent, we measure the driving time between geographical centers of the growth poles and others. (In the case of the southern growth pole, the geographical center of the three provinces is the city of Bien Hoa.) Seven Mekong Delta provinces are directly adjacent to Ho Chi Minh City, Binh Duong or Dong Nai area, but only two Mekong Delta provinces' geographical centers are within two hours driving from Bien Hoa. Geography, like river crossings, and an overburdened road system, increase travel time in this region.

Travel time is important for the argument that proximity increases the pressures on local government. Living in the economic centers is very expensive in comparison to life in less developed areas. Migration becomes much cheaper when a migrant can commute home for weekends and make use of family and social services in the home province, such as doing the laundry there, and taking food to the city for consumption during the work week. Moreover, many laborers do not register in their place of work and as a result cannot access government-funded or subsidized public services there. Visiting a public health clinic in the home province or sending children to school there makes a significant financial difference compared to paying the higher rates for non-residents. Many laborers cannot afford life in the city after starting a family and depending on public services more than young and single workers. Hence, travel time is a key factor in the calculation of transaction cost of migration. Where workers can return home for weekends, the cost-benefit analysis shifts significantly when compared to starting a permanent household in the receiving province. Hence, the implication of travel time is obvious. The lower the travel time is, the lower are the transaction costs for migrants, directly through lower bus or train fares, and indirectly as they can go home for the weekend, bring food from the family farm, do laundry at home and rent very cheap dormitory rooms in the city instead of establishing a more permanent residence. For factories, travel time (and distance) affects the cost of bringing goods to market or port.

Travel time calculations refer to travel from all provinces to Ha Noi and to Bien Hoa, the capital of Dong Nai province and the geographical center of the three high-investment southern provinces. The online service Googlemaps provides travel time estimates for all locations. When Googlemaps is fed a starting point without exact address or town, it starts in the geographical center of the province.

Table 6.5. Distances in km and hours (as per Googlemaps, from geographical center to geographical center, on main road; provinces adjacent growth poles in bold italics, within two hours shaded)

From	To Ha Noi		To Da Nang		To Center HCMC-Binh Duong.-Dong Nai	
	km	time	km	time	km	time
Red River Delta						
Vinh Phuc	63	1h 00 min				
Bac Ninh	37	0 h 43 min				
Quang Ninh	218	3 h 40 min				
Hai Duong	83	1 h 23 min				
Hai Phong	130	2 h 05 min				
Hung Yen	72	1 h 11 min				
Thai Binh	113	1 h 45 min				
Ha Nam	67	1 h 13 min				
Nam Dinh	93	1 h 34 min				
Ninh Binh	95	1 h 42 min				
Northern Mountains						
Ha Giang	282	4 h 28 min				
Cao Bang	251	4 h 14 min				
Bac Kan	154	2 h 38 min				
Tuyen Quang	135	2 h 03 min				
Lao Cai	274	4 h 04 min				
Yen Bai	185	2 h 35 min				
Thai Nguyen	70	1 h 20 min				
Lang Son	152	2 h 24 min				
Bac Giang	109	1 h 52 min				
Phu Tho	102	1 h 34 min				
Dien Bien	481	6 h 42 min				
Lai Chau	571	8 h 04 min				
Son La	417	5 h 58 min				
Hoa Binh	85	1 h 26 min				
Central Coast						
Thanh Hoa	156	2 h 45 min	769	12 h 14 min		
Nghe An	392	5 h 34 min	755	11 h 09 min		
Ha Tinh	345	6 h 03 min	581	9 h 00 min		
Quang Binh	511	8 h 14 min	486	6 h 59 min		
Quang Tri	600	10 h 06 min	307	4 h 51 min		

Thua Thien-Hue	658	11 h 07 min	262	4 h 07 min		
Da Nang	924	14 h 59 min	--	--	899	14 h 41 min
Quang Nam			93	1 h 38 min	805	13 h 05 min
Quang Ngai			131	2 h 20 min	794	13 h 02 min
Binh Dinh			251	4 h 20 min	657	10 h 43 min
Phu Yen			374	6 h 08 min	600	9 h 52 min
Khanh Hoa			503	8 h 40 min	426	7 h 05 min
Ninh Thuan			605	10 h 17 min	327	5 h 32 min
Binh Thuan			752	12 h 48 min	220	3 h 42 min
Central Highlands						
Kon Tum			285	4 h 33 min	613	10 h 06 min
Gia Lai			339	5 h 27 min	558	9 h 11 min
Dak Lak			514	8 h 25 min	368	6 h 19 min
Dak Nong			661	10 h 18 min	251	4 h 35 min
Lam Dong			963	15 h 30 min	282	4 h 57 min
Southeast						
Binh Phuoc					213	3 h 53 min
Tay Ninh*					113	2 h 08 min
Binh Duong					--	--
Dong Nai					--	--
Ba Ria-Vung Tau					89	1 h 25 min
Ho Chi Minh City					--	--
Mekong Delta						
Long An					83	1 h 33 min
Tien Giang*					109	2 h 04 min
Ben Tre					119	2 h 10 min
Tra Vinh					251	4 h 10 min
Vinh Long					193	3 h 24 min
Dong Thap					188	3 h 07 min
An Giang					322	5 h 15 min
Kien Giang					311	4 h 41 min
Can Tho					208	3 h 46 min
Hau Giang					240	4 h 06 min
Soc Trang					267	4 h 29 min
Bac Lieu					335	5 h 22 min
Ca Mau					382	6 h 00 min

* Adjacent *and* less than 10% more than 2 hours away

We then adjust this starting point to the nearest highway. In Table 6.5., provinces are visually categorized in travel times of up to two hours and from where reaching the growth poles takes longer. To be sure, some workers living farther afield than two hours of travel time commute home on weekends, yet it is difficult to do so on a regular basis. Vietnam has a five-and-half day work week. Factories (and many offices) work the Saturday morning shift, and start up again early Monday morning. Overtime work is expected from factory workers. Weekends are short, limited to Saturday afternoon and Sunday. Lengthy weekend commutes are difficult. Any cut-off time is necessarily arbitrary, but the two-hour cut-off is reasonable given the short weekend and the fact that only six provinces are within 30 minutes above the cut-off. Two of the provinces (Tay Ninh and Tien Giang) are just outside the range of 120 minutes travel time (within 10%, or 12 minutes) *and* adjacent to the growth poles. These two provinces are identified separately with an asterisk in Table 6.5.because they fall in the above-mentioned category of provinces where a substantial part of their population and factories have very easy access through both short travel times and a part of the population being immediately adjacent.

6.3. Distance and Reform Efforts

So far, this chapter has (a) provided an overview over the changes in the regulatory framework within which ordinary Vietnamese make decisions about migration in search of job opportunities, and (b) provided data about migration in Vietnam resulting from the changing regulatory framework, but also from the new economic realities in

Vietnam. In this section, we analyze these data against Assumption 2, that proximity of a reformed province will push laggards towards reforms.

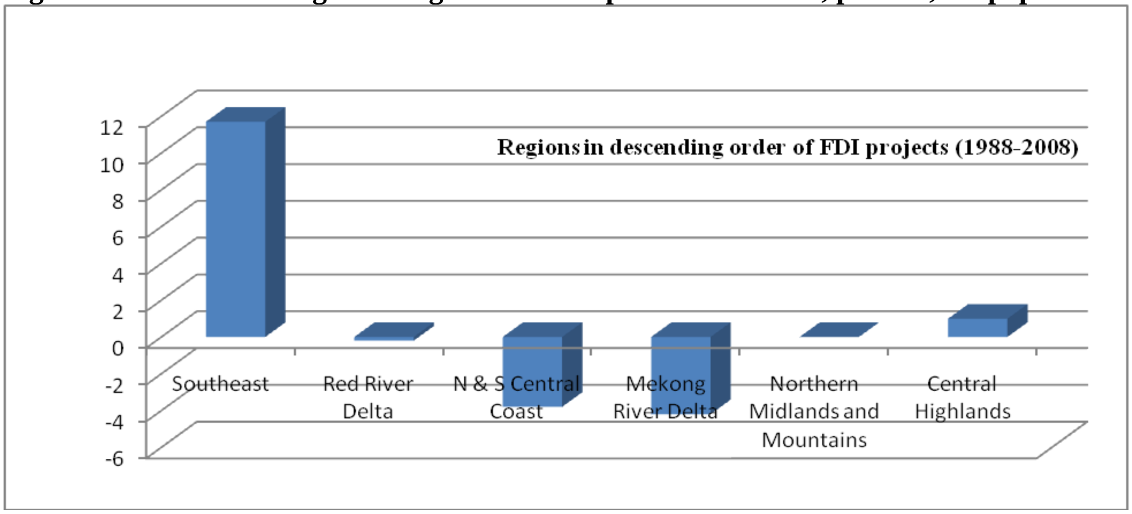
To reiterate, by ‘reformed province’ is meant a province that has implemented changes in its regulatory regime and has improved implementation (reduced corruption and red tape) in order to provide a more conducive business environment for investors to locate in the province. Such a ‘reformed business climate,’ was operationalized in Chapter 5 by the *Provincial Competitiveness Index*, or PCI, which separates historical, geographical and other causes for investment that governance cannot influence from those that can be impacted by political leadership regardless of material conditions. The PCI shows that improved governance is directly associated with more foreign investment, although natural disadvantages play a significant role. Since we assume that migrants move from their home provinces to other locations not because they read the annual publication of the PCI, but because they expect improvements in their living conditions, this chapter will use investment and employment numbers more than PCI scores to explain why people move. In the final analysis, however, we are not trying to identify why people move, but what impact such migration has on reforms – the quality of governance. For this purpose, PCI numbers are again required.

6.3.1. Migration in the context of economic performance and good governance

As Vietnam’s economy changed in the aftermath of the *doi moi* reforms, Vietnam experienced increased migration levels common to rapidly developing countries. The rate of migration accelerated rapidly between the census of 1999 (covering migration between 1994 and 1999) and that of 2009 (2004-2009). In the first period, 1.3 million Vietnamese migrated, in the second the number had nearly doubled to 2.4 million. As Section 6.2. demonstrates, the direction of migration changes between the two time periods. In the five years covered by the first census, migrants move to the two industrializing regions, the Southeast and to a lesser extent the Red River Delta, but also to the Central Highlands, where the government was making agricultural land available to in-migrants. By the 2004-2009 period, the Central Highlands have lost much of their luster for migrants. The region still exhibits a slightly positive net migration rate, but while the in-migration numbers have fallen by half, out-migration has doubled. In the new economy, industrial jobs exert a much greater pull than agricultural land.

In-migration shows significant increases where investment is high – in the Red River Delta with Ha Noi (163,000 to 289,000) and the Southeast (580,000 to 1,635,000). In the Red River Delta, however, investment is concentrated in the Ha Noi-Hai Duong-Hai Phong corridor. Other parts of the region lose population, and the region's overall population declines. Figure 6.3.a. shows the relationship between the number of investment projects received between 1988 and 2008 and net migration visually. The Southeast added 11.7% of its population through migration, all other regions (with the exception of the Central Highlands, which were discussed), lose population. Figure 6.3.b. shows the same connection between migration and investment in a different visual format. With the exception of the Central Highlands, migration follows investment. This is also true for the Northern Midlands, where recent in-migration is associated with a dam construction project.

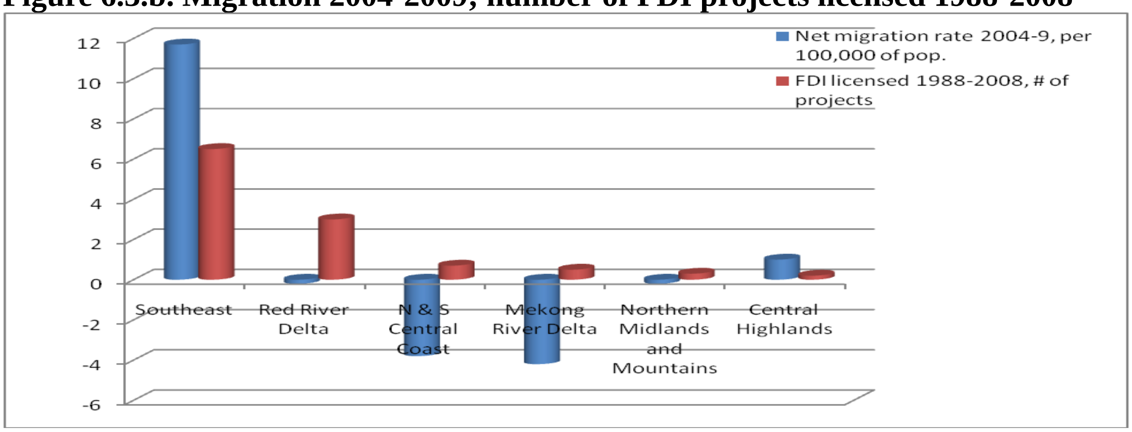
Figure 6.3.a. Net inter-regional migration in the period 2004-2009, per 100,000 population



Source: Census 2009 (migration); Statistical Yearbook 2008 (investment)

This migratory flow is expected to reverse itself as these construction jobs disappear. With respect to out-migration numbers, the Northern Mountains and Central Highlands have a large number of ethnic minorities who, due to inter-ethnic animosities are less likely to leave their ancestral homes.

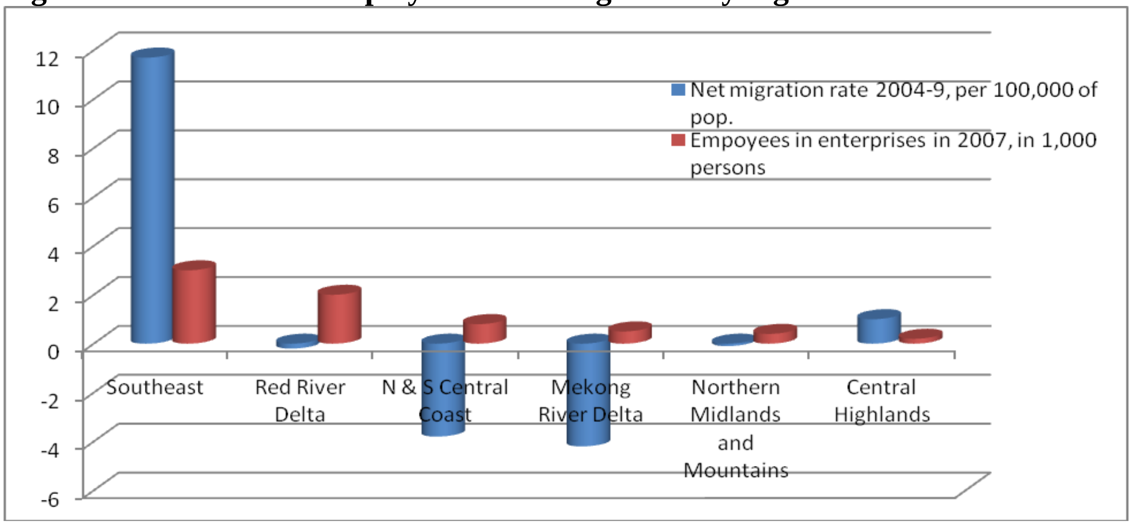
Figure 6.3.b. Migration 2004-2009; number of FDI projects licensed 1988-2008



Source: Census 2009 (migration); Statistical Yearbook 2008 (investment)

To indicate that investment is a proxy for job opportunities, Figure 6.3.c. substitutes investment projects by the number of officially employed workers in the industrial sector. This figure closely parallels those for foreign investment, but is worth investigating for a theoretical reason.

Figure 6.3.c. Industrial employment and migration by region



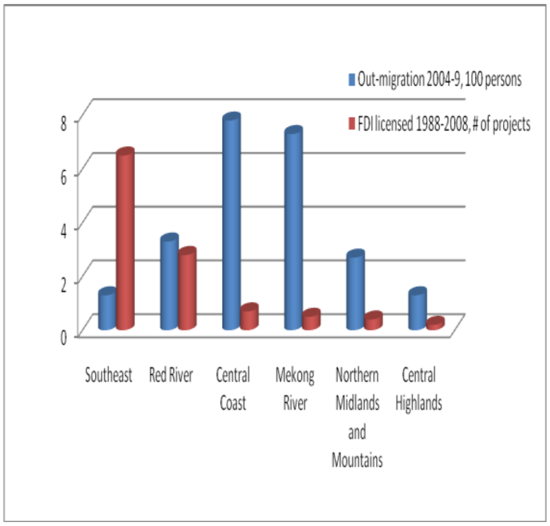
Source: Census 2009 (migration); Statistical Yearbook 2008 (investment)

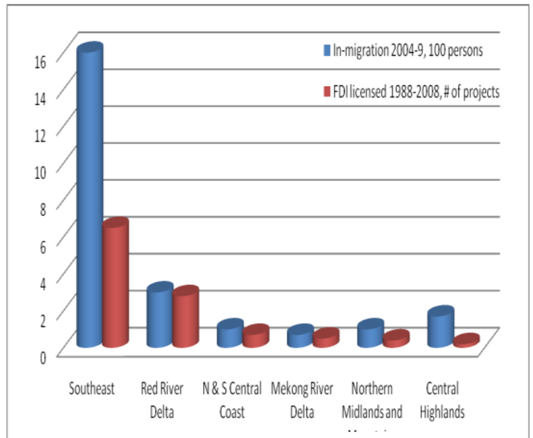
Critics of trade opening and investment-based development strategies have argued that foreign investment may reduce overall employment due to higher efficiency in production and to capital's demand for lower taxes and as a result for a smaller government sector. Chapter 7 will address this race-to-the-bottom hypothesis in greater detail. Figures 6.3.b. and c. show how closely industrial employment mirrors investment levels, thus challenging the critics' assertion.

Separating by in- and out-migration, the picture is equally clear: migrants leave the low-invested regions to settle in high-investment ones. While people still move into the Central Highlands in search for farmland, this region is showing significant outflows as well. Similar holds for the Red River Delta. Improved economic conditions attract job seekers (to Ha Noi), but a large number of people move away (mostly to the Southeast). Table 6.2.a. has indicated that much of the migration from all over Vietnam moves into the Southeast. Only people the Northern Mountains find the closer-by Red

River Delta their destination of choice.

Figure 6.4. In-migration and out-migration 2004-2009; FDI licensed 1988-2008 (# of projects)

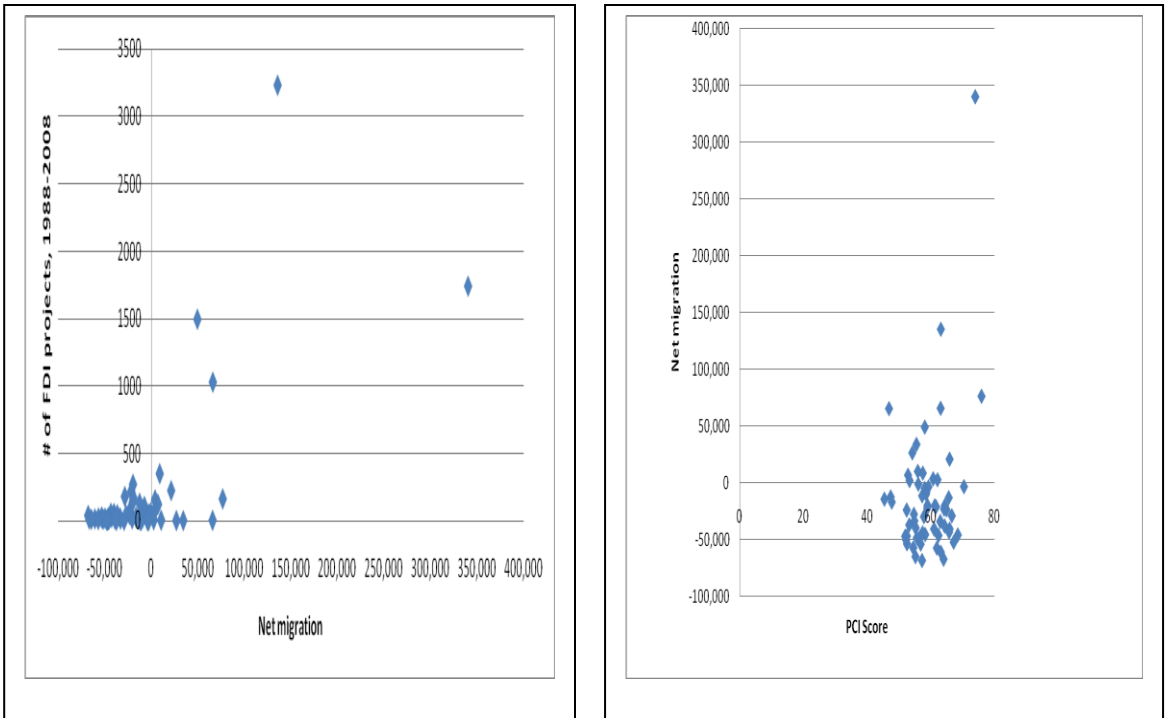




Source: Census 2009; Statistical Yearbook 2008

The close association between good governance and investment allows the assumption that migration will be similarly closely linked to PCI scores as to investment levels. Figure 6.5. illustrates this relationship on the provincial level (regions are not asssigned a PCI score). Provinces with few investment projects are clustered in the negative net-migration zone. Equally, high levels of in-migration are closely associated with high PCI score. Outside the (relatively, by Vietnamese standards) land-rich Central Highlands provinces, only provinces with a minimum PCI score of 57.57 receive net in-migration. For a net in-migration of more than 50,000 persons, a PCI score of over 60 is required (with the exception of Dak Nong, whose political restructring was explained above).

Figure 6.5. Net migration and number of FDI projects, PCI scores 2009



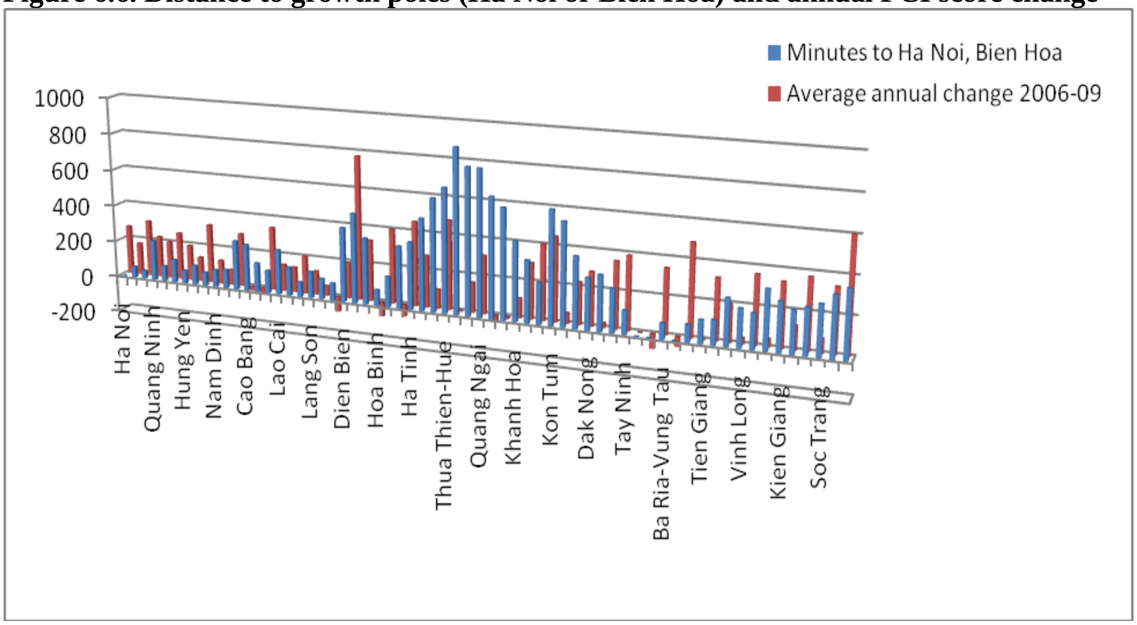
Source: Census 2009; Statistical Yearbook 2008

The data paint a clear picture of migration as a choice in favor of remunerated labor over traditional life style and in favor of good governance over predatory political elites. This is a confirmation of what migration research has shown the world over. But with Vietnamese migrating along and across their country, support for Assumption 2 needs more analysis. Is proximity to a successful reformer indeed an added incentive to reform, or does reform anywhere in Vietnam force less progressive leaders to mend their ways? We now turn our attention to the question whether proximity indeed breeds contestation.

6.3.2. Good governance clusters

Demonstrating the impact of proximity to a reformed or economically successful province and good governance is extremely difficult. Simply correlating distance from a development pole with PCI score yields no useful results, for a good reason. Figure 6.6. shows the relationship.

Figure 6.6. Distance to growth poles (Ha Noi or Bien Hoa) and annual PCI score change



Source: PCI 2009, distance by Googlemaps, calculations by author

For the proximity-breeds-contestation assumption to hold, we would need to see an inverse relationship between red and blue bars – the farther a province to the growth poles (the longer the blue bar), the lower the PCI score improvement (red bar) should be. Even without further statistical analysis, this is obviously not the case. Mancur Olson (1996) explains the underlying principle with his metaphor of "big bills on the sidewalk." The argument in the paper is that poor (or, in our case, badly governed) jurisdictions are more likely to show significant improvements because they still have the big bills to pick up (or, in an often used phrase, the low-hanging fruits to harvest).

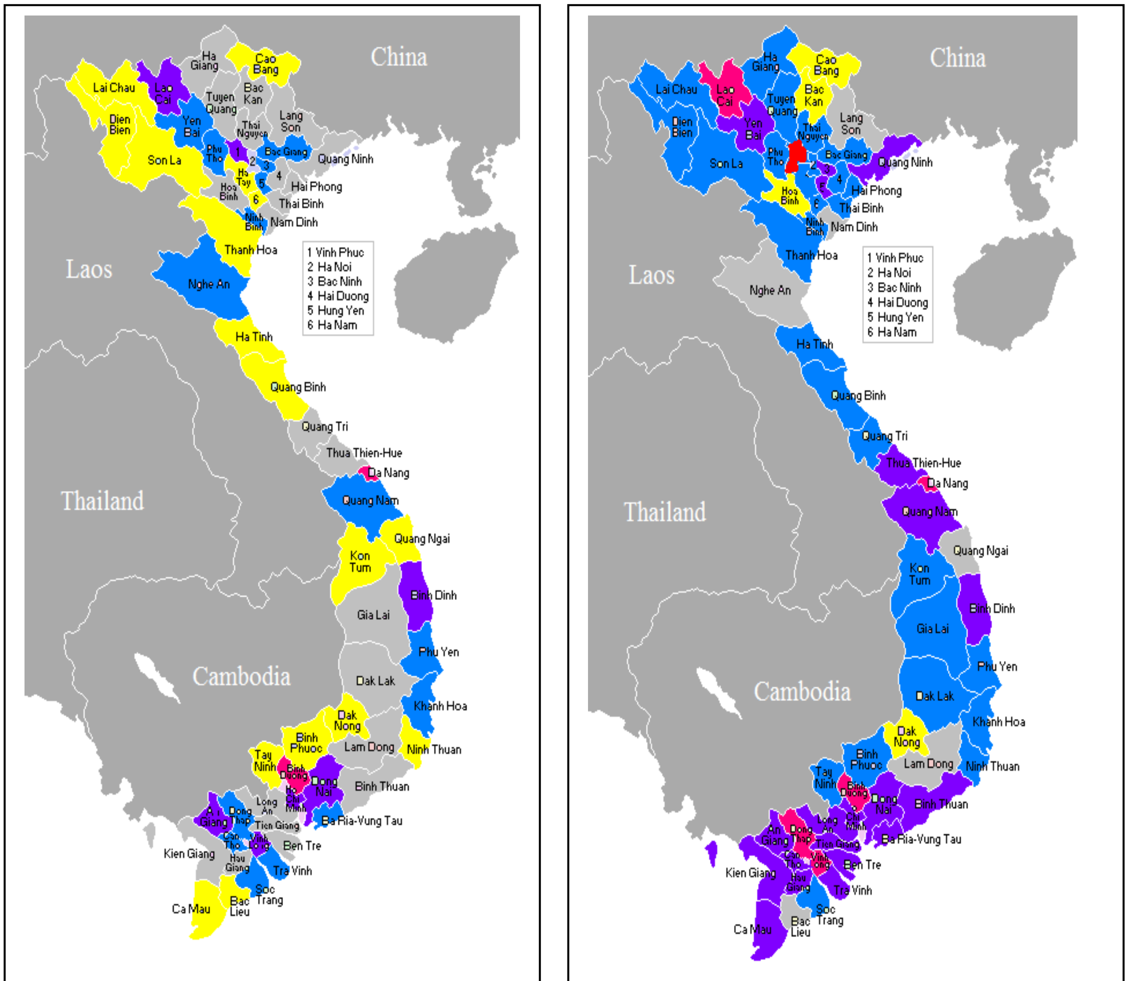
As they move on and pick up those big bills, making further improvements becomes increasingly difficult – the problem of marginality. First, as big bills get picked up, there are fewer left to find. Second, as a jurisdiction improves, what constitutes a ‘big bill’ changes. Finding a dollar in Washington represents inspires a different amount of happiness than finding one in Ca Mau, one of Vietnam’s poorest provinces.

As Chapter 4 has laid out, the government in Vietnam placed foreign investment into a few southeastern provinces in the early phases of economic reform. As a result, this region experienced industrialization, job growth and economic improvements early, setting it on a path-dependent reform course. Nearby provinces were forced to reform early, following the trajectory suggested in Assumption 2. Malesky’s account of reforms in Binh Duong and Dong Nai in response to Ho Chi Minh City’s early success confirms this view (Malesky 2004a; 2004b). This means that we cannot look at PCI improvements and proximity to the two (or three, including Da Nang) growth poles alone to test Assumption 2. PCI improvements are a function of starting position as much as proximity. A province that starts poorly has more room to improve and can improve more easily than a province that started out very high already. Moreover, there are multiple relationships at work:

- Governance (PCI score) is related to investment
- Governance is related to in-migration
- Investment is related to migration

This problem of multiple causation (Ragin 1987) – one outcome is caused by several causes – requires a different approach to testing whether contestation among nearby competing elites is among the factors causing improved economic governance. If it can be established that good governance comes in clusters and that these clusters are growing in concentric circles around the early success stories, such a finding would substantiate Assumption 2. Figure 6.7. shows the changes in quality of governance between the first edition of the PCI in 2006 and the latest in 2009.

Figure 6.7. Changes in PCI score by category, 2006-2009



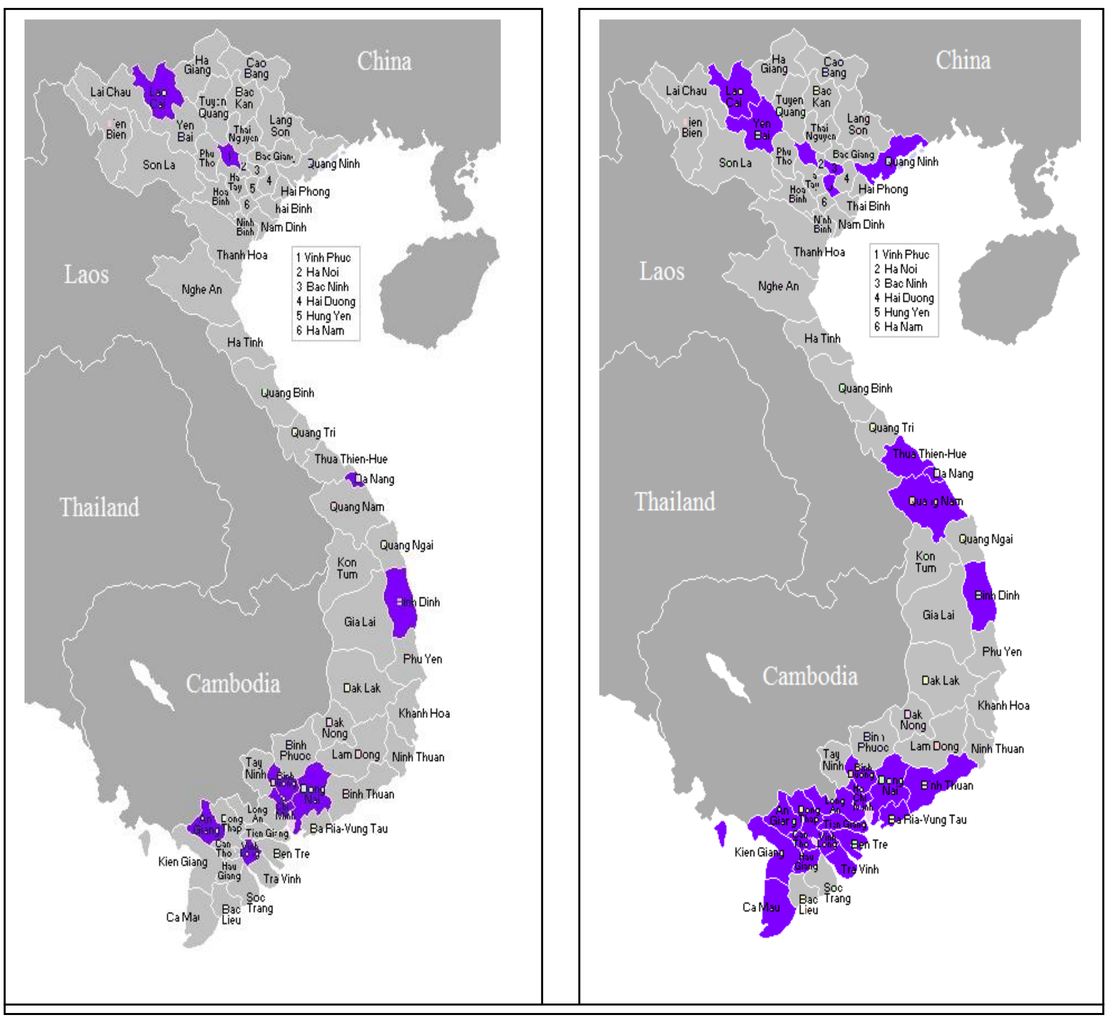
Quality of Governance, Categories

Lighter = lower Darker = higher

Source: PCI 2006, 2009

Improvements in quality of governance are made all over Vietnam. Only very few provinces fall into a lower category in 2009 than in 2006. The range between top and bottom score declines, through moderate improvement on the top and larger ones on the bottom. On the very bottom, in the low quality of governance category, only two provinces do not move up (Cao Bang and Dac Nong, two remote, mountainous provinces with substantial ethnic minority populations), while two more decline into this category (Bac Kan, mountainous, remote, minority-populated, and Hoa Binh, a province near Ha Noi that represents an aberration from the proximity theory).

Figure 6.8. Provinces ranked high or excellent, 2006-2009



On the other end of the spectrum, so many provinces move up into a higher category, that it is difficult to see whether proximity to a growth pole plays a role. Figure 6.8. provides a better picture with regard to this question. In this graphic rendition, the clustering of quality of governance is evident. Provinces in the orbit of the southern and northern investment magnets of Ho Chi Minh City-Binh Duong-Dong Nai and Ha Noi show across the board improvements in governance scores. The graphic also suggests that Da Nang in the center is emerging as a growth pole in its own right. Its immediate neighbors have moved up one and two categories respectively in four years to land in the categories excellent and high; all other nearby provinces have improved their scores as well.

6.4. Discussion of Data

The data generally support Assumption 2, but leave the causal explanation open to further investigation. Reform clusters exist in Vietnam. Proximity to the southern or northern growth pole means that a province is likely to have improved its own quality of governance over the last few years. Given the multicollinearity of various factors (governance, investment, employment levels, in-migration) the data do not tell us what the causal mechanisms for governance reform are. Nonetheless, it is unlikely that in-migration causes better governance, or that migrants create new jobs or foreign investment. The logical chain appears to be the following:

Investment (initially placed by the central government into Ho Chi Minh City) ⇒ ***Benefits for local leaders*** ⇒ ***Incentives*** for good business climate ⇒ ***Governance reform*** ⇒ ***More investment*** ⇒ ***Increased job opportunities*** ⇒ ***Migration***

The main argument in this study is that the various factors reinforce each other in the process. Once investment begins to provide benefits for local leaders, those leaders have an incentive to attract more of it. As local underemployment declines as a consequence of industrialization, factories offer better conditions and migrants are attracted by the emerging opportunities. New factories require more workers; as a result the successful provinces benefit from migrants as much as the migrants benefit from the success of the province to which they move.

From this logic chain alone, we cannot discern a motive for laggard provinces to reform. They could let workers move away and benefit from remittances and central government transfer payments. On the other hand, since both remittances and transfers are difficult to translate into rents, local leaders have stronger incentives to improve their business climate and attract investment themselves. As a result, we cannot conclusively say whether out-migration or the hope for investment leads to reforms in the provinces that have caught up in recent years. The clustering of reformed provinces, however, indicates that proximity to success models plays a role. The causal factor may be the hope for spill-over more than fear of out-migration. Long An province is cooperating with Ho Chi Minh City's government to bring labor-intensive industries into Long An, where the cost of living is lower and more space is available to house industrial parks. The chairman of the Long An Industrial Zone Authority, however, declared in an interview that Long An had suffered from out-migration and needed to attract workers from rural areas and other provinces if the province wanted to increase inward investment (Phi 2007b). The question pertained to strategies on how to attract more investment in the future and was not prompted. This indicates that Long An authorities are concerned with population loss and its impact on the provinces competitiveness.

Proximity plays a role in migration decisions, but it is unclear to what degree. On one hand, the data from the Northern Mountains and the Mekong River Delta indicate that migrants prefer staying closer to home. This is reflected in the logic of transaction cost, but also the cultural preference in Confucian society to being close to one's ancestral lands (Gallina 2007). Migrants from all provinces prefer the Southeast, except those from the Northern Mountains, who move to the Ha Noi area. In the 1999 census, we can substantiate the proximity argument by analyzing migration patterns between the North Central and South Central Coast (the two regions are integrated into one for the 2009 census). While residents from both regions prefer the Southeast, southerners do so by a factor of 8.6, northerners by a factor of 5. Given the worse transportation infrastructure prior to 1999, residents of neither North nor South Central Coast could have gone home for the weekend. As a result, this one significant factor in the cost-benefit calculation of migration is irrelevant for residents in the central area. Mekong River residents, by contrast, migrate overwhelmingly to the Southeast. With the construction of a number of bridges over the many arms of the Mekong in the delta, returning home on the weekend has become possible for many Mekong River Delta area migrants, reducing the cost of living in the city significantly.

To summarize the data in light of Assumption 2, we can say that there is good evidence that (the fear of) large-scale migration represents leaders of laggard provinces with incentives to improve their own standards of governance. The clusters of PCI improvements around provinces with large in-migration are evidence for such a claim. Proximity to Ha Noi or Ho Chi Minh City-Binh Duong-Dong Nai improves the likelihood of governance reforms significantly. Alternative plausible explanations remain, however.

6.5. Conclusion

This chapter has tested Assumption 2, that proximity between laggard and reformed provinces pushes the laggards toward catching up, in an attempt to avoid economic and demographic decline in comparison to the successful neighbors. While the analysis leaves questions about causality open, it demonstrates that the outcome follows the predictions of the hypothesis. Wealthy provinces attract migrants from near and far, but especially from near. Laggard provinces engage in catch-up reforms, especially when they are in close proximity to a successful province.

The harmony-of-interest hypothesis argues that Assumption 2 is based on a harmony of interest between the laggard provinces and their residents. Local officials will reduce their rent seeking to prevent large outflows of residents to better managed, wealthier provinces. While this assumption is plausible, based on the data, alternative explanations remain possible. Officials in poor provinces could be reforming in order to attract overflow investment from wealthy ones rather than to avoid emigration of their citizens. Even if this was their primary motive, however, all forms of investment projects require human capital. Ultimately, provinces need to retain their best human capital, and may even have to attract in-migrants to sustain rapid industrialization.

In the context of governance and migration, better governance *alone* does not prevent people from migrating if employment opportunities remain poor and salaries low. We have established that better ranking on the PCI's good governance score is associated with higher levels of foreign investment. But do a good investment climate and more factories translate into better living conditions for subordinate groups, the regular working class? The literature has discussed the possibility of a situation in which political and economic elites trade protection for wealth at the expense of the rest of society. Rent-seeking crony economies are the result. If this is the case, we would have to see a widening of inequalities, low salaries, regulations that favor capital over labor, reduced public goods provision and declining social services. If, by contrast, Vietnam's economic development can be explained by a harmony of interest among the various actors, we should see a development path in which all interest groups benefit from each other. So far, we have shown that a harmony of interest exists between
(a) political elites and investors in high-investment provinces (Chapter 5); and
(b) political elites and their citizens in less successful provinces, especially if they are in proximity to successful ones (this chapter).

Chapter 5 showed that elites in rich provinces bargain with investors to obtain investment capital and the rent associated with it, as well as political benefits of employment, economic growth and the recognition and promotions that come with successful economic performance (which we earlier called *political rent*). In this bargaining process, coercive elites reduce their immediate predation in return for long-term economic and political benefits. Investors, for their part, accept a certain level of rent seeking as the price for a reasonably good business climate.

The present chapter laid out the mechanisms by which it becomes necessary for the political elites in poorer provinces to get onto the bandwagon and reform as well, in order to avoid the negative consequences – in both economic and political terms – of out-migration of capital and labor to the investment poles. These elites make rational choices as well, weighing the cost of reform against the cost of inaction, and find that the closer they are to successful provinces, the higher the cost of stasis. As evidence for this hypothesis, we demonstrated that reforms occur in concentric circles around earlier growth poles.

The next two chapters analyze the interactions between elite and non-elite and asks whether they are characterized primarily by a harmony of interest as we have seen in Chapter 5 (between political and economic elites in rich provinces) and Chapter 6 (political elites and non-elites in poor provinces), or whether in rich provinces economic and political elites engage in rent seeking in what amounts to a divergence of interest approach.

CHAPTER 7: GOVERNMENT-CITIZEN RELATIONS AND THE HARMONY OF INTERESTS

This chapter expands on the harmony-of-interest theory by investigating whether it extends to the relationship between political elites and workers in successful provinces. The race-to-the-bottom assumption as we have defined it for this study argues that in such a case, elites should collude with each other to allocate wealth among them, rather than allowing it to trickle down to subordinate groups as well.

It is widely accepted that political elites and economic elites routinely trade favors for their mutual benefit – a harmony of interest between them is not hotly contested. Similarly, the harmony of interest between political elites and their citizens in investment-poor jurisdictions may not be universal, but does not engender many theoretical objections, either. Where political elites fear the loss of the disenchanted citizenry, they take action. Where they can, they build a wall and use coercive power to obtain a desired end result. If they cannot use coercion, as is the case in a federal system that has rules about freedom of migration – rules which jurisdictions are not free to alter – they address the out-migration issue by other means, such as introducing reform measures.

The more contested question that remains in this hypothesis about the impact of mobility on the harmony of interest is this: *Why do political and economic elite groups in investment-rich provinces not see it in their interest to collude against regular citizens? Why do they not reduce labor protections and social wages for workers to* *keep taxes for businesses to a minimum, in return for increased rent paid by investors to political elites?* Since those provinces are the ones to offer jobs in a country with significant rural underemployment and 1.3 million new annual entrants in the labor force[64] (Vietnam Trade Office 2008), these wealthy provinces appear to be in a good position *not* to bargain with non-elite groups. We have claimed in Chapter 3 that no such collusion among elite groups is taking place under the harmony-of-interest hypothesis. The next phase of the exploration of the harmony-of-interest hypothesis tests whether our assumption is accurate, and if so, why it obtains.

A collusion scenario has been theorized by critics of trade opening starting with early dependency theory and leading up to scholars engaging with the phenomenon of globalization. In this chapter, we lay out very briefly the arguments for and against this scenario and re-state the hypothesis of this study and the testable assumptions formulated in Chapter 3. We then present the empirical evidence for Assumption 3, by evaluating data associated with public goods provision, such as availability of health care services, public schools and entertainment opportunities. Recognizing that the number of schools or hospital beds does not necessarily translate into quality service, we compare these quantitative data to a new large-N survey of 30 provinces, in which citizens are asked to rate the quality of governance from the end user perspective (as opposed to the business perspective in the *Provincial Competitiveness Index* discussed

64 Vietnam's population growth rate is slowing down and the number is declining fast due to a two-children policy. Nonetheless, the population is expected to peak at around 110 million, up from today's 87 million, and a demand for job growth will remain a political reality for at least the next decade.

in Chapter 5). Finally, we conclude by placing the harmony-of-interest theory within the findings of this chapter.

7.1. Policy Convergence and Elite Collusion

With the growth in the importance of international investment, theorists have argued that the free flow of capital imposes its rules on the state. Especially poor jurisdictions either accept the demands of investors for minimum regulatory requirements and low taxes or see capital bypass them into other locations where the political leaders are willing to accept the rules set by capital. The result is "policy convergence," as jurisdictions converge around the low global standard created by the multinational firms which search the globe for the best return on their investment (Drezner, 2000; 2001). The poor bear the brunt of the pain through low wages and a government unable to provide them with social services, due to low tax revenues.

The large number of studies addressing the convergence theory has not shed much light on the problem. Some research has found a race to the bottom. Tonelson (2001), for example, shows that governments restrict labor rights to become more competitive in the race for international capital. And Chan (2003) found a decline of wages and labor standards in China's coastal provinces as a result of competition for foreign investment. She points out, however, that the household registration rules in China turn most rural migrants into illegal residents, subject to fines and deportation from the cities, and as a result make them captives in their jobs, who are unable to demand even existing legal protections, let alone ask for the creation of new ones. By reducing legal labor mobility, China has created an extralegal working class, which due to its status has extremely little bargaining power. Employers can tell legal workers who make demands that they can always find a more docile migrant. This finding corresponds with other studies, which show that a convergence at the lowest common denominator is possible, but depends on various conditions. Amaro and Miles (2006) claim that is a myth that investors look only for lenient regulatory regimes and the lowest possible wages. Instead, they evaluate infrastructure and human capital. Hence convergence on the lowest denominator is avoidable if a jurisdiction determines what for of investment it wants to attract and plans for it.

A number of studies find that support for workers increases under conditions of trade opening and competition for foreign investment. Rodrik (1998) writes that trade opening exposes the population to risk, which the government tends to mitigate by higher spending for social services and human capital improvements. The riskier the terms of trade for a jurisdiction, the more the government will spend in order to reduce disapproval of the free-trade policies that tend to benefit the elites. This finding is validated by a number of studies on government spending in times of economic opening (Cameron 1978; Quinn 1997; Bhagwati 2004). Drezner tests the convergence theory in developing countries by investigating whether the most "globalized" areas are the least labor-friendly, and finds that union activity and labor standard enforcement are not negatively affected in industrial parks and export processing zones, where international investors account for the greatest share of the economic activity (Drezner 2001).

Virtually all these studies investigate state spending based on two assumptions: (1) The state is withering away under the forces of globalization and (2) the state is inherently intent on assisting its citizens against the forces of the global market. In this study, however, the question is not whether the state is in decline, but whether it is colluding with economic elites against regular citizens. Nonetheless, the literature remains relevant: If the state spends more on public goods, it is not in decline, but it is also not colluding against its citizens. In the following, we build on the literature and investigate the question of state rent seeking in the context of Vietnam's interprovincial contestation. We hypothesize a harmony-of-interest scenario between (provincial) state and citizens and between (provincial) state and capital. We then test the assumption against empirical evidence.

7.1.1. Race to the top

Based on the findings from the literature about globalization, trade and investment, and the convergence theory, we hypothesize that in Vietnam, the harmony of interest is not limited to groups in the elite ranks. Instead, the hypothesized race to the bottom can, under certain circumstances, be a race to the top, in which economic elites, political elites and non-elites share a commonality of purpose and all interest groups end up better off than they would without cooperation. First, let us reiterate the assumption relevant to this aspect of the study.

Assumption 3 stated that *higher levels of foreign investment correlate with higher investment by the provincial government into social welfare, as the governments* *recognize that in a quasi-federal system where people are free to migrate, labor can easily become a scarce factor and excessive predation against non-elites would drive them away*. Since Chapter 5 has shown how important human capital is for the perception of good governance and business climate, provincial governments have a strong interest in providing an acceptable quality of living for residents to tilt the cost-benefit analysis against out-migration. The higher the demand for workers in a jurisdiction, the stronger the incentive for the government to provide better living conditions for residents to stay put, or for in-migrants to decide to settle there.

The political logic in this assumption is one of a harmony of interest between non-elites and governments in high investment provinces; the causal connection is the need to maintain a good business climate for investors. With regards to the empirics, we expect social services and public goods provision to be at least as good as, if not better than, those in poorer provinces with less need for workers.[65] This assumption tests the competing race-to-the-bottom and federalist theories. The variables are, first, foreign investment levels as a proxy for both demand for labor[66] and for the existence of foreign

[65] In reality, the relationship is a bit more complicated than this formulation. Since rich provinces offer jobs and better salaries, workers may be willing to forgo some social benefits in return. Especially in the case of migrant workers, who tend to be young and single, certain public services are not of high importance. Primary education and care for the elderly, for example, is not of great importance for childless workers in their late teens or early twenties. But as more and more provinces open industrial parks, return migration is picking up (see Chapter 6) and the contest for human capital is increasing. Under Assumption 3, we expect to see social services improve exactly as competition among provinces heats up – a form of convergence, one that follows logically from Thieboutian assumptions about federalism, but one that contradicts race-to-the-bottom assumptions.

[66] To be sure, domestic investors also need workers. The reason to use foreign investment rather than all labor-requiring investment is that many domestic companies are not fully free to make location choices. State-owned enterprises are often bound to the province whose government owns them, and many private companies do not have the financial ability to choose the best industrial parks. Foreign investors have most bargaining power, because they can choose any province, but also because they can choose to bypass Vietnam altogether. This choice of variable has already been discussed in a different context, and

capital with which the political elites could collude; and, second, predation against subordinate groups. The former is easily measured, the latter will be measured through a number of indicators: the difference in living standard between elite and subordinate interest groups (approximated by income quintiles), poverty rates and changes thereof, access to social services, and the differences in income and social services in in- and out-migration provinces (to indicate what portion of surplus is returned to social services versus being appropriated by elites).

7.2. Vietnam's Inter-Provincial Competition and Public Goods

Assumption 3 claims that political elites in provinces with high levels of inward investment understand that their economic success depends on the availability of human capital. Lack of qualified workers would drive the cost of labor up and make the province less competitive for foreign investors. The few provinces where foreign investment is concentrated depend on in-migration to fill the industrial manpower needs. In Dong Nai, for example, a provincial official said that 70% of the 300,000 workers in industrial zones are migrants from other provinces (Van 2007). In neighboring Binh Duong, the Central Institute for Economic Management found that in 2004, 40%, or 232,000, of the provinces total industrial workforce of 590,000 were migrants (CIEM 2005). Overall, some 6.5% of Vietnam's population migrated at least between districts in the five-year period prior to the 1999 census (GSO and UNFPA 2005: 10-11). While Vietnam has a very high internal migration rate in international

is applicable in this section as well.

comparison, it also suffers from increasingly high levels of return migration – migrants who work in an industrial park for a time and return home when they no longer want to endure the hardships or social and cultural deprivations associated with living away from the family network and native village. This return migration has become a significant problem, as most provinces set up industrial parks of their own and workers with experience in the famous economic zones in and around Ho Chi Minh City can get jobs closer to home. A provincial official in Binh Duong suggested an annual return migration rate of 25-33% every *Tet* holiday, the Vietnamese New Year (Viet 2007); Nike experiences turnover rates of some 50% annually (Levi 2011). Workers tend to stay until *Tet* for the bonus, and simply do not return after the week-long break, causing production interruptions and increased cost with hiring and training of new employees.

The most affected provinces are actively trying to prevent return-migration and have identified social service provision as a major factor that pushes people out of the industrial zones and back to their provinces of origin. This issue is indeed return migration. Statistics indicate that very few residents originally from the highly invested provinces move away in search of a better life. Migrants leaving the investment poles are largely in-migrants returning to their province of origin. This suggests that two factors drive the decision, cultural and social ones. Culturally, Vietnamese want to stay close to family and birth place. Socially, the lack of social services and social life in a place where a person lacks permanent registration leads to hardships that locals do not suffer. Binh Duong's provincial construction company BECAMEX, which builds and manages industrial parks as well as roads and other infrastructure, recognizes the importance of providing quality of life in addition to jobs to reduce turnover:

> We actually build industrial sites, not only parks. We add markets, kindergartens, schools, hospitals. Workers come here when they are very young. Once they get married, if they don't have this social infrastructure, they cannot continue to work. In order to keep workers here longer, we need to create favorable social conditions. Since hospitals, schools et cetera need a long time to amortize, we provide special land price to make it easier to invest in these. We also built a theater and sports facilities. Management is as important as salaries. … BECAMEX organizes van service to Ho Chi Minh City to keep workers happy, give them options (Xuyen 2007).

The statement reflects the harmony-of-interest hypothesis, but it comes from an official at a company that earns money from building infrastructure. To investigate whether the understanding that social services are important for worker retention in a high-investment province translates into actual policy, we analyze investments made into social services that are mainstay of good governance and key to quality of life for working families without the means to procure them easily in the private market. Vietnam's General Statistics Office provides data on a wealth of indicators in two annual publications, the Statistical Handbook (published late in the year with preliminary data) and the Statistical Yearbook (published later with adjusted data and analysis). For the purpose of this argument, the following are most relevant:

- provision of education from kindergarten to secondary school;
- number of hospital beds per capita;
- libraries as a proxy for after-work entertainment services and social life opportunities.

Two significant complaints from workers about living conditions in investment poles are not addressed on a province-by-province base in the Statistical Yearbook, public transportation and housing. Housing is a major problem that will be discussed in the context of Assumption 4 in the next chapter. For public transportation, it can only be said that bus service in the main cities, including the investment poles, has been expanded rapidly over the last decade, and that industrial parks even far away from urban centers are served.

In addition to the discussion of social service provision, one indicator that reflects the level of elite rent seeking is the gap between rich and poor. Do the poor share the benefits of economic growth, or do these benefits primarily accrue to the rich and powerful through rent seeking? We use the following indicators to answer that question:

- poverty rate and change in poverty rate over time;
- income distribution by income quintile.

Poverty data are inaccurate, according to critics. Local government officials fear that unflattering data on poverty, unregistered migrants and inadequate provisions of mandated services or widespread violation of labor laws and social protection regulations would hurt their careers. As a result, they try to avoid that the most vulnerable populations are surveyed. Poverty is significantly higher than officially described, a study finds, among people working in petty trade and the informal economy. In these sectors, lowly educated and extremely poor workers, mostly migrants, do not know their rights and as a result fall through the cracks of social protection (Pincus and Sender 2007). To make sure that this study measures what it intends, it checks what ratio of total income in a province comes from salaries and wages, since salaried, official workers are not likely to be undercounted, nor do they often fall through the cracks of the system.

7.2.1. Industrial employment

This study has concerned itself with the impact of economic development on rent seeking. For reasons laid out throughout, it has used foreign investment into efficiency-seeking projects as a variable that best reflects economic development. Although it is intuitive that a large amount of foreign investment will lead to a large amount of industrial employment, this is not beyond the need for testing. First, the impact of new investment on the ratio of official to inofficial jobs depends on population size. In a more populous province, any given number of new industrial jobs has a lesser impact on the ratio than in a scarcely populated one. Second, where there are already sizable levels of industrial jobs, more investment may shift workers from one industrial job into another. (This was the case when foreign investors displaced a large number of inefficient state-owned enterprises and hired their workers.) In provinces with few industrial jobs, a larger portion of new hires will move from the inofficial into the official sector. Third, foreign investment is said to create fewer jobs than domestic firms as it uses labor-replacing technologies. Hence, the impact of foreign investment on the ratio of official to inofficial jobs needs to be tested.

Table 7.1. Share of salaries and wages in total provincial income

Province	Total income	% of salary/wages	Province	Total Income	% of salary/wages
Ha Noi	1050	50.76	Binh Phuoc	695	29.64
Quang Ninh	867	46.94	Ninh Binh	509	29.47
Ba Ria-VT	776	45.88	Ha Nam	501	29.14
Ho Chi Minh	1480	43.92	Quang Tri	436	29.13
Da Nang	853	43.49	Hung Yen	556	28.6
Khanh Hoa	598	43.31	Thai Binh	514	28.21
Hai Phong	720	43.06	Bac Giang	490	28.16
Dong Nai	867	42.56	Vinh Long	580	27.41
Quang Nam	459	39.87	Yen Bai	424	27.36
Long An	627	37.8	Tuyen Quang	450	26.67
Tay Ninh	697	37.16	Dien Bien	305	26.56
Quang Ngai	455	36.7	Kien Giang	675	26.37
Vinh Phuc	540	36.67	Tien Giang	630	26.03
Ninh Thuan	491	36.05	Bac Ninh	669	26.01
Kon Tum	445	35.28	Nghe An	413	25.42
Phu Yen	523	34.42	Lai Chau	273	25.27
Binh Duong	1215	34.4	Ha Giang	329	25.23
Hoa Binh	416	34.38	Ben Tre	614	25.08
Nam Dinh	527	34.35	An Giang	691	25.04
Thua Thien-Hue	517	34.24	Hau Giang	609	24.47
Binh Dinh	553	34	Dong Thap	609	23.65
Can Tho	780	33.72	Tra Vinh	509	23.58
Cao Bang	395	33.16	Soc Trang	495	23.23
Bac Kan	388	32.47	Lam Dong	596	23.15
Hai Duong	609	32.18	Lang Son	455	21.98
Quang Binh	420	32.14	Bac Lieu	610	21.64
Binh Thuan	577	31.54	Dak Lak	507	21.5
Thanh Hoa	395	31.4	Son La	394	20.81
Thai Nguyen	555	30.63	Ha Tinh	400	18.25
Gia Lai	498	30.32	Dak Nong	500	17
Phu Tho	520	30	Ca Mau	666	16.97
Lao Cai	400	29.75			

Source: Statistical Yearbook 2008

Table 7.1. shows the percentage of total income in the province that comes from salaries or wages. This number does not exclusively reflect industrial labor, but it helps gauge the relative importance of the official economy in comparison to petty trading, the gray economy and agriculture – all sectors of great importance in developing economies in general and Vietnam in particular. A strong relationship is evident between the strength of the formal economy and the total income level in a province.

The 10 provinces with the highest total income are all in the category of having a share of wages between 33.72% and 50.76%.[67] The table indicates clearly that industrialization is associated with higher incomes. This finding is bolstered when taking remittances into consideration. More than half of migrant workers remit money to their families (Deshingkar 2006: 8), and two thirds of those send more than VND1,000,000 (approximately $60 in the exchange rate at the time of the research in 2005, or about $50 in summer of 2011) per year (GSO and UNFPA 2005: 72). Average income was approximately $900 in 2005 (around $1,100 in 2011), and much less in poorer rural areas. These remittances represent a significant injection into the total income column of remittance-receiving provinces. As a result, industrialization even pushes up total income in provinces with few factories via remittances.

It has already been demonstrated that foreign investment and industrialization go hand in hand. Table 7.2. shows the relationship between foreign investment and the percentage of total income stemming from the official economy. Of the top-10 foreign investment recipients, four are not in the top 10 in terms of percentage of total income

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[67] That top number is Ha Noi, whose status as national capital creates plenty of salaried government officials.

stemming from salaries and wages, but all four are close: Binh Duong (#2 in FDI) ranks 17 in the wage-ratio scale; Hai Duong (#8 in FDI and #25 in wages); Vinh Phuc (9/13); and Tay Ninh (10/11). Among those with the lowest wage ratio in total income, Lam Dong remains the eternal statistical outlier (15/56). Lan Son is the other province with a bottom-10 wage-to-total-income ratio in the upper half of the FDI table (#24 in FDI), but with only 49 investment projects, far from the upper tier.

Table 7.2. Income from salaries and wages, top and bottom ranks, and FDI projects

% of income from wages (rank)	Province (FDI projects 1988-2008 (rank)		% of income from wages (rank)	Province (FDI projects 1988-2008 (rank)	
1	Ha Noi	3	6	Khanh Hoa	16
2	Quang Ninh	12	7	Hai Phong	5
3	Ba Ria-Vung Tau	7	8	Dong Nai	4
4	Ho Chi Minh City	1	9	Quang Nam	22
5	Da Nang	11	10	Long An	6
63	Ca Mau	50	58	Bac Lieu	49
62	Dak Nong	56	57	Lang Son	24
61	Ha Tinh	45	56	Lam Dong	15
60	Son La	51	55	Soc Trang	52
59	Dak Lak	58	54	Tra Vinh	40

Sources: Statistical Yearbook 2008; Statistical Handbook 2009

The numbers provide strong evidence that foreign investment is closely associated with a higher share of salaries and wages in the economy. If Pincus and Sender (2007; see above) are accurate in their claim that severe poverty is largely associated with employment in the gray economy – petty trading, inofficial employment and agriculture – then the data support the claim that no race to the bottom is taking place. The data do not, however, support the harmony-of-interest assumption, since no causal connection can be deduced from the evidence in this section. The next section investigates whether elites appropriate large shares of the fruits of economic growth for themselves through use of their coercive power. To do so, the section investigates income distribution data and change in distribution over time.

7.2.2. Income distribution

In a race-to-the-bottom scenario, political and economic elites would collude with each other to reduce the share of economic growth that trickles down to non-elite interests. The empirically observable result would be a widening in the income gap between income quintiles. This section tests the evidence. Income quintile data on a province-by-province level have not been made available by the Government Statistics Office on a time-series basis. Data on income by quintile must be used in conjunction with general poverty data to draw conclusions. Table 7.3. lists the multiplier between the lowest and highest income quintile by province. Under a race-to-the-bottom scenario, the provinces with most investment should exhibit the highest income differences. The top-10 foreign-investment recipients are shaded, the ten[68] provinces with the highest and lowest income differential are identified by ranking in foreign investment attraction between 1988 and 2008. Provinces are arranged from lowest to highest income differential, the first column represents the lowest tier in income differential, the third the highest.

Among the top-10 investment recipients, three fall into the tier with the lowest income differential, two into the highest. A geographical cluster is visible: the three neighboring high-investment provinces of Ho Chi Minh City, Binh Duong and Long An

68 In the ranking of the lowest differences, four provinces share the 10th rank, hence the listing of 23 cases.

share the same multiplier of income differential (the highest income quintile receives 6.2 times the income of the lowest). The other high-performing neighbor, Dong Nai, is just two-tenths of a percentage point higher. Ba Ria-Vung Tau is an outlier, but its investment structure is different. As a major port, Ba Ria-Vung Tau has attracted investment geared toward the heavy industries rather than the light manufacturing that prevails in the rest of the region. Tay Ninh, another high-performing neighbor, ranks in the first tier. The four northern top investment recipients are distributed among all three tiers.

Table 7.3. Income difference between lowest and highest quintile in multiples (2006 numbers)

Province (lowest to highest)	Multiple	Province	Multiple	Province	Multiple
Ha Giang *(52)	5	Tuyen Quang	6.2	Nghe An	6.9
Binh Thuan (17)	5.3	Binh Phuoc	6.2	Bac Lieu	6.9
Vinh Phuc (9)	5.4	Binh Duong	6.2	Thai Nguyen	7
Nam Dinh (34)	5.4	Ho Chi Minh	6.2	Hoa Binh	7
Can Tho (18)	5.5	Long An	6.2	Khanh Hoa	7.1
Hai Duong (8)	5.6	Phu Yen	6.3	Bac Kan	7.2
Thai Binh (34)	5.6	Yen Bai	6.4	Soc Trang	7.2
Bac Giang (21)	5.6	Quang Tri	6.4	Lao Cai	7.3
Da Nang (11)	5.6	Thua Thien-Hue	6.4	Ca Mau	7.3
Hung Yen (13)	5.7	Dong Nai	6.4	Tra Vinh	7.5
Ha Nam (29)	5.7	Tien Giang	6.4	Dong Thap	7.6
Quang Nam (22)	5.7	Ben Tre	6.4	Hai Phong (5)	7.7
Kon Tum (61)	5.7	Hau Giang	6.4	Kien Giang (36)	7.8
Thanh Hoa	5.8	Phu Tho	6.6	Quang Ninh (12)	7.9
Quang Binh	5.8	Lai Chau	6.6	Gia Lai (52)	7.9
Quang Ngai	5.8	An Giang	6.6	Dak Lak (58)	7.9
Vinh Long	5.8	Ninh Binh	6.7	Lam Dong (15)	7.9
Dien Bien	6	Ha Tinh	6.7	Ba Ria-VT (7)	8.1
Tay Ninh	6	Ha Noi	6.8	Ninh Thuan (42)	8.5
Son La	6.1	Bac Ninh	6.8	Cao Bang (48)	8.8
Binh Dinh	6.1	Lang Son	6.8	Dak Nong (56)	8.8

** Ranking of number of FDI projects, 1988-2008* *Source: Statistical Yearbook 2008*

Among the 13 provinces (10 ranks) with the lowest income differential, seven are in the top tier in terms of foreign investment projects received in the last two decades, only two in the bottom tier, and four in the middle tier. Among the ten provinces with the highest income differentials, four are in the top tier of investment ranking (including eternal outlier Lam Dong), another four in the bottom tier, two are middling attractors of foreign capital. These data indicate that there is no increased rent seeking detectable among high investment attractors. The four highest-invested provinces are in the middle column of income differentials. On the upper end of the income gap, investment-rich and poor provinces are equally represented, while in the low income-gap provinces, more than half of the provinces are in the top tier with regards to foreign investment over the last two decades. Given that small-scale agriculture is generally fairly egalitarian and that modernization automatically leads to increases in inequality through the creation of a hierarchy by skills on one hand, capital ownership on the other, these results are even more remarkable.

7.2.2.1. Inequality over time

The data from the previous section are a snapshot. An alternative investigation of the inequality data must include changes over time. The Statistical Yearbook does not provide comparable provincial income quintile data to investigate whether the investment rich provinces started out highly egalitarian and are drifting apart, while the rest of the country is getting less polarized. An alternative approach is to compare poverty data over time. This is not a perfect comparison, since income inequality could in theory increase while poverty still declines, but at the least, such an approach allows to draw conclusions on whether foreign investment impoverishes the lower classes or not.

Table 7.4. places the provinces in the order of poverty rate in 2008, from lowest to highest. Ranking them by the rate of poverty reduction would have yielded a dramatically different result, in which the poorest provinces would have largely been on top. But given that almost all provinces reduced their poverty rate by more than the residual poverty in the top provinces, such an order would not provide analytical value. The nine provinces with the lowest poverty rates are also among the 12 top investment recipients. Only three of the top investment recipients are not among the lowest 10 in poverty, and only one is not in the best tier (Vinh Phuc ranked 25). High levels of foreign investment are closely connected to low levels of poverty.

Pincus and Sender (2007) have pointed out that there is an undercount in the official poverty rate, also due to the exclusion of migrants who maintain their household registration in their province of origin and are therefore counted in their original home rather than the province where they work. Two factors reduce the importance of this distortion. First, this systemic error in counting residents may reduce the poverty rate in some investment-rich provinces, but it also alters income statistics in poor provinces. Second, since the migrants this research is concerned with are in the official sector, they are unlikely to be among those living in extreme poverty (for a summary of Pincus and Sender's argument, see above in this chapter).

Table 7.4. Poverty rates and their change over time, by province in percent

Province	2006	2007	2008	2006-08	Province	2006	2007	2008	2006-08
Ho Chi Minh City *(1)	0.5	0.5	0.3	-0.2	Binh Dinh	16.0	15.4	14.2	-1.8
Binh Duong (2)	0.5	0.5	0.4	-0.1	Lam Dong	18.3	17.6	15.8	-2.5
Ha Noi+ (3)	3.0	2.9	2.4	-0.6	Phu Yen	18.5	17.8	16.3	-2.2
Da Nang (11)	4.0	3.8	3.5	-0.5	Thai Nguyen	18.6	17.7	16.5	-2.1
Dong Nai (4)	5.0	4.8	4.3	-0.7	Phu Tho	18.8	18.0	16.7	-2.1
Tay Ninh (10)	7.0	6.7	6.0	-1.0	Bac Giang	19.3	18.5	17.5	-1.8
Hai Phong (5)	7.8	7.4	6.3	-1.5	Soc Trang	19.5	18.7	17.9	-1.6
Ba Ria-Vung Tau (7)	7.0	6.7	6.3	-0.7	Tra Vinh	21.8	20.7	19.0	-2.8
Quang Ninh (12)	7.9	7.5	6.4	-1.5	Ninh Thuan	22.3	21.2	19.3	-3.0
Can Tho	7.5	7.1	7.0	-0.5	Lang Son	21.0	20.0	19.3	-1.7
Bac Ninh	8.6	8.2	7.5	-1.1	Quang Ngai	22.5	21.7	19.5	-3.0
Long An (6)	8.7	8.3	7.7	-1.0	Quang Nam	22.8	22.1	19.6	-3.2
An Giang	9.7	9.2	8.5	-1.2	Yen Bai	22.1	21.3	20.4	-1.7
Khanh Hoa	11.0	10.5	9.1	-1.9	Tuyen Quang	22.4	21.6	20.6	-1.8
Binh Phuoc	10.5	10.0	9.1	-1.4	Dak Lak	24.3	23.1	21.3	-3.0
Binh Thuan	11.0	10.5	9.2	-1.8	Quang Binh	26.5	26.0	21.9	-4.6
Kien Giang	10.8	10.3	9.3	-1.5	Nghe An	26.0	25.2	22.5	-3.5
Thai Binh	11.0	10.5	9.8	-1.2	Dak Nong	26.5	25.4	23.3	-3.2
Vinh Long	11.0	10.5	9.8	-1.2	Gia Lai	26.7	25.6	23.7	-3.0
Hai Duong (8)	12.7	12.1	10.1	-2.6	Thanh Hoa	27.5	26.6	24.9	-2.6
Hung Yen	11.5	10.9	10.3	-1.2	Quang Tri	28.5	27.6	25.9	-2.6
Tien Giang	13.2	12.5	10.6	-2.6	Ha Tinh	31.5	30.8	26.5	-5.0
Dong Thap	12.1	11.5	10.6	-1.5	Kon Tum	31.2	30.1	26.7	-4.5
Nam Dinh	12.0	11.4	10.6	-1.4	Hoa Binh	32.5	31.3	28.6	-3.9
Vinh Phuc (9)	12.6	12.0	11.3	-1.3	Lao Cai	35.6	34.6	33.2	-2.4
Ha Nam	12.8	12.2	11.6	-1.2	Cao Bang	38.0	36.7	35.6	-2.4
Ca Mau	14.0	13.3	12.7	-1.3	Son La	39.0	37.9	36.3	-2.7
Ninh Binh	14.3	13.7	13.0	-1.3	Bac Kan	39.2	38.0	36.8	-2.4
Hau Giang	15.0	14.3	13.3	-1.7	Ha Giang	41.5	40.4	37.6	-3.9
Thua Thien-Hue	16.4	15.6	13.7	-2.7	Dien Bien	42.9	41.3	39.3	-3.6
Bac Lieu	15.7	14.9	13.9	-1.8	Lai Chau	58.2	56.3	53.7	-4.2
Ben Tre	16.2	15.4	14.2	-2.0					

Statistical Yearbook 2009; Household Living Standard Survey 2008

+ Ha Noi merged with Ha Tay province in 2008. The data here exclude the more rural Ha Tay. Including the new territories and populations, Ha Noi's poverty rate would be 6.6%.

** Ranking of number of FDI projects, 1988-2008.*

A longer-term comparison of poverty rates calculates the rates by region. (The discrepancy in the number or regions with other tables occurs because these regions were re-aligned in 2008. They serve no political functions, their only use is statistical.) Table 7.5. indicates that the short-term trends in Table 7.4. are observable all the way back to 1993.

Table 7.5. Poverty rates by region, in percent

Region	1993	1998	2002	2004	Change 1993-2004
Northeast	86.1	62.0	38.4	29.4	-65.9
Northwest	81.1	73.4	68.0	58.6	-27.3
Red River Delta	62.7	29.3	22.4	12.1	-80.7
North Central Coast	74.5	48.1	43.9	31.9	-57.2
South Central Coast	47.2	34.5	25.2	19.0	-59.8
Central Highlands	70.0	52.4	51.8	33.1	-52.7
Southeast	37.0	12.2	10.6	5.4	-85.0
Mekong Delta	47.1	36.9	23.4	15.9	-66.2
Whole Country	58.1	37.4	28.9	19.5	-66.4

Source: World Bank 2005

In the long run dating back to the beginning of large-scale inflows of foreign investment, the Southeast anchored by Ho Chi Minh City begins with the lowest poverty rate. Nonetheless, it achieves the most impressive reductions. The Red River Delta with Ha Noi, Hai Duong and Hai Phong starts with the third-lowest poverty rate, but achieves the second strongest reduction. The long-term data do not suggest that the investment boom that started in the mid-1990s and accelerated in the 21st century has harmed the poor in the most heavily invested regions.

7.2.3. Public health care

Assumption 3 holds that local government in highly invested provinces needs to provide good enough public services to tilt the cost-benefit analysis of workers who consider voting with their feet in favor of staying over moving away. Where rent seeking is excessive and the basket of public services that people desire is insufficient as a result, workers are more likely to move away, human capital availability will decline, labor rates will increase and business climate suffer. As a result, in keeping with federalist theory, political elites in successful provinces will forego excessive rent seeking and provide basic social services. Health care is one of the crucial public services, together with education. The communist government of Vietnam has based its legitimacy on the provision of basic health and education services, and Vietnamese citizens expect these services to be provided. In this section, we investigate whether publicly provided health care services follow the race-to-the-bottom assumption or the harmony-of-interest assumption of this study.

Table 7.6. indicates the ratio of patients (residents in the province) per available hospital bed in public institutions,[69] a good indicator for commitment to public health. The median for the country as a whole is 448 people per hospital bed. Budgeting in Vietnam remains centralized, and provinces must negotiate their budgets and the implementation of the line items with the center. Consequently, there should be a significant level of uniformity in an area as crucial to the Communist Party's legitimacy

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69 To reduce budget exposure, the government encourages investment in private health facilities, but licensing in this sector remains complicated and the vast majority of hospitals are still public. The private sector serves largely the expatriate, tourist and very wealthy domestic market.

as health service provision. Recently, however, the government has begun to experiment with block grants to increase efficiency (Bartholomew et al. 2005). This increasing *granted* budget autonomy paired with the autonomy that provinces have routinely *taken* leads to significant differences in social service provision across provinces. As the discussion of fence breaking has shown, the most successful provinces have felt least compelled to follow central government decisions when the local leadership considered it important to deviate from them.

Table 7.6. Resident to hospital bed ratio, 2008

Province	Pop. (1,000)	People to beds	Province	Pop (1,000)	People to beds	Province	Pop. (1000)	People to beds
Bac Kan	295	232	Thai Nguyen	1127	393	Dong Thap	1668	482
Cao Bang	513	263	Thanh Hoa	3405	393	Quang Binh	848	485
Lao Cai	615	273	Vinh Phuc	1003	398	An Giang	2149	490
Kon Tum	433	283	Phu Tho	1317	409	Thai Binh	1784	505
Yen Bai	743	314	Bac Giang	1560	416	Long An	1439	513
Ha Nam	786	318	Ninh Binh	900	420	Tien Giang	1674	524
Ho Chi Minh	7165	318	Binh Thuan	1172	426	Phu Yen	863	543
Ha Tinh	1230	319	Ninh Thuan	566	427	Dak Lak	1733	549
Quang Tri	599	322	Khanh Hoa	1160	436	Dong Nai	2491	549
Hai Phong	1842	335	Nghe An	2919	441	Binh Phuoc	878	551
Hoa Binh	789	336	Hau Giang	758	448	Dak Nong	492	565
Da Nang	891	344	Hung Yen	1131	449	Soc Trang	1293	580
Dien Bien	493	351	Quang Ngai	1219	456	Bac Lieu	858	599
Son La	1084	356	Lam Dong	1189	459	Tay Ninh	1068	603
Tuyen Quang	728	357	Kien Giang	1688	461	Vinh Long	1030	608
Lang Son	733	358	Ca Mau	1207	465	Binh Duong	1497	666
Quang Ninh	1147	363	Ben Tre	1256	467	TT-Hue	1089	689
Lai Chau	371	371	Bac Ninh	1027	474	Ba Ria-VT	997	690
Ha Giang	727	373	Nam Dinh	1826	474	Tra Vinh	1004	697
Quang Nam	1421	385	Binh Dinh	1489	475	Ha Noi*	6472	698
Hai Duong	1707	391	Gia Lai	1278	481	Can Tho	1190	744

Source: Statistical Yearbook 2008

** In 2008, Ha Noi absorbed the poorer, rural Ha Tay. This number reflects the new, combined province.*

According to the race-to-the-bottom assumption, the most successful provinces would also be those most likely to engage in elite collusion against non-elite groups. Foreign investment levels do not appear to be indicative of number of hospital beds per capita. Top investment recipient Ho Chi Minh City ranks seventh-best (note that a lower ratio is better than a higher one), while the second-highest investment-receiving province, Binh Duong, ranks sixth from the bottom. In the next table (7.7.), provinces that deviate from the median by at least 20% are shown, together with ranking in the number of foreign investment projects received between 1988 and 2008 and alternative explanations for quality of health service provision, good governance (as per the *Provincial Competitiveness Index*) and population density. The logic behind the variable population density is that in sparsely populated provinces, it is more difficult to get patients to hospitals, hence one needs to bring more hospitals to the dispersed population.

Table 7.7. Patient-to-bed ratio in provinces 20% above or below national median, 2008

Provinces 20% better than median (358 and below)					Provinces 20% worse than median (538 and above)				
Province	Patients to bed	PCI rank	FDI projects rank	Pop. density	Province	Patients to beds	PCI rank	FDI projects rank	Pop. density
Bac Kan	232	**61**	**52**	61	Can Tho	744	**21**	**18**	849
Cao Bang	263	**63**	**48**	76	Ha Noi*	698	33	**3**	1935
Lao Cai	273	3	23	96	Tra Vinh	697	**16**	40	438
Kon Tum	283	**51**	**61**	45	Ba Ria-VT	690	**8**	**7**	502
Yen Bai	314	23	40	108	TT-Hue	689	**14**	**20**	215
Ha Nam	318	40	29	914	Binh Duong	666	**2**	**2**	555
Ho Chi Minh	318	16	1	3419	Vinh Long	608	**5**	45	696
Ha Tinh	319	**47**	**45**	204	Tay Ninh	603	28	**10**	264
Quang Tri	322	**46**	**44**	126	Bac Lieu	599	59	49	343
Hai Phong	335	36	5	1210	Soc Trang	580	41	52	390
Hoa Binh	336	**60**	29	172	Dak Nong	565	62	56	76
Da Nang	344	1	11	694	Binh Phuoc	551	42	**19**	128
Dien Bien	351	27	**63**	52	Dak Lak	549	38	58	132
Son La	356	**52**	**51**	76	Dong Nai	549	**18**	**4**	422
Tuyen Quang	357	35	**58**	124	Phu Yen	543	49	26	171
Lang Son	358	**57**	24	88					
Nat'l average				260	** Includes Ha Tay after 2008 merger.*				260
PCI rank: top tier shaded, bottom tier bold FDI projects: top tier shaded; bottom tier bold Pop. density: above nat'l average shaded					*PCI rank: bottom tier shaded, top tier bold FDI projects: bottom tier shaded, top tier bold Pop. density: below nat'l average shaded*				

Source: Statistical Yearbook 2008

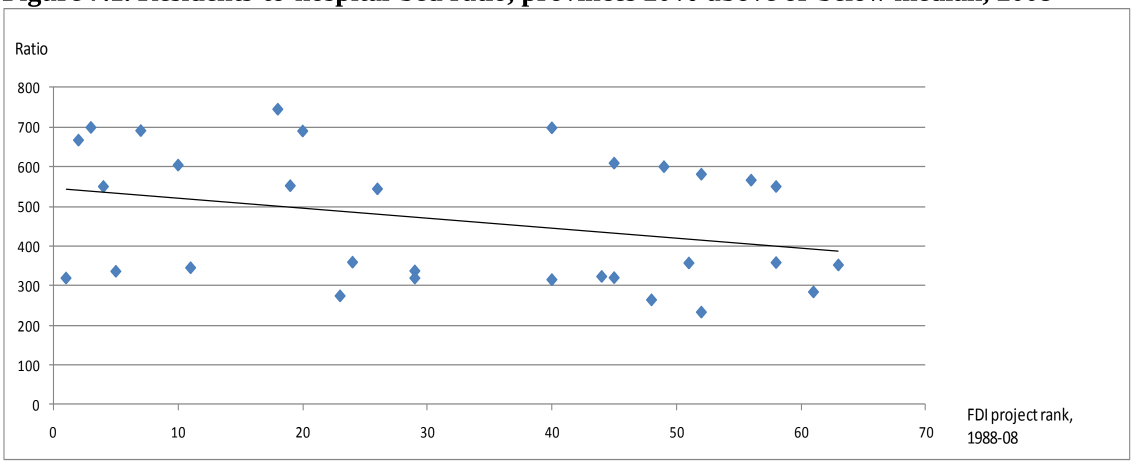
The best predictor of provision of hospital beds above or below the national median number is population density. Provinces with dispersed populations provide more hospital beds per capita to allow the sick to get to a hospital near them. Of the 16 provinces that provide at least 20% more hospital beds per capita than the national median, the population density of 12 is below average. Of interest for the research question are the four others. Those provinces that provide significantly above-median hospital access are all high investment recipients. Three are in the top tier: Ho Chi Minh City (#1), Hai Phong (#5) and Da Nang (#11). The fourth, Ha Nam, is the 29^{th} – highest recipient of foreign capital. Rather than leading to a decline in health services, foreign investment appears to help provinces to over-provide in comparison to the driving variable, population density.

The data indicate a causal chain in which low population density forces the government to provide more hospitals and beds to a more widely dispersed population, while in more densely populated areas, high levels of foreign investment appear to provide an alternative push to invest in hospital beds. Governance ranking seems less important. Only three of the over-providers are in the top tier of the PCI ranking.

On the under-provider side, out of 15 provinces, one in three has a population density below the national average. Seven are in the top tier of investment recipients, five in the bottom tier. Seven rank in the top tier for good governance, while three rank in the bottom. Among under-providers, the relationship between low population density and higher provision of hospital services holds, but additional correlations between hospital bed ratio and either PCI or FDI ranking are less obvious.

The following three figures show the impact of population density and foreign investment on hospital bed ratio. Figure 7.1. plots the hospital bed ratio and the number of foreign investment projects received for the 31 provinces in Table 7.7. The trend line indicates that a lower ranking on number of FDI projects is associated with higher hospital bed ratio – more investment in a province leads to more people sharing one hospital bed. More investment, then, is bad for the quality of hospital care.

Figure 7.1. Residents-to-hospital-bed ratio, provinces 20% above or below median, 2008



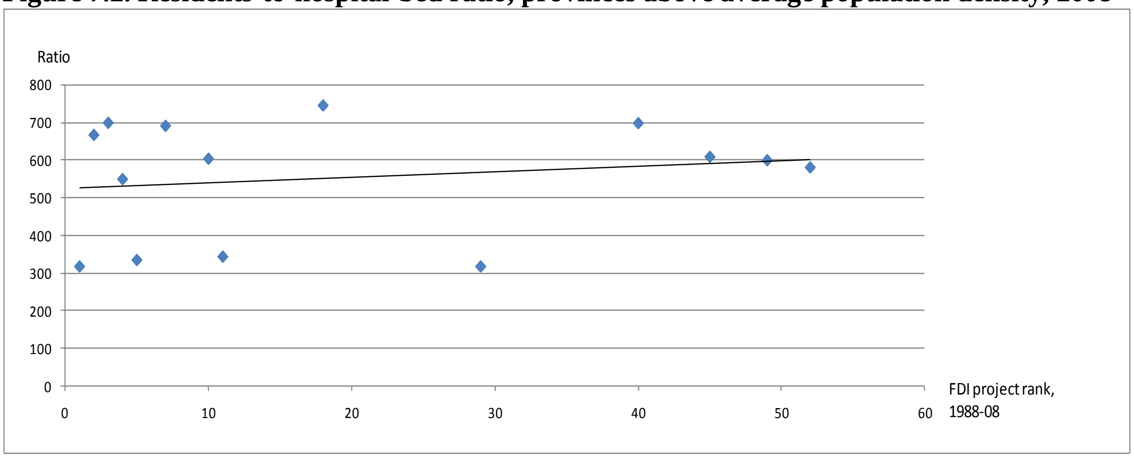
Source: Statistical Yearbook 2008

The next graph, Figure 7.2., plots the same relationship only for provinces above average population density. For this sample, the trend line is reversed. In provinces where population density is high, hosting more foreign investment projects is associated with a slightly better level of hospital services. Conversely, in provinces with low population density, ranking higher on the foreign-investment scale is bad for hospital services. The more investment low-population province gets, the more people have to share a hospital bed.[70]

70 What the charts also show us is that on the high-population-density chart, most of the provinces that dropped off are in the lower FDI ranks, while in the low-population-density chart, the high-ranking side

The divergence in impact is a puzzle. Why would more foreign investment in densely populated provinces improve the patent-to-bed ratio, while worsening it in low-density provinces? Additional research is needed, and we can only speculate at potential causes here. It is plausible that poor provinces (and those with little population, which in Vietnam are generally remote, and with little investment tend to be poor) receive more generous transfer payments from Ha Noi. These payments are used for social services to avoid discontent among a poor population with few job opportunities.

Figure 7.2. Residents-to-hospital-bed ratio, provinces above average population density, 2008

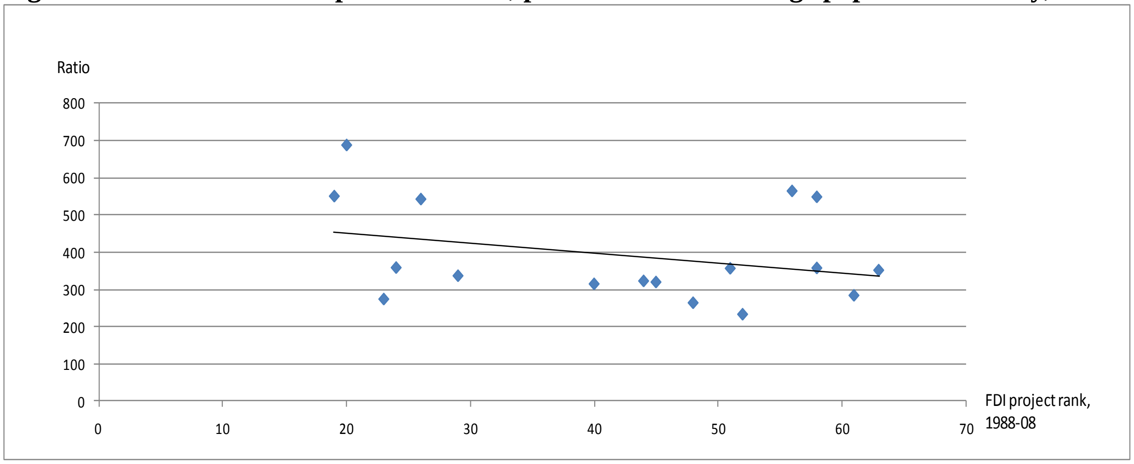


Source: Statistical Yearbook 2008

Budgeting rules take poverty into account for transfer payment negotations. It is therefore plausible that a poor province loses transfer payments as it begins to attract investment. Overall still poor, the province's social service provision standards decline. Research would need to address the transfer payment formulae in relationship to changes in investment level.

of the chart is empty, confirming once again the PCI's claim that population density is strongly positively correlated with investment levels (see Chapter 5).

Figure 7.3. Residents-to-hospital-bed-ratio, provinces below average population density, 2008



Source: Statistical Yearbook 2008

The data suggest that low population density is the main causal factor for more hospital beds per capita. When populations are dispersed, more hospitals need to be built to cover the terrain. The data also suggest that investment does *not per se* cause a decline in health services provision. It does so only in connection with population density, which in Vietnam is a good indicator for poverty. Hence, declining health standards in connection with increased investment are part of the picture, but appear to be related to poverty and geographical factors. Remoteness is associated with population density and poverty; investment is a variable that hitchhikes along through its association with population density as a causal factor (low density → less attraction to investors) and poverty as an outcome.

7.2.3.1. Health services over time

Since snapshot data are always dependent on a baseline, comparing data over time and investigating the rate of change adds important information. The General Statistics Office provides comparable health data for 2005. Table 7.8. lists the 11 provinces with improvements of or above 20%, and the 10 provinces where there are now more patients per bed[71] than in 2005, that is, where service has declined.[72] The table also lists the PCI ranking in 2009 and the ranking in the number of foreign investment projects received between 1988 and 2008. It is of note that of the 10 provinces in decline, Ha Noi has merged with poorer Ha Tay, and Ha Noi's data are therefore not readily comparable to other provinces whose statistics are not adulterated by such a change in geographic boundaries and an absorption of a population with different characteristics.

Table 7.8. Changes in patient-to-bed ratio, 2005-2008

Improvement of ratio 20% or more				Deterioration of ratio (all provinces)			
Province	% Change 2005-08	PCI 2009 rank	FDI projects rank	Province	% Change 2005-08	PCI 2009 rank	FDI projects rank
Ha Giang	45	13	**58**	Binh Duong	-33	2	2
Vinh Phuc	30	6	9	Quang Binh	-7	**56**	**44**
Dong Thap	27	4	39	Kon Tum	-6	**61**	**51**
Dak Lak	25	38	**58**	Da Nang	-6	1	11
Long An	25	12	6	Ha Noi	-6	33	3
Binh Phuoc	24	42	19	Gia Lai	-4	**52**	**43**
Khanh Hoa	21	30	16	Lao Cai	-4	3	23
Binh Thuan	21	11	17	Tay Ninh	-2	28	10
Ben Tre	21	15	42	Son La	-2	**52**	**51**
Soc Trang	21	41	**52**	Bac Lieu	-1	**59**	**49**
Quang Tri	20	**46**	**44**				
Average		23.5	32.7	Average		34.9	31.6
First tier performers shaded; bottom tier performers in boldface.							

Source: Statistical Yearbook 2005

The data provide three conclusions. First, it is easier to find big bills on the sidewalk for those that are very poor. Mancur Olson's (1996) formulation indicates that progress is easier as long as the low-hanging fruit has not yet been harvested, as even a small improvement gives a large increase in welfare. This is the case here. The median rate of

71 Patients per bed is a statistical notion, but in Vietnam it has a more immediate meaning. It occurs regularly that patients physically have to share beds, and is common during regional epidemic disease outbreaks.

72 Note that only one province has a more-than-20% decline.

residents to hospital beds in 2005 was 504. Except for Quang Tri, all top improvers start above that rate, that is, with a worse ratio. The worst performer in 2005, Ha Giang (820 people per bed) is also the top-improver. Second, foreign investment is barely associated with improvements or declines. The average ranking in the table listing provinces by number of foreign investment projects between 1988 and 2008 is 32.7 for improving provinces, 31.6 for declining ones. Third, good governance matters. The average rank in the *Provincial Competitiveness Index* was 23.5 for improvers, 34.9 for decliners.

Individual provinces stand out. Binh Duong, the second-best performer on the PCI as well as the FDI ranking, is the worst decliner by orders of magnitude. Lao Cai is both a top performer on the PCI and has a low-density population structure, both factors associated with health care improvements. Yet Lao Cai is among the top-10 decliners. (One factor could be that this poor province started from a very good performance – baseline matters.)

Overall, the data do not establish a convergence at the bottom in the provision of health care services. Rather, high levels of investment appear to mitigate the tendency of providing a less favorable patient-to-bed ratio in densely populated provinces. Yet a race to the top in which high investment levels invariably push a province to increasingly good levels of hospital services is also not observable. In the following section, we compare the data on health care with those on education.

7.2.4. Education

Education is another government service on which the Communist Party has staked its legitimacy. Access to quality education for all has been a national priority, and Vietnam indeed does extremely well in literacy and numeracy rates in international comparison. In an indication of the importance of education to the government, the Government Statistics Office provides a variety of data about education, access to and provision thereof. To respond to the research question in this study, the ratio of pupils to teachers is most suitable. First, it is an internationally recognized factor in the quality of education. Second, the cost of hiring teachers increases in a linear function, unlike classrooms which are hard to cut within existing schools, while cutting entire schools is more visible and engenders more opposition. Rent seekers would be tempted to cut out teachers first to save money. We investigate kindergarten education, because in this category data are available to calculate the pupil-teacher ratio per province. For primary and secondary schools, we need to calculate residents-to-schools ratio, because teacher and pupil data are not disaggregated to the provincial level.

7.2.4.1. Kindergarten

As was already discussed in the case of health care, education goals are set by the central government, while implementation of policies are increasingly left to the provinces. Pupil-teacher ratios are converging around 20 (national median), with a range between 11 and 32. Table 7.9. shows the data. Following the methodology used in the section on health, the provinces that significantly over-perform (have a pupil-teacher ratio 20% or more below the median) and under-perform (20% or more above the median) are separated and compared against potential explanatory variables. There is a clear regional distinction in these data.[73] Northern provinces do significantly better than those from the south. All the top-performing provinces are from the Northern Midland and Mountain Area or the Red River Delta region.

Table 7.9. Kindergarten pupil/teacher ratio

Province	Pupils/ class	Pupils/ teacher	Province	Pupils/ class	Pupils/ teacher	Province	Pupils/ class	Pupils/ teacher
Hoa Binh	21	11	Ha Tinh	28	19	Thai Nguyen	27	23
Cao Bang	20	13	Dak Lak	27	19	Quang Ngai	24	23
Ninh Binh	26	14	Dong Nai	30	19	Long An	27	23
Ha Giang	17	14	Hai Phong	32	20	Can Tho	30	23
Lao Cai	19	14	Nghe An	27	20	Thai Binh	30	24
Quang Ninh	20	15	Quang Nam	25	20	Binh Thuan	28	24
Lang Son	19	15	Phu Yen	23	20	Gia Lai	25	24
Lai Chau	19	15	Khanh Hoa	27	20	Bac Ninh	28	25
Bac Kan	17	16	Kon Tum	23	20	Ninh Thuan	26	25
Phu Tho	24	16	Binh Phuoc	29	20	Tay Ninh	26	25
Yen Bai	25	17	Ba Ria-VT	31	20	Dong Thap	29	25
Bac Giang	24	17	Ha Noi	28	21	Kien Giang	28	25
Dien Bien	21	17	Hung Yen	26	21	Hau Giang	26	25
Quang Tri	24	17	Ha Nam	28	21	Lam Dong	30	27
Thua Thien-Hue	26	17	Nam Dinh	28	21	Tra Vinh	26	27
Da Nang	31	17	Binh Dinh	25	21	Soc Trang	27	27
Tuyen Quang	20	18	Binh Duong	35	21	Bac Lieu	31	28
Quang Binh	27	18	Ho Chi Minh	37	21	Ca Mau	29	28
Hai Duong	26	19	Vinh Phuc	30	22	An Giang	26	29
Son La	21	19	Dak Nong	26	22	Ben Tre	31	30
Thanh Hoa	25	19	Vinh Long	26	22	Tien Giang	35	32

Source: Statistical Yearbook 2008

Among the worst performers, only Bac Ninh is from the north, the other 13 provinces are from the Mekong River Delta (10), the Southeast (1), the Central Highlands (1) or the Central Coast (1). In addition to geography, the best predictor of provincial performance for kindergarten teacher-to-student ratio is population density. Like in health care provision, a dispersed population requires more teachers dispersed into small communities than would be the case in more densely populated areas, where

73 The North has a longer history of communism, one possible explanation for better education numbers.

students can be brought to the kindergartens and their teachers. A commitment to equality of access forces less densely populated provinces to increase the number of teachers. Good governance as measured by the *Provincial Competitiveness Index* does not improve kindergarten provision. Only one of the top-tier PCI performers (Lao Cai) falls in the excellent providers of access to kindergartens, yet Lao Cai is an extremely sparsely populated province and thus predisposed to provide a lower ratio of teachers to students.

Table 7.10. Teacher-to-pupil ratio in provinces 20% above or below national median, 2008

Ratio 20% or more below nat'l median (better)					Ratio 20% or more above nat'l median (worse)				
Province	Pupils/ teacher	PCI Rank 2009	FDI projects rank	Pop. dens	Province	Pupils/ teacher	PCI Rank 2009	FDI projects rank	Pop. dens
Hoa Binh NM	11	**60**	30	172	Tien Giang MR	32	**9**	31	674
Cao Bang NM	13	**63**	**48**	76	Ben Tre MR	30	**15**	42	532
Ha Giang NM	14	34	**52**	91	An Giang MR	29	**20**	45	608
Lao Cai NM	14	3	23	96	Ca Mau MR	28	**22**	49	226
Ninh Binh RR	14	32	37	648	Bac Lieu MR	28	59	48	343
Lang Son NM	15	**57**	24	88	Tra Vinh MR	27	**17**	40	438
Lai Chau NM	15	**45**	**61**	41	Soc Trang MR	27	41	52	390
Quang Ninh RR	15	26	12	188	Lam Dong CH	27	54	**15**	122
					Ninh Thuan CC	25	48	42	168
					Tay Ninh SE	25	28	**10**	264
					Hau Giang MR	25	**13**	58	473
					Bac Ninh RR	25	**10**	**14**	1248
					Kien Giang MR	25	**19**	36	266
Nat'l average				260	Dong Thap MR	25	**4**	39	494
Average		40.0	35.9		Average		25.6	37.2	
Over-performers: above average population density shaded PCI and FDI rank: top tier shaded; bottom tier bold					*Under-performers: below average population density shaded PCI and FDI rank: bottom tier shaded; top tier bold*				

Source: Statistical Yearbook 2008; Statistical Yearbook 2010 (pop. density)

Half of the high-performing provinces in the kindergarten category are in the bottom tier of the PCI ranking. On the under-performing side, the picture is reversed. Only three of the 14 provinces in this category are bottom-tier PCI performers, while nine of the top-tier PCI performers provide a kindergarten student-to-teacher ratio 20% worse than the national average. Good governance as measured in the PCI is not reflected in kindergarten access. The average PCI rank for top performers is 40.0, for bottom performers 25.6.

Surprisingly, for foreign investment projects, the results are reversed. Among the top kindergarten providers, one is a top-tier investment recipient and three are bottom-tier recipients, among under-performers, low FDI recipients are more prevalent. Five of the kindergarten under-performers are bottom-tier FDI recipients, while only two are in the top tier. The average ranking on the FDI scale for top performers is 35.9, for bottom kindergarten providers 37.2. Attracting foreign investors appears to push provinces to improved performance in kindergarten provision (but not necessarily to top performance), while good governance as per the PCI has no positive impact on government spending on kindergartens. The next section looks at elementary and secondary school data to see whether the same patterns hold.

7.2.4.2. Elementary, lower secondary and upper secondary school

The Statistical Yearbook provides data on number of schools on each level (which is here aggregated in the total of schools on all three levels). We then calculate the number of residents per school. Since comparable data are provided for 2005 (Statistical Yearbook 2006), we can calculate the changes between 2004 and 2008. The national median for residents per school is 2,817. Calculating over-performers with a ration at least 20% lower (2,254 residents per school) and under-performers with a ration at least 20% higher (3,380), we find that the number of such 'outliers' is very high: 16 provinces do 20% better, an identical number is doing worse (with the caveat that Ha Noi had to absorb poorer Ha Tay provinces, which skews the statistics). Table 7.11. provides the data for the 16 over- and under-performers.

Again, population density emerges as the top predictor for high and low performance. The patterns between PCI and foreign investment levels as predictors for provincial performance in providing a low ratio of schools to residents are similar to those for kindergartens. Among over-performers, only one is ranked in the top tier of the PCI (again Lao Cai). Lao Cai is also low-population-density provinces. Only one province with above-average population density is among the education over-performers. An even higher percentage of over-performers were in the bottom PCI tier (11 out of 16, compared to four out of eight on kindergartens). On the other side of the chart, under-performing provinces are composed largely of top PCI performers (12 in 16). It must be pointed out, though, that all five urban provinces and many of the densely populated ones are also highly invested. The PCI has shown (see Chapter 5) that population density is an important criterion for foreign investors to locate in a province.

Table 7.11. Residents per school ratio in provinces 20% above or below national median, 2008

Ratio 20% or more below nat'l median (better)					Ratio 20% or more above nat'l median (worse)				
Province	Residents/ school	PCI rank 2009	FDI projects 1988-08 rank	Pop. dens.	Province	Residents per school	PCI rank 2009	FDI projects 1988-08 rank	Pop. dens.
Cao Bang	1296	**63**	**48**	76	HCMC	8499	**16**	**1**	3419
Lao Cai	1355	3	23	96	Binh Duong	7129	**2**	**2**	555
Bac Kan	1405	**61**	**52**	61	Da Nang	5210	**1**	**11**	694
Lai Chau	1520	**45**	**61**	41	Dong Nai	4763	**18**	**4**	422
Lang Son	1566	**57**	24	88	Can Tho	4667	**21**	**18**	849
Hoa Binh	1651	**60**	29	172	Ha Noi	4494	33	**3**	1935
Dien Bien	1706	27	**63**	52	Tien Giang	4359	**9**	31	674
Yen Bai	1881	23	40	108	Ba Ria-VT	4103	**8**	**7**	502
Quang Tri	1896	**46**	**44**	126	Hai Phong	3846	36	**5**	1210
Kon Tum	1899	**51**	**61**	45	Khanh Hoa	3718	30	**16**	222
Ha Giang	1908	34	**52**	91	An Giang	3606	**20**	45	608
Quang Binh	2104	**44**	**56**	105	Bac Lieu	3590	59	49	343
Son La	2105	**52**	**51**	76	Long An	3527	**12**	**6**	320
Phu Tho	2159	**53**	25	373	Ben Tre	3518	**15**	42	532
Tuyen Quang	2186	35	**58**	124	Binh Dinh	3495	**7**	28	246
Ha Tinh	2245	**47**	**45**	204	Dong Thap	3383	**4**	39	494
Average		43.8	45.9		Average		17.2	20.5	
Over-performers: above average population density shaded *PCI and FDI rank: top tier shaded; bottom tier bold*					*Under-performers: below average population density shaded* *PCI and FDI rank: bottom tier shaded; top tier bold*				

Source: Statistical Handbook 2009

Since population density is a crucial factor for school, kindergarten and hospital provision, the connection is not surprising. By the same token, 10 out of the 16 most underperforming provinces are in the top tier for attracting foreign development. Since development and population density are associated, the performance in the provision of social services is not surprising, and the causal pathways are potentially better explained by geographical factors than by a race to the bottom.

The fact that outliers with high PCI and good performance have a tendency to fall into the low-population-density category implies that population density is a predominant factor for provincial performance on social services, but also on investment. A race to the bottom cannot be excluded from the data in this category, but more research needs to be conducted, especially about the motivations for school and kindergarten spending. Table 7.12. shows a clear negative correlation between improved resident-to-school ratio (i.e.: a lower ratio) and foreign investment levels.

Table 7.12. Changes in ratio of residents to schools, 2005-2008, and FDI 1988-2008

Province	Improvement 2005-08	Province	Change 2005-08	Province	Decline 2005-08
Hau Giang	-515	Cao Bang	-119	Hung Yen	9
Quang Ngai	-287	Phu Yen	-117	Binh Phuoc	9
Nam Dinh	-280	Dien Bien	-116	Son La	27
Binh Dinh	-275	Khanh Hoa	-102	Lao Cai	28
Dak Lak	-271	Dak Nong	-91	Bac Kan	33
TT-Hue	-264	Lai Chau	-90	Nghe An	42
Ninh Thuan	-214	Bac Giang	-85	Tay Ninh	44
Lang Son	-210	Tien Giang	-82	Bac Ninh	51
Quang Tri	-191	Ninh Binh	-76	Quang Ninh	63
Thanh Hoa	-190	An Giang	-63	Kon Tum	70
Kien Giang	-190	Vinh Long	-61	Hai Phong	79
Ben Tre	-146	Phu Tho	-58	Tuyen Quang	103
Quang Nam	-142	Lam Dong	-55	Can Tho	109
Ha Nam	-140	Hai Duong	-50	Quang Binh	113
Dong Thap	-138	Hoa Binh	-46	Bac Lieu	165
Tra Vinh	-137	Binh Thuan	-37	Ba Ria-Vung T.	201
Ca Mau	-135	Ha Giang	-32	Ha Noi	285
Ha Tinh	-125	Yen Bai	-6	Dong Nai	412
Soc Trang	-124	Gia Lai	-5	Da Nang	472
Thai Binh	-122	Thai Nguyen	0	Ho Chi Minh C.	1217
Vinh Phuc	-120	Long An	3	Binh Duong	2666

First tier FDI recipients 1988-08 shaded brown (light); bottom tier performers blue (dark).

Sources: Statistical Yearbook 2008; 2005

Almost two in three provinces improved their residents-to-schools ratio between 2005 and 2008, boom years in Vietnam's economy. Of the 40 improvers, six are top-tier investment recipients, while 15 are in the bottom tier of the investment charts. Of the 22 provinces whose ratio becomes worse, 14 are top, six bottom investment performers. While population density can explain the difference in number of schools in a province, it cannot account for the decline in performance in the rich provinces. Table 7.13. compares the school performance data from Table 7.12. with the ranking on the *Provincial Competitiveness Index*.

Table 7.13. Changes in ratio of residents to schools, 2005-2008, and PCI ranking 2009

Province	Change 2005-08	Province	Change 2005-08	Province	Change 2005-08
Hau Giang	-515	Cao Bang	-119	Hung Yen	9
Quang Ngai	-287	Phu Yen	-117	Binh Phuoc	9
Nam Dinh	-280	Dien Bien	-116	Son La	27
Binh Dinh	-275	Khanh Hoa	-102	Lao Cai	28
Dak Lak	-271	Dak Nong	-91	Bac Kan	33
TT-Hue	-264	Lai Chau	-90	Nghe An	42
Ninh Thuan	-214	Bac Giang	-85	Tay Ninh	44
Lang Son	-210	Tien Giang	-82	Bac Ninh	51
Quang Tri	-191	Ninh Binh	-76	Quang Ninh	63
Thanh Hoa	-190	An Giang	-63	Kon Tum	70
Kien Giang	-190	Vinh Long	-61	Hai Phong	79
Ben Tre	-146	Phu Tho	-58	Tuyen Quang	103
Quang Nam	-142	Lam Dong	-55	Can Tho	109
Ha Nam	-140	Hai Duong	-50	Quang Binh	113
Dong Thap	-138	Hoa Binh	-46	Bac Lieu	165
Tra Vinh	-137	Binh Thuan	-37	Ba Ria-Vung T.	201
Ca Mau	-135	Ha Giang	-32	Ha Noi	285
Ha Tinh	-125	Yen Bai	-6	Dong Nai	412
Soc Trang	-124	Gia Lai	-5	Da Nang	472
Thai Binh	-122	Thai Nguyen	0	Ho Chi Minh	1217
Vinh Phuc	-120	Long An	3	Binh Duong	2666

First tier 2009 PCI shaded brown (light); bottom tier performers blue (dark).

Sources: Statistical Yearbook 2008; 2005

Comparing PCI score and performance in improvement in provision of lower residents-to-school rates gives a less clear-cut picture than foreign investment levels. While the worst four decliners are all top-tier PCI performers, overall, high scorers on the PCI are found in all three tiers of school performance. Eight top-tier PCI provinces are among the top improvers in school performance, eight in the bottom tier, the remaining five in the middle. The low PCI performers are not concentrated, either: seven are top-tier improvers of their school ratio, six are decliners, eight remain in the middle tier with moderate improvements.

PCI performance is not a major factor in explaining improved or declined performance in delivering a better school-to-population ratio. More research needs to be done in the question of the relationship between foreign investment and declining school performance. If a race to the bottom is the explanation, it would be hard to explain the less clear connection with hospital care or other indicators measured by the PCI. One avenue for research is the fact that the six bottom performers are all highly invested provinces with significant in-migration numbers. The low performance in improving the school-to-resident ratio could be due to their being simply outstripped by population growth. Since we have shown that population movements are moving in the direction of highly invested provinces, such an explanation is a logical starting point for additional research. Since investment should bring in more money, rich provinces should theoretically be able to catch up with migration-caused population growth. The vagaries of Vietnam's budgeting system with its multi-year budgets negotiated between the center and the provinces may pose obstacles, though. Investigating these connections must be the subject of another research project, however.

7.2.4.3. Libraries

The dearth of social life in heavily industrialized areas has been recognized as a significant reason for return migration. Many factory workers, migrants and non-migrants, are young and single. As they grow into an age where starting a family becomes the social norm, many leave the job and return to their home province. While it is not a government function to provide social life for factory workers, some investors and provincial investment authorities are responding to the problem by demanding a closer integration between industrial zones and livable areas (refer to the BECAMEX quote in this chapter as one example).

Table 7.14. 1,000 residents/library in provinces 20% above or below national median, 2008, and FDI

Ratio 20% or more below nat'l median (better)			Ratio 20% or more above nat'l median (worse?)	
Province	1,000 Residents/library		Province	1,000 Residents/library
Bac Kan	37		Ho Chi Minh City	2573
Cao Bang	40		Da Nang	167
Lai Chau	53		Dong Thap	271
Kon Tum	54		Dong Nai	898
Quang Tri	60		Ha Noi	557
Ha Giang	61		Thai Binh	163
Lang Son	61		Binh Duong	305
Lao Cai	62		Tien Giang	330
Dien Bien	62		Nam Dinh	219
Yen Bai	68		An Giang	424
Dak Nong	70		Vinh Phuc	112
Hoa Binh	72		Bac Lieu	102
Gia Lai	80		Ninh Thuan	256
Quang Ninh	82		Ben Tre	210
Quang Ngai	87			
Phu Tho	88			
Son La	90		*Top-tier FDI recipient between 1988 and 2008 in brown (light), bottom in blue (dark).*	

Source: Statistical Handbook 2008

National statistics do not provide data on pool halls or romantic cafes, nor is government involved in starting or running those. The next chapter demonstrates the interest local governments have shown in zoning policies to integrate living and work areas.

For this section, we briefly review one way in which the local government provides after-work social life (and also for adult continued education), libraries. The data on libraries differ from education and health care insofar as the range of over- and under-performers is wide and many provinces are at least 20% above or below the median for the resident-library ratio or the books-per-resident ratio.

Table 7.15. 1,000 residents per library in provinces 20% above or below national median, 2008, and PCI

Ratio 20% or more below nat'l median (better)			Ratio 20% or more above nat'l median (worse)	
Province	1,000 Residents/library		Province	1,000 Residents/library
Bac Kan	37		Ho Chi Minh City	2573
Cao Bang	40		Da Nang	167
Lai Chau	53		Dong Thap	271
Kon Tum	54		Dong Nai	898
Quang Tri	60		Ha Noi	557
Ha Giang	61		Thai Binh	163
Lang Son	61		Binh Duong	305
Lao Cai	62		Tien Giang	330
Dien Bien	62		Nam Dinh	219
Yen Bai	68		An Giang	424
Dak Nong	70		Vinh Phuc	112
Hoa Binh	72		Bac Lieu	102
Gia Lai	80		Ninh Thuan	256
Quang Ninh	82		Ben Tre	210
Quang Ngai	87			
Phu Tho	88			
Son La	90		*Top-tier PCI performer in brown (light), bottom in blue (dark).*	

Source: Statistical Handbook 2008

The median number for residents per library is 113,000. A 20% better performance results in 90,000 residents per library or lower, a 20% worse performance in 136,000. Tables 7.14. and 7.15. list the provinces in those two categories and show the association with PCI performance and investment numbers. If provincial investment authorities understand the importance of social life for worker satisfaction, they do not act on it. The correlation between a high number or libraries to residents and low investment is strong. Of course, the question whether the causal variable is population density, which affects both service provision and investment levels, cannot be answered. Except for poor but well-governed Lao Cai, no high PCI performer does well on providing libraries. High scores on the PCI are clearly associated with low library provision. Good governance has no impact on the provision of this citizen service.

7.2.5. Quality of governance beyond the numbers

The previous sections have drawn conclusions about the provision of social services based on data about their availability. While unavailable social services are bad services, the reverse is not necessarily true. Services may be made available but be of poor quality, or not respond to the needs of citizens. In this section, we allow recipients of government services, regular citizens, a say in the matter. Federalist theory has pointed to the exit option – voting with one's feet where local government is too predatory and the cost-benefit analysis not favorable. Migration occurs and is an important factor in policy making, as this study has reiterated. Yet it is not an easy step, and it is not free of transaction cost. Therefore, observing exhibited behavior does not always allow for causal inference. A multitude of reasons can shape a person's decision to migrate, ranging from job opportunities to cultural beliefs about the importance of proximity to family or native land, to purely personal reasons, like putting distance between oneself and an abusive spouse. Based on circumstances, rentiers may be able to get away with a significant amount of predation before the threat of out-migration becomes a reality. In Vietnam, the fact that 1.3 million of new entrants into the labor force are looking for jobs annually (Vietnam Trade Office 2008) while existing working-age people in the countryside remain underemployed creates an army of replacement workers for every one who chooses to leave.

The data in the previous sections suggest shortfalls of the *Provincial Competitiveness Index.* The PCI is designed to measure the degree to which a provincial government uses policy to create an investment-friendly climate for economic growth. This is one important aspect of the harmony-of-interest theory. But the highest-ranking provinces in the PCI appear to fail in providing improvements in the provision of basic services, such as better teacher-to-student or patient-to-hospital ratios. Some of the data did not allow a rejection of a collusion assumption. Such a collusion, however, would be antithetical to the harmony-of-interest theory. We have provided plausible alternative explanations for the poor social service performance of provinces that are highly ranked on the PCI, the most likely being collinearity between population density as a causal variable for both investment and for higher ratios of students to teachers and patients to hospitals. By asking a cross-section of recipients, or consumers, of government services how they feel about them, we can add qualitative substantiation to the hard data. A recent study of residents in 30 provinces has made this possible.

In a large-N survey, the government of Vietnam in cooperation with the United Nations Development Program asks residents of 30 provinces about their perception of the quality of local government, provincial government and public administration. This survey, the *Vietnam Provincial Governance and Public Administration Performance Index 2010*, or PAPI, represents a check on the data in this chapter (CECODES at al. 2010). It also provides an alternative to the *Provincial Competitiveness Index*, which asks for similar evaluations, but only surveys entrepreneurs.

Most importantly, if perception of governance and public administration differ between the PAPI and the PCI, one a survey of non-elite respondents, the other one of entrepreneurs, the hypothesis that political and economic elites collude with each other would be supported. If the survey of non-elite groups comes to similar conclusions as the business survey PCI, collusion is less likely.

The shortcoming of the PAPI is twofold: First, it surveys only half the provinces. While it has devised a statistical method to minimize the effects (see below), for the purpose of comparison, the PAPI sample often randomly leaves out too large a part of the sample of interest to this study. For example, on hospital bed provision, the PAPI covers a significant number of over-providers of beds, but through the vagaries of its case selection leaves out almost all the underperformers. We therefore reduce the use of the PAPI to categories where a PCI sub-index and a PAPI sub-index are comparable. The second shortcoming is that the categories are too broad to make a good comparison between the PAPI and the PCI. Since one of the goals of the PAPI was to do so – there are comparisons with the PCI in the PAPI – the sub-index selection is not sufficiently well developed.

7.2.5.1. The Provincial Governance and Public Administration Performance Index – PAPI

The PAPI's subtitle states the importance of the exercise: "Measuring citizens' experiences." The survey captures citizens' satisfaction with governance across six dimensions: (1) participation; (2) transparency; (3) vertical accountability; (4) corruption; (5) public administrative procedures; and (6) public service delivery. For this research, we select dimensions that respond to the hypothesis.

- Transparency: This dimension responds to the question whether local government self-limits its predatory powers in expectation of long-term benefits from economic growth that comes as a result of better governance. Only if citizens know their rights can they demand redress. The relevant questions are:
    - Poor households receive support. (The general belief that poor households are appropriately identified and supported by local authorities is an important measure of good governance in a country where especially in rural areas many households are still poor, yet may not know their rights nor be willing to complain if these rights are violated.)
    - The budget is made available. (Only where residents know what money is supposed to be spent on can they hold government accountable. A

heavily rent-seeking local government would try to maintain secrecy around the local budget.)

    - Compensation for lost land is close to market value. (Land clearance for commercial use is one of the most frequent and financially rewarding forms of rent seeking in Vietnam. Fair compensation indicates government self-limitation.)

- Control of Corruption: Citizens' ability actively to address corruption problems is a key step toward good governance. A number of question in this dimension are relevant.
    - Officials divert state funds for personal use.
    - Bribes are necessary to obtain land titles, construction permits, notary services, hospital services, education services, public employment.
    - Corruption has an effect on your family.
    - For what government positions are connections not necessary.
    - The province is serious about fighting corruption.
    - Respondent is aware of the anti-corruption laws.
    - Respondent was a victim of corruption but chose not to denounce it.
- Public administrative procedures:
    - Score the quality of construction or land use permit process.
    - How many windows did the respondent go to for a construction or land use permit?

    - The land use rights permit process has been simplified over the past three years.

- Public Services Delivery: This category surveys how citizens feel about public services such as those for which quantitative data were presented in the previous sections.
    - Rate the quality of public primary education.
    - Distance from home to nearest primary school in kilometers.
    - Rate the quality of hospitals.
    - Do poor households receive subsidized health care?
    - Are medical checks free for young children under six years of age?
    - What percentage of households have electricity?
    - Quality of road nearest your house (dirt, gravel, concrete, paved).
    - Frequency of garbage pick-up.
    - Tab water at home as source of drinking water.
    - Respondent drinks rain water as primary source of water.
    - Crimes experienced in the last year.
    - Assessment of safety in the village, town.
    - Safety improvements in the past three years.

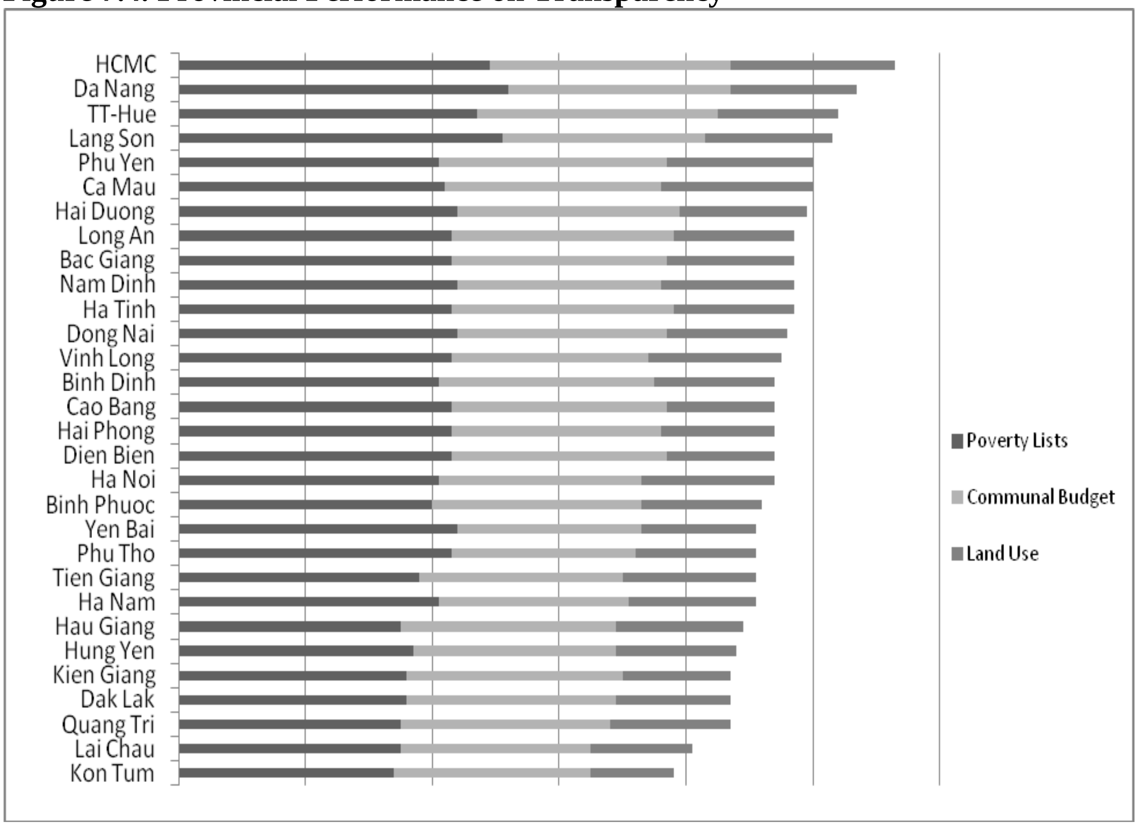
The PAPI surveys only 30 provinces, for reasons related to time and funding. It expects to expand to all provinces in its next iteration. The selection of provinces is based on the *propensity matching score method*. In this methodology, a score is created for each province along a large number of variables, including data on wealth, population size, urbanization, education levels, infrastructure, region and others. Based on this score, provinces are categorized in pairs of those with the closest-matching characteristics, or "nearest twins" (CECODES at al. 2010: 89). This method aims at assuring balance between the provinces treated and the rest, by increasing the probability that the treated province reflects its twin closely.

7.2.5.2. Transparency

Transparency relates to good governance via accountability of office holders. When residents know their rights and are informed about government activities, they can hold officials accountable for violations of laws and regulations. As Pincus and Sender (2007; see this chapter, above) have pointed out, most severe poverty in Vietnam exists in social groups that are either ignorant of their rights or too powerless to demand redress. Transparency addresses these problems. In the PAPI, transparency is linked to good governance through the direct link between the provision of information and its extension to accountability in public administration. Information is a public good in itself, while "[O]pacity, or the inability of government agencies to provide information about their policies and implementational aspects, leads to rent seeking opportunities. This typically arises as government officials hold information so they can make decisions that primarily serve interests of special groups" (CECODES at al. 2010: 23).

The PAPI recognizes the growing pressure from domestic businesses and international investors for more transparency (Ibid: 24) and finds that at the local level, transparency is weakest where it has the greatest impact on rent seeking, such as land management (Ibid: 25). Figure 7.4. shows the transparency sub-index three sub-dimensions. The sub-index is calculated from the responses to 14 questions, grouped into the three categories in the chart, (1) access to official lists of poor families and the perception that families in poverty are supported according to the laws, (2) access to and knowledge of the communal budget, and knowledge about and (3) influence over land use policy. These three variables correspond most closely to the PCI sub-indices on transparency, and land access and security.

Figure 7.4. Provincial Performance on Transparency



Source: PAPI 2010

Lang Son is ranked 55 by business but fourth by residents. In the case of the country's economic capital as well as backwater Lang Son, a race to the top in transparency appears to have taken place. Only one, Tien Giang, is ranked significantly lower by its residents than by its businesses.

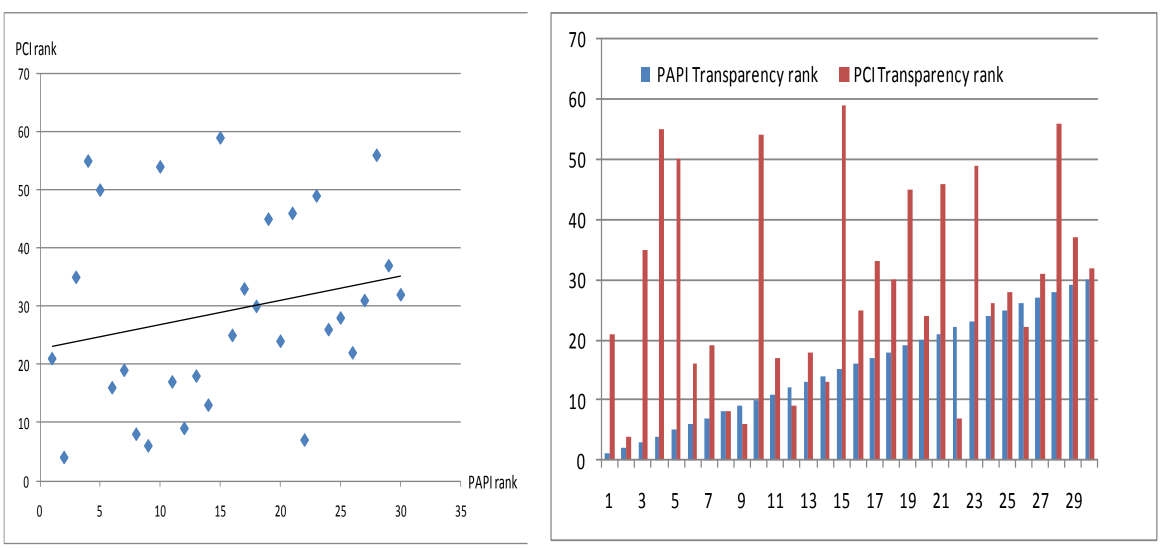
Table 7.16. Transparency in comparison

Province	PAPI rank	PCI rank	Province	PAPI rank	PCI rank	Province	PAPI rank	PCI rank
HCMC	1	21	Ha Tinh	11	17	Phu Tho	21	46
Da Nang	2	4	Dong Nai	12	9	Tien Giang	22	7
TT-Hue	3	35	Vinh Long	13	18	Ha Nam	23	49
Lang Son	4	55	Binh Dinh	14	13	Hau Giang	24	26
Phu Yen	5	50	Cao Bang	15	59	Hung Yen	25	28
Ca Mau	6	16	Hai Phong	16	25	Kien Giang	26	22
Hai Duong	7	19	Dien Bien	17	33	Dak Lak	27	31
Long An	8	8	Ha Noi	18	30	Quang Tri	28	56
Bac Giang	9	6	Binh Phuoc	19	45	Lai Chau	29	45
Nam Dinh	10	54	Yen Bai	20	24	Kon Tum	30	51
Province in the same tier in PAPI and PCI are shaded.								

Source: PAPI 2010; PCI 2009

Table 7.16. compares PAPI and PCI on transparency-related dimensions. Among the 10 top-tier rated provinces in the PAPI, six are also top tier in the PCI. In the middle the number is four, in the lower tier five. Interestingly, Ho Chi Minh City, which barely makes the upper tier of the charts when entrepreneurs are asked to rate their province, wins the top billing from its citizens.

Figure 7.5.a. and b. Transparency PAPI vs. PCI: Two ways of showing the relationship



Figures 7.5.a. and b. show graphically the slight positive correlation between the PAPI and PCI rankings. A number of provinces with significantly diverging values on the transparency variable, especially in the top ranks of the PAPI (Lang Son #4 in the PAPI, #55 in the PCI, or Phu Yen #5 versus #50) have an impact on the overall trend line. There is convergence toward the lower ranks, however. With the exception of Tien Giang, which ranks low on the PAPI but high on the PCI, no provinces that are rated badly by their citizens are considered transparent by their entrepreneurs. With respect to transparency, we can therefore rejection collusion between economic and political elites. If such a collusion were taking place, provinces would receive high rankings from their business elites, while being seen as predatory by their citizens.

Table 7.17. PAPI transparency and PCI land access and security in comparison

Province	PAPI rank	PCI rank	Province	PAPI rank	PCI rank	Province	PAPI rank	PCI rank
HCMC	1	59	Ha Tinh	11	15	Phu Tho	21	47
Da Nang	2	26	Dong Nai	12	57	Tien Giang	22	1
TT-Hue	3	46	Vinh Long	13	8	Ha Nam	23	34
Lang Son	4	18	Binh Dinh	14	13	Hau Giang	24	11
Phu Yen	5	23	Cao Bang	15	56	Hung Yen	25	17
Ca Mau	6	2	Hai Phong	16	61	Kien Giang	26	4
Hai Duong	7	43	Dien Bien	17	7	Dak Lak	27	37
Long An	8	24	Ha Noi	18	55	Quang Tri	28	45
Bac Giang	9	42	Binh Phuoc	19	33	Lai Chau	29	50
Nam Dinh	10	44	Yen Bai	20	29	Kon Tum	30	16

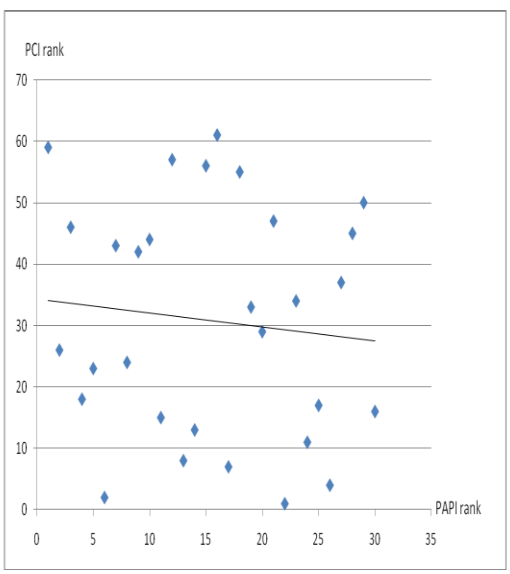
Province where PAPI and PCI are in the same tier shaded light (brown).
Top-bottom reversals (top PAPI-bottom PCI) dark (blue).

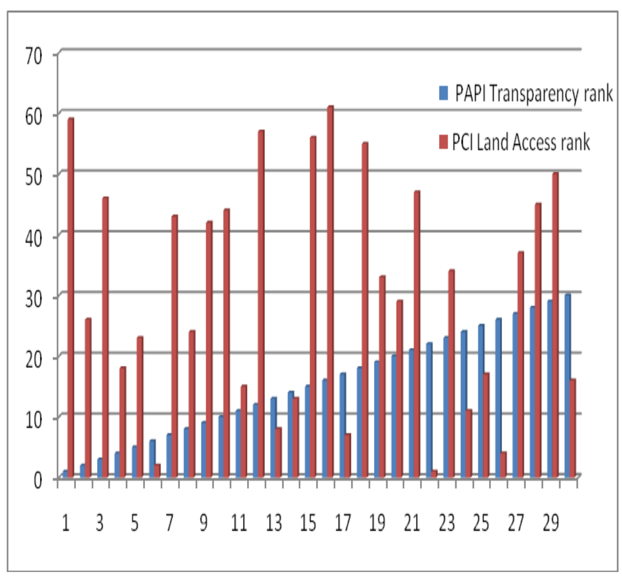
Source: PAPI 2010; PCI 2009

Another transparency-related indicator in the PCI covers land access and security. In the PAPI, respondents are asked whether they find land compensation rates set by the government fair. This puts residents at odds with businesses. The investor who wants the land cleared wants to pay as little as possible, while the resident wants the highest price. Hence we would expect that provinces that make their residents happy fare badly in the opinion of investors and vice versa (except, of course, if a province is so corrupt that it pays landowners little but charges the investors a lot, and the difference disappears in some pockets).

Because the hypothesis predicts a negative correlation, bottom-tier PCI provinces in the top tier of the PAPI and top-tier PCI provinces in the bottom category of the PAPI are shaded. Supporting the assumption, the correlation between PAPI and PCI ranking is negative – better ranking by citizens in the PAPI is associated with worse ranking by entrepreneurs in the PCI. Only two provinces are ranked in the first tier of the PAPI and the PCI, while four top-ranked PAPI provinces are bottom-ranking in the PCI. In the bottom PAPI tier, three provinces are also bottom rankers in the PCI, while five are top-tier PCI performers. The following graphs 7.6.a. and b. visualize this relationship in different formats.

Figure 7.6.a. and b. PCI: PAPI transparency vs. PCI land access and security



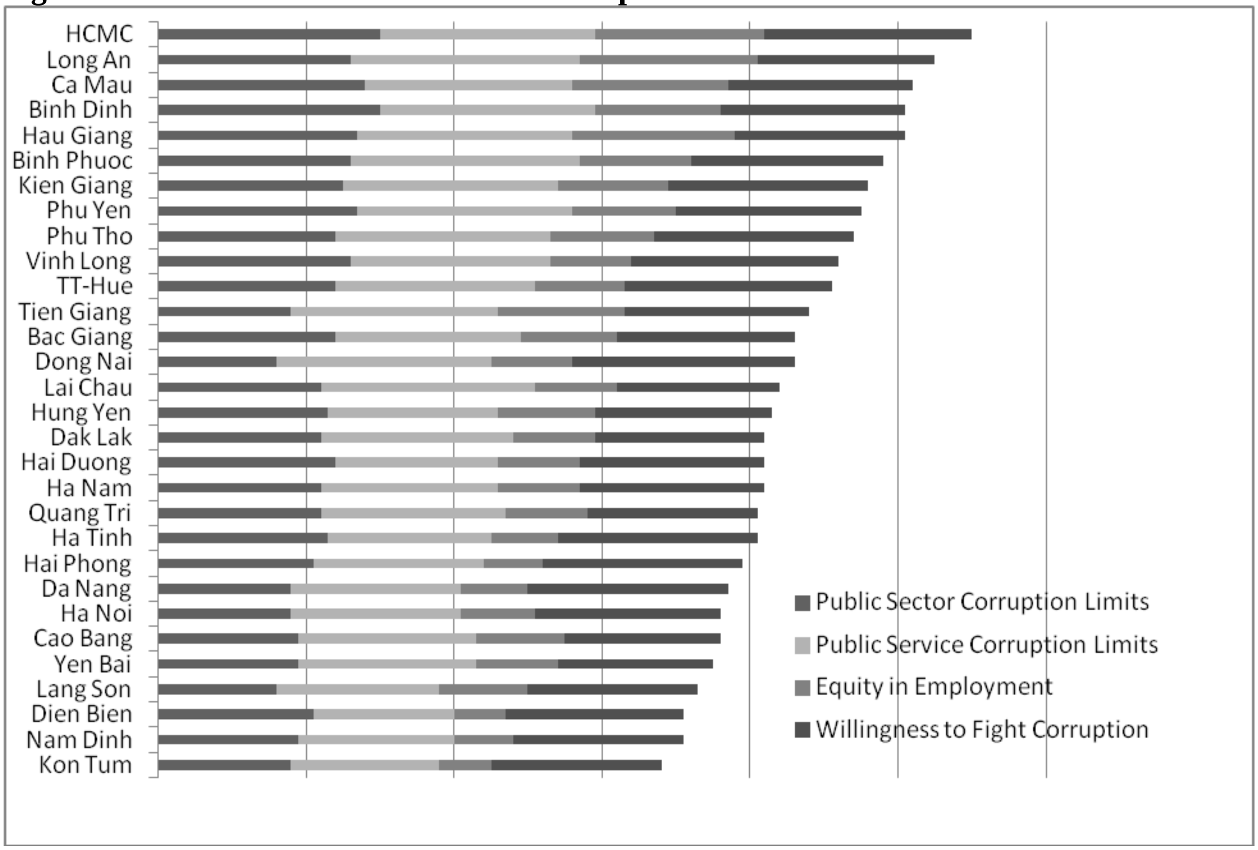


The result is, however, a race to the top rather than to the bottom. In a race to the bottom, we would have expected the highest-invested provinces to rank badly with residents and well with investors, with whom they collude. The opposite is the case. Investment magnets like HCMC, Da Nang, Hai Duong and Long An rank in the top tier of the PAPI, but lowly with businesses. (Note that the problem is not only transparency, but simply that highly invested provinces have less land available. The PCI measures access in general, not only transparency in access. The data do not falsify the PCI or make any claims about the quality of these provinces, but they do show that elite collusion against regular citizens is unlikely.)

7.2.5.3. Corruption

The PAPI measures corruption across four categories: perceptions on limits on public sector corruption, perception on limits on public service corruption, perception about equity in public employment and the will to fight corruption. The PCI includes one sub-index that corresponds to the PAPI category of corruption: informal charges. Figure 7.6. shows the PAPI category corruption with its four sub-dimensions. Surprisingly, Ho Chi Minh City does well on all four sub-categories and takes first place in fighting the perception of citizens in fighting corruption. This differs markedly from the way entrepreneurs perceive this province. Table 7.18. shows the PAPI ranking in three tiers and identifies provinces whose PAPI and PCI ranking fall into the same tier.

Figure 7.7. Provincial Performance on Corruption



Source: PAPI 2010

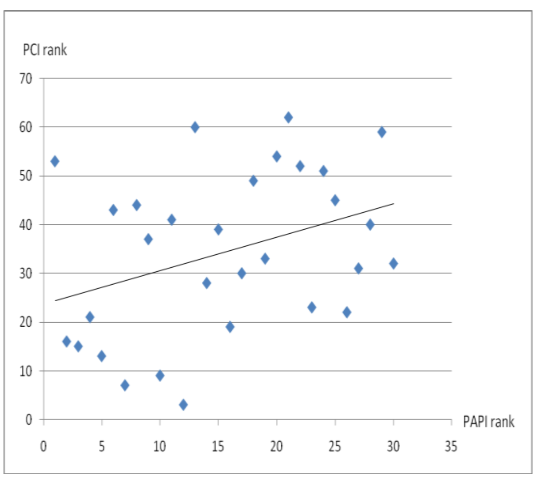
Table 7.18. Corruption vs. informal charges – PAPI vs. PCI

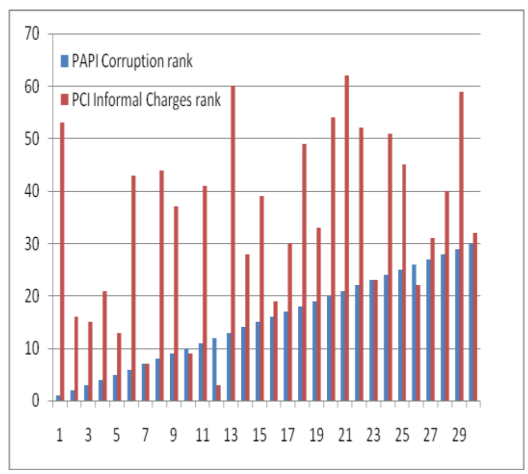
Province	PAPI rank	PCI rank	Province	PAPI rank	PCI rank	Province	PAPI rank	PCI rank
HCMC	1	53	TT-Hue	11	41	Ha Tin	21	62
Long An	2	16	Tien Giang	12	3	Hai Phong	22	52
Ca Mau	3	15	Bac Giang	13	60	Da Nang	23	23
Binh Dinh	4	21	Dong Nai	14	28	Ha Noi	24	51
Hau Giang	5	13	Lai Chau	15	39	Cao Bang	25	45
Binh Phuoc	6	43	Hung Yen	16	19	Yen Bai	26	22
Kien Giang	7	7	Dak Lak	17	30	Lang Son	27	31
Phu Yen	8	44	Hai Duong	18	49	Dien Bien	28	40
Phu Tho	9	37	Ha Nam	19	33	Nam Dinh	29	59
Vinh Long	10	9	Quang Tri	20	54	Kon Tum	30	32
Province where PAPI and PCI are in the same tier are shaded.								

Source: PAPI 2010; PCI 2009

Governments that fight corruption in the business world also treat their residents more fairly. Of the top tier PAPI provinces, six are also top tier in the PCI. Among the 10 bad performers in PAPI, five are also in the low end in the PCI. Ho Chi Minh City's divergent performances with businesses (bad) and residents (very good) defies explanation and requires more research. Certainly, Ho Chi Minh City does not appear to be racing to the bottom. Given Ho Chi Minh City's urban density, number of migrants and social problems that are already leading to a significant increase in labor costs, it is possible that the provincial leadership simply understands the importance of providing good services to residents. Such an explanation fails to account for the bad performance with businesses, which also suffer from the increase in cost and may want to leave. (Of course, the provincial government is trying to push some of the older, low-value-added companies out. Future research could investigate whether perception of corruption is worse among manufacturing companies that the government wants to relocate to neighboring provinces than among those higher-end companies it wants to retain.)

Figure 7.8.a. and b. PAPI corruption vs. PCI informal charges





Equally, other provinces with high investment levels and high labor needs should behave similarly, but do not. The combination of top performance in the PAPI and bottom ranking in the PCI is unique to Ho Chi Minh City among the top invested and in-migration provinces.

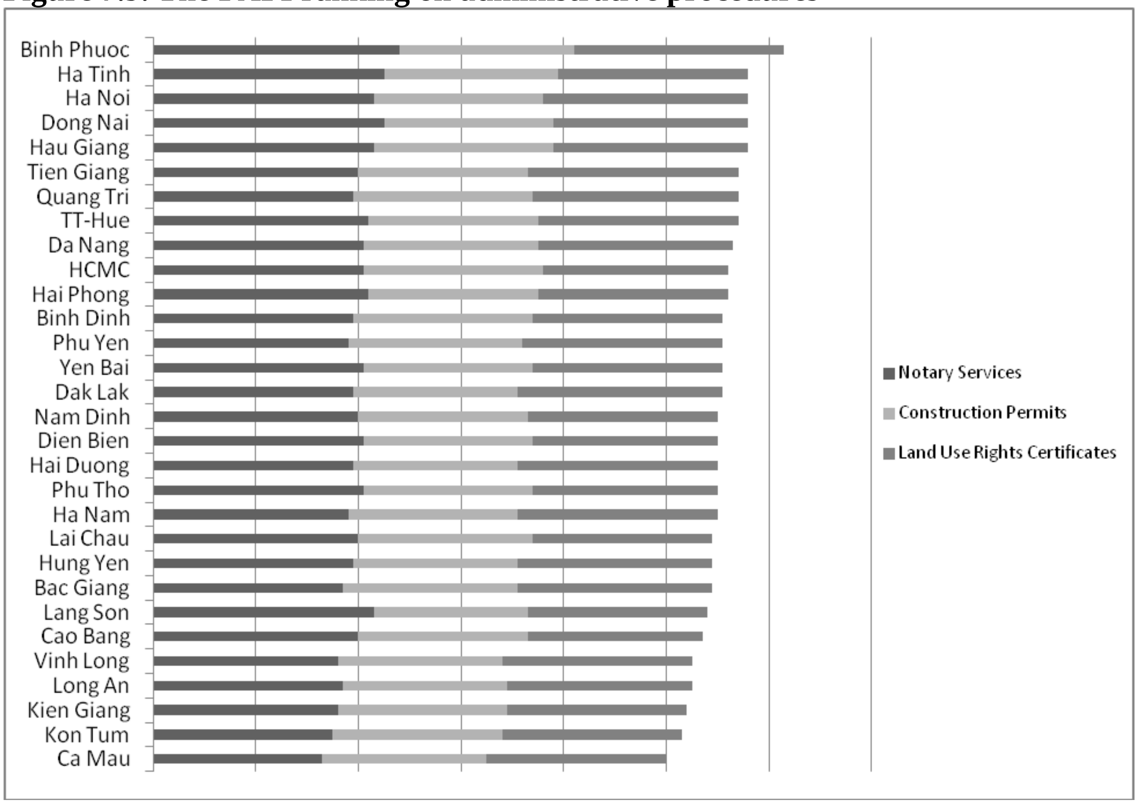
7.2.5.4. Administrative services

This category measures how citizens perceive their interaction with the government bureaucracy. The three sub-categories measure notary services, and importantly for the comparison with the PCI, construction permit and land use access certificate procedures. These latter two are significant sources of graft and rent. Officials can extract bribes or other forms of rent, like inspection requirements, legal support for filing documents, which in Vietnam's familistic culture can be provided by family members of the official who has the final decision over the application. Moreover, land use and construction are among the most frequent interaction between citizen and government (with the exception of routine interactions, such as the issuance of birth or death certificates, for which it is much harder to extract rent). The PAPI asks several questions about time and effort it takes to obtain construction permits and land use rights certificate.

Table 7.19. shows a comparison between the PAPI results on administrative procedures and the PCI category on the time spent on regulatory compliance. Four provinces share top tier billing in both surveys, four are in both middles, while five rank in the bottom tier of both rankings. The top investment provinces also do well on the PAPI. In the bottom PAPI category, three provinces exhibit the characteristics expected from a collusion between business and economic elites, namely strong performance

when judged by entrepreneurs but negative responses from citizens: Vinh Long, Long An and Kien Giang score high on the PCI but lowly on the PAPI. Overall, however, the trend is positive – better performance in the PAPI is correlated with better performance on the PCI, as Figures 7.10. a. and b. indicate.

Figure 7.9. The PAPI ranking on administrative procedures



Source: PAPI 2010

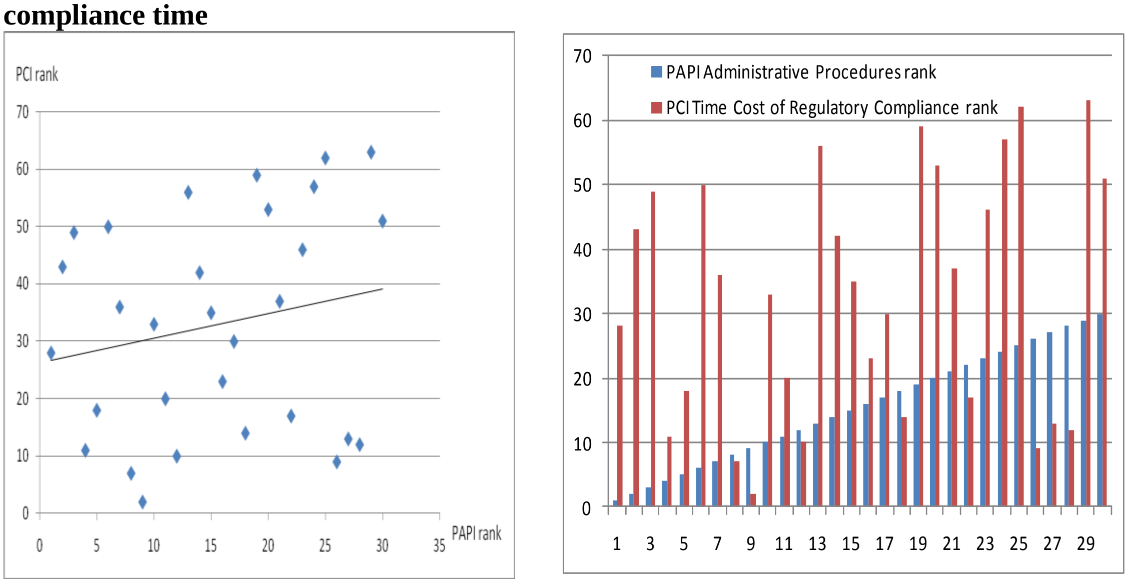
The second PCI category that compares to the PAPI administrative procedures is land access and security. Land access was compared to the PAPI transparency dimension above, because knowing fair land value is a precondition for demanding it. The PAPI questionnaire returns to the issue. In the transparency category, respondents were asked whether they thought the land value set by the government for compensation purposes was fair. Now, they are asked how difficult it is to get access to land use certificates. These certificates establish property right to land.

Table 7.19. Administrative procedures in PAPI and time cost of regulatory compliance in PCI

Province	PAPI rank	PCI rank	Province	PAPI rank	PCI rank	Province	PAPI rank	PCI rank
Binh Phuoc	1	28	Hai Phong	11	20	Lai Chau	21	37
Ha Tinh	2	43	Binh Dinh	12	10	Hung Yen	22	17
Ha Noi	3	49	Phu Yen	13	56	Bac Giang	23	46
Dong Nai	4	11	Yen Bai	14	42	Lang Son	24	57
Hau Giang	5	18	Dak Lak	15	35	Cao Bang	25	62
Tien Giang	6	50	Nam Dinh	16	23	Vinh Long	26	9
Quang Tri	7	36	Dien Bien	17	30	Long An	27	13
TT-Hue	8	7	Hai Duong	18	14	Kien Giang	28	12
Da Nang	9	2	Phu Tho	19	59	Kon Tum	29	63
HCMC	10	33	Ha Nam	20	53	Ca Mau	30	51
Province where PAPI and PCI are in the same tier shaded.								

Source: PAPI 2010; PCI 2009

Figure 7.10.a. and b. PAPI vs. PCI on administrative procedures and regulatory compliance time



While three of the top-ranked PCI provinces also are in the highest PAPI tier, overall there is little overlap in the rankings. One possible explanation is that the concerns of businesses (get access to land owned by farmers for industrial use) and of individuals (easy, hassle-free registration of land, no fear of losing it to changes in zoning) diverge.

When an entrepreneur wants quick and efficient re-zoning and clearance to move the development project forward, the individual owner prefers security that the land will not be taken. Figures 7.11.a. and b. indicate a strong negative correlation between on ranking on the administrative procedures dimension in the PAPI and land access and security in the PCI. This result confirms the negative correlation for transparency and land access in this chapter above. The divergence of interest between businesses and individual land owners forces the government to choose one side over the other, leading to diverging outcomes in perception of government performance within these two groups.

Table 7.20. Administrative procedures in PAPI and land access and security in PCI

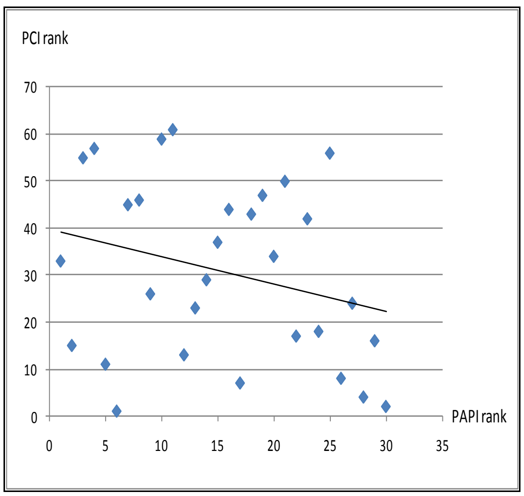
Province	PAPI rank	PCI rank	Province	PAPI rank	PCI rank	Province	PAPI rank	PCI rank
Binh Phuoc	1	33	Hai Phong	11	61	Lai Chau	21	50
Ha Tinh	2	15	Binh Dinh	12	13	Hung Yen	22	17
Ha Noi	3	55	Phu Yen	13	23	Bac Giang	23	42
Dong Nai	4	57	Yen Bai	14	29	Lang Son	24	18
Hau Giang	5	11	Dak Lak	15	37	Cao Bang	25	56
Tien Giang	6	1	Nam Dinh	16	44	Vinh Long	26	8
Quang Tri	7	45	Dien Bien	17	7	Long An	27	24
TT-Hue	8	46	Hai Duong	18	43	Kien Giang	28	4
Da Nang	9	26	Phu Tho	19	47	Kon Tum	29	16
HCMC	10	59	Ha Nam	20	34	Ca Mau	30	2

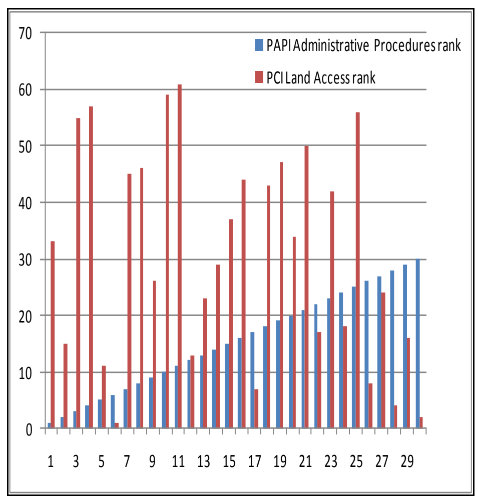
Province where PAPI and PCI are in the same tier shaded.

Source: PAPI 2010; PCI 2009

There is indication that some of the best practices implemented for the business clients have found their way into general governance. On the question whether applicants for a land use certificate had to see only one official, 100% of respondents answered in the confirmative in multiple provinces. The one-door policy was an early competitive strategy of provinces in luring foreign investment. The response rate to this question opens other issues, however, that reflect the problems of surveys. The median response for this question (in Hue and Binh Phuoc) was 77.84%. If a province has a one-door policy, why did three out of four applicants benefit from it, while the other quarter did not? Complicating factors that required another step? While this is possible, it cannot explain that the bottom-ranking province on this question, Lang Son, allows 14.52% of residents to get a land use certificate in one quick step, since it is difficult to imagine that over 85% in that province, but nobody in multiple others made mistakes with their paperwork. These surveys provide a useful general overview, but leave questions about individual cases or implications open to further investigation.

Figure 7.11.a. and b. PAPI vs. PCI on administrative procedures and land access and security

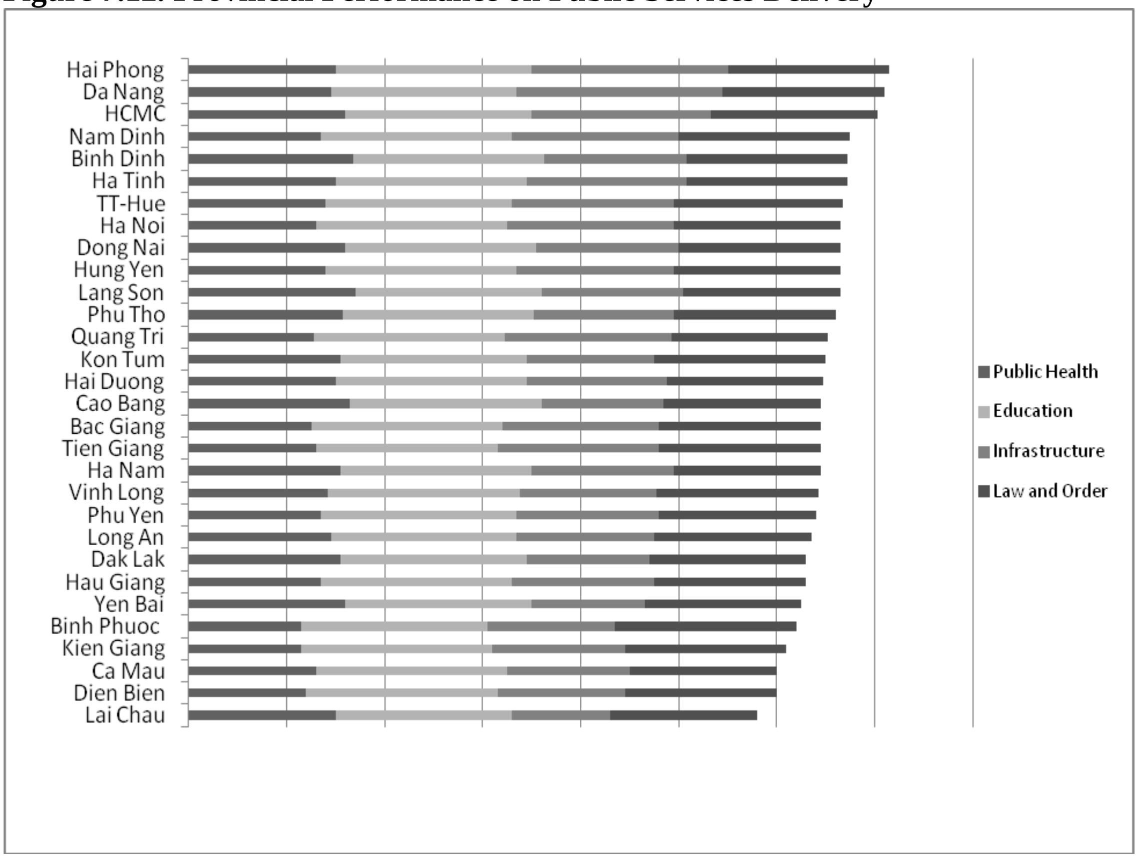




7.2.5.5. Public service delivery

The category of public service delivery reflects most closely the discussion about social service provision discussed in the race-to-the-bottom debate. Respondents answer questions about their perception of public education, health care, infrastructure quality near their homes, garbage pickup and protection from crime. The questions are grouped into four categories, public health, education, infrastructure and public order. Figure 7.12. shows the ranking. Urban provinces, like Da Nang, Hue, Ha Noi or Ho Chi Minh City are less challenged in the provision of infrastructure, but the chart shows that some rural provinces make great strides in that area as well. Overall, the three top performers are provinces with the official status of municipalities (i.e.: urban provinces) and high investment recipients. The bottom part of the table is made up of rural provinces with low investment numbers.

Figure 7.12. Provincial Performance on Public Services Delivery



Source: PAPI 2010

Comparing the PAPI with the PCI, the PCI sub-index that reflects the PAPI questionnaire for this dimension best is that on infrastructure. The PCI also measures perception of the legal institutions, which is remotely related to public order. But because regular Vietnamese do not use the courts in the same manner as businesses do, and legal institutions are different in nature from the "government service" of public security, the sub-index was not compared to the PAPI dimension. Table 7.21. points to a strong association between PAPI and PCI results. Eight out of 10 top-tier PAPI provinces also rank in the top in the PCI. Five middling PAPI provinces are middling in the PCI, and the bottom five PAPI provinces are all in the lowest PCI tier. This outcome is intuitive at first sight: provinces that provide good infrastructure for their business sector also do well with the rest of their citizens. Yet the PAPI concerns itself with much more than roads and telephones, including health care provision, education and garbage collection from villages.

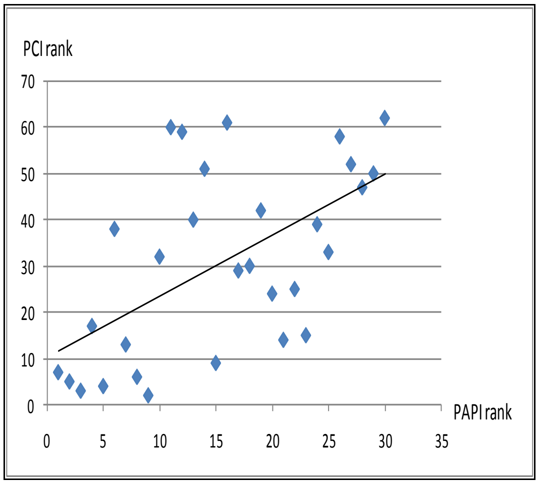
Table 7.21. The PAPI public service delivery and the PCI's infrastructure

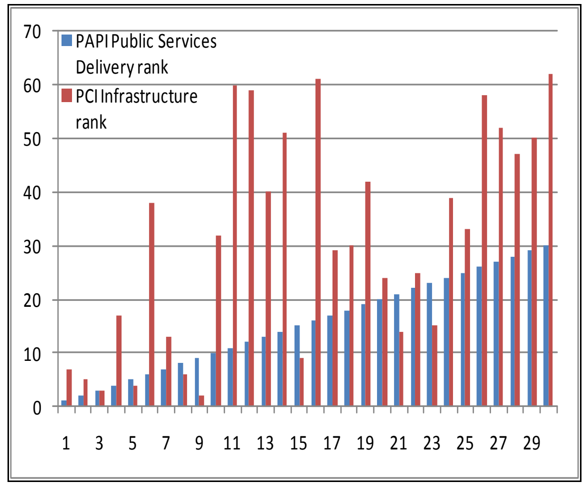
Province	PAPI rank	PCI rank	Province	PAPI rank	PCI rank	Province	PAPI rank	PCI rank
Hai Phong	1	7	Lang Son	11	60	Phu Yen	21	14
Da Nang	2	5	Phu Tho	12	59	Long An	22	25
HCMC	3	3	Quang Tri	13	40	Dak Lak	23	15
Nam Dinh	4	17	Kon Tum	14	51	Hau Giang	24	39
Binh Dinh	5	4	Hai Duong	15	9	Yen Bai	25	33
Ha Tinh	6	38	Cao Bang	16	61	Binh Phuoc	26	58
TT-Hue	7	13	Bac Giang	17	29	Kien Giang	27	52
Ha Noi	8	6	Tien Giang	18	30	Ca Mau	28	47
Dong Nai	9	2	Ha Nam	19	42	Dien Bien	29	50
Hung Yen	10	32	Vinh Long	20	24	Lai Chau	30	62
Province where PAPI and PCI are in the same tier shaded brown.								

Source: PAPI 2010; PCI 2009

In a race to the bottom, government would provide businesses good services in return for rent, but would fail to provide services to its citizens. The strong positive correlation between the perception of citizens and entrepreneurs serves as evidence against elite collusion. Figures 7.13.a. and b. show the trend graphically. The PAPI allows to draw additional conclusions about the race-to-the-bottom assumption by adding perceptions of the performance of government by regular citizens to those surveyed in the *Provincial Competitiveness Index*. Its planned expansion to all provinces in its 2011 edition will further widen its applicability.

Figure 7.13.a. and b. Trend between PAPI public service delivery and PCI's infrastructure ranks

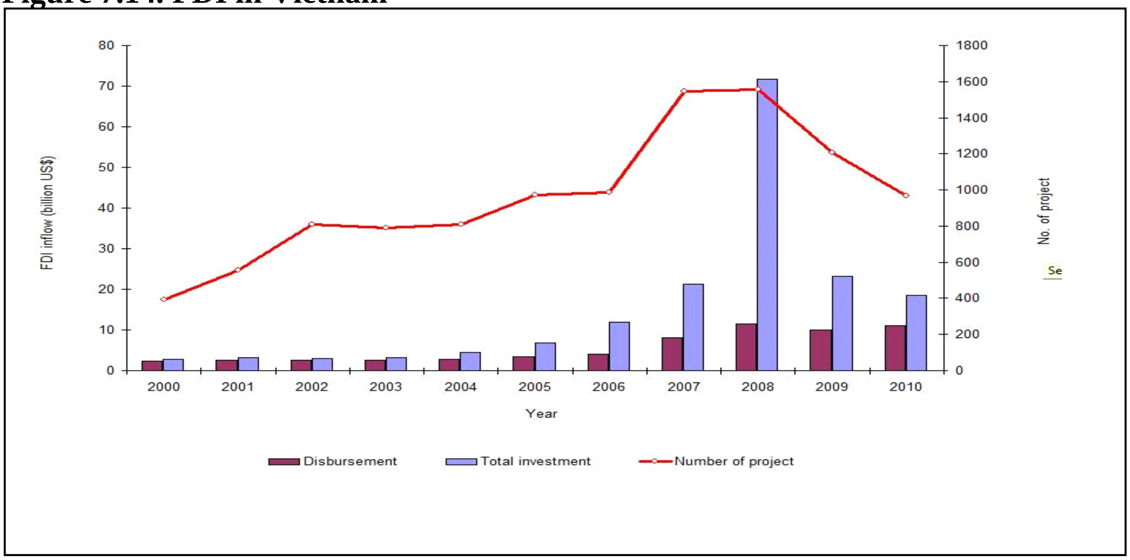




7.3. Conclusion

In this chapter, we tested Assumption 3 against the race-to-the-bottom theory. Assumption 3, one part of the harmony-of-interest theory of this study, claims that high levels of investment correlate with better, not worse, public goods provision, because governments in highly invested provinces recognize the importance of abundant human capital for the long-term economic growth of their jurisdiction. Since highly invested provinces in a poor country like Vietnam attract migrants from areas with high un- or under-employment, migration should flow into the most developed provinces and reduce labor scarcity there. As a result, labor's bargaining power is reduced. But when more jurisdictions follow the leaders and begin to compete for the most qualified workers, we should expect to see upward pressure on labor rates and public goods provision in the most developed provinces, where loss of human capital would be most dearly felt. Vietnam is in the stage of broadening of the manufacturing boom now. Since the country joined the World Trade Organization in January 2007,[74] foreign investment has taken off around the country (see Figure 7.14.), and return migration from the receiving provinces back to the province of migrants' origin is increasing.

Figure 7.14. FDI in Vietnam



Source: Ministry of Planning and Investment

Under the harmony-of-interest assumption, we should see a race to the top, as the most successful provinces implement policies for worker satisfaction in an attempt to prevent out-migration. Instead of colluding with economic elites in exchanging political protection (low taxes, low wages, few regulations, weak enforcement and repression of

74 Approval occurred in 2006 and license applications increased in expectation of membership even before final approval.

strikes) in return for rents, we expect to see political elites to work with businesses to retain workers.

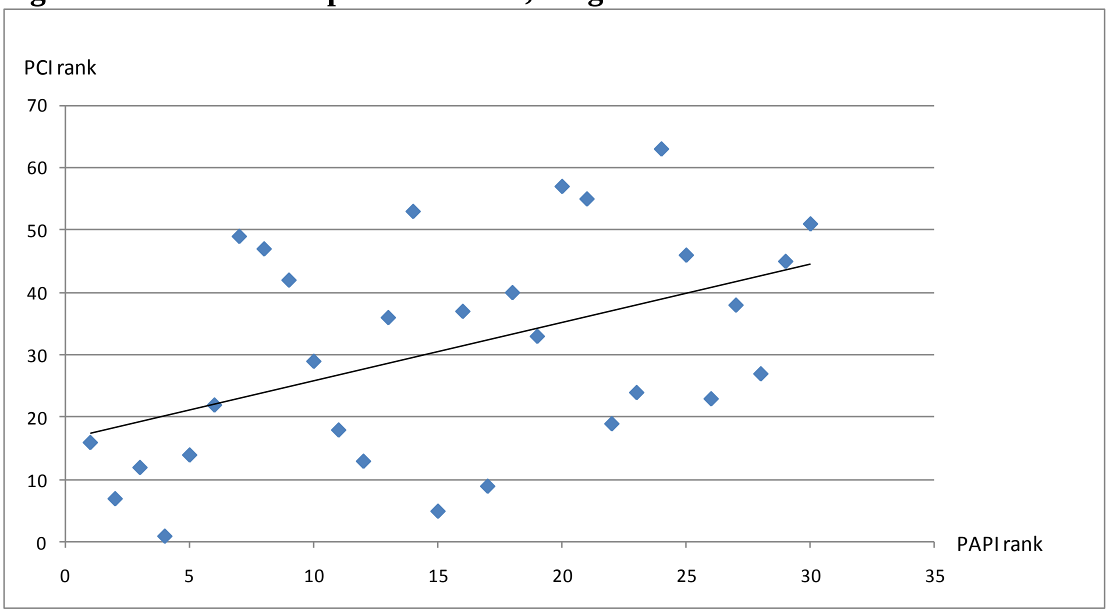
The data in this chapter were, as is generally the case in the social world, mixed. We observed a race to the top in the case of some variables; we also found some unexpected results. Importantly, income distribution and poverty data show that the economic boom has not led to a significant concentration of wealth in a few hands at the expense of general impoverishing of workers. Instead, the more heavily invested provinces exhibit a lower gap between first and fifth quintile than most of the much less industrialized ones. Since industrialization comes with social stratification and rising inequalities, this is a surprising result. Regions with most investment have reduced poverty most significantly, although one must be aware of the problem if migrants who maintain their household registration in their province of origin and do not enter into the statistics where they work. Since industrial work in the formal sector is not generally associated with extreme poverty, it is unlikely that this statistical problem skews the results much. On the contrary, remittances to the home province are likely to lift families out of poverty in those provinces. The *Vietnam Living Standard Survey* counts intra-family transfers as income and remittances are part of income and poverty statistics.

On social service provision, we compared the level of service with the governance ratings of the *Provincial Competitiveness Index* that surveys businesses, and with the *Provincial Governance and Public Administration Performance Index,* which asks how citizens perceive their governments. We also analyzed the impact of foreign investment level on social service provision. While in some variables, investment and governance survey rankings were negatively correlated with social service provision, on most variables the association was positive or inconclusive. One of the most illuminating findings was the relationship between population density on one hand, and on the other both better social service levels and lower investment. The causal chain is likely to run from low population density to low investment – investors generally do not like remoteness and small markets – and also from low population density to a need for more social services to cover dispersed populations. If this is correct, the negative correlation between investment and social service provision would be spurious. To support the point, we controlled for population density and found that investment mitigates high population levels. While more densely populated provinces exhibit a lower level of social service provision, high investment levels push social service provision up in comparison with other populous provinces with less investment.

Another way of testing the race-to-the-bottom assumption was to check whether regular citizens evaluate governance and public goods provision differently from entrepreneurs. If political and economic elites collude against non-elites, these non-elites should have a diametrically opposed view of the quality of governance from the business elites. We generally failed to find such a correlation. Most interestingly, in some cases of highly invested provinces, citizens found their government more honest and transparent than businesses did. Comparing sub-indices of PCI and PAPI again failed to support a race to the bottom.

Finally, Figure 7.15. shows the relationship between the weighted overall ranking of the business survey PCI and the citizen survey PAPI. It indicates that the sum-total of the various dimensions that make up each survey, ranking high on one is closely associated with ranking high on the other. No collusion between interest groups at the expense of the third can be gleaned from these data.

Figure 7.15. Relationship PAPI to PCI, weighted overall indices



In summary, this chapter has looked at the interest structure from the perspective of the provincial political elite in rich provinces and subordinate groups. We found that in accordance with the harmony-of-interest assumption, provincial governments in investment-rich provinces see it in their interest to bargain with their working-class residents in order to keep them in the province. The alternative – out-migration due to excessive predation or insufficient public goods provision – would lead to human resource scarcity, drive labor rates up and hurt the business climate.

In the next chapter, we test Assumption 4, which reflects a similar logic as does Assumption 3, but from a different angle. We investigate the interest structure from the point of view of businesses in rich provinces to see whether they support the political decisions of local governments, or whether they would prefer to collude with them against the working class. This is important because in today's globalizing world, major investors can vote with their feet even more effectively than workers can.

CHAPTER 8: CAPITAL-LABOR RELATIONS AND THE HARMONY OF INTEREST

In this chapter, we look at the same logic as in Chapter 7, but from another actor's point of view. The claim in the harmony-of-interest matrix in Chapter 3 was that all actors in the economic bargain act rationally when they accept the deal they get and would not be better off to push for more. We now apply this claim to the capital-labor relationship in Assumption 4. We expect business elites in wealthy provinces[75] to bargain with their employees along similar lines as laid out in Chapter 7 for provincial elites and their citizens. This means that we expect enterprises to support a more generous social wages basket for their workers rather than to lobby government for cut-throat tax rates and minimum regulation, as critics of international economic opening have suggested.[76]

To recapitulate, Assumption 4 holds that *labor conditions are better in provinces with high investment levels (and thus with high demand for industrial employment) than in provinces with low investment numbers*. *Rather than lobbying for low minimum wage and lesser labor protection regulations, employers are expected to offer fringe benefits to improve living conditions, but also to lobby for public goods provision by local governments*, to limit out-migration and turnover, and the associated cost of hiring and training new workers. While companies can take on social functions

[75] The logic of the harmony-of-interest theory also applies to business elites in poor provinces. In poor provinces, however, the issue does not arise in the same form, due to a different incentive logic for political elites, as discussed in Chapter 6.

[76] Karl Marx already declared that capitalists will only pay their workers a wage that allows them to survive and procreate, to assure a constant supply of labor. In a sense, the logic of this argument is similar. With migration thrown into the mix, the steady supply of labor, however, includes the need to prevent out-migration.

if the government ignores them (providing housing, public transportation or training, among others), such voluntary social service provision can put companies at a competitive disadvantage in comparison to those firms that do not follow suit. As a result, we expect companies to provide such services when absolutely necessary and where a social norm has arisen that pushes most companies to offer the same services. In general, companies prefer to pay taxes and let the government provide government functions, since such an approach prevents free riding and undercutting of norms by the most ruthless companies.

Following the logic of a harmony-of-interest theory, not the race-to-the-bottom view as described earlier,[77] it is assumed that companies make a rational decision to support their workers' quality of life instead of squeezing them as much as possible and risk high turnover as a result of return migration by disenchanted workers. Where labor is similarly mobile as capital and scarce because of high and increasing demand, interests of investors and workers begin to overlap. Both want good working conditions and a reasonable public goods basket – workers to improve their standard of living, investors to avoid costly turnover and strikes. The *political logic is the logic of federalism and Tilly's contestation theory* as laid out in Chapter 2.

This assumption is difficult to test empirically separate from Assumption 3, with which it is closely connected. The outcomes hypothesized in these two assumptions are premised on the same variables. Indeed, the two assumptions make the same case, just

[77] In Chapter 2.4., we defined 'race to the bottom' for our purposes as the collusion between economic and coercive (political) elites for the sake of allocation of resources for their benefit and at the detriment of worker protection or social wages for non-elites.

from the perspectives of different actors. In Chapter 7, we collected data on social service provision. Here, evidence is gathered qualitatively, through interviews with investors and provincial government officials. We assess local attitudes toward spending on workers satisfaction (construction of dormitories, provision of public transportation for commuting workers and similar standard-of-living services), the willingness of companies to provide voluntary social spending, and the lobbying for higher versus lower taxes, welfare spending and social wages by industry. Chapter 7 collected data, Chapter 8 provides support for causality by asking actors about their preferences and the reasons for them. Therefore, in addition to testing Assumption 4, the qualitative information in this chapter validates the data in the previous one. Exhibited behavior itself is not a good guide to causal chains – multiple interpretations are always possible. Asking actors *why* they behave in a certain way is a strong validation for a hypothesis or the associated null-hypothesis.[78] In Chapter 7, we tested statistical data against the hypothesized results of the harmony-of-interest theory. Here, we ask actors about their preferences and see whether their responses conform to the expectations from Assumption 4 as well as the observed outcomes from Chapter 7.

First, we describe the fiscal realities underlying provincial policy-making capacity under which all social service provision – and also all lobbying for or against – takes place. Second, we summarize, with focus on human resource and public goods provision issues, the content of interviews with provincial officials responsible for investment management and promotion, industrial parks and export processing zones

78 There is always a possibility of preference falsification, where expressed and exhibited behavior diverge. If data and expressed preference converge, the underlying assumptions are gaining power.

and industrial park management officials. In this section, we evaluate how officials on the government and business side perceive the social service provision issues we discussed in the previous chapters. Then we evaluate survey responses from companies about their policy preferences and company practices with respect to human capital. Lastly, we describe the on-the-ground reality in the relationship among workers, businesses and provincial government.

8.1. Budget Realities and Provincial Policy Preferences

Provincial governments have the responsibility for managing foreign investment in the province. Every province has a Department of Planning and Investment, which is the provincial office affiliated with the line ministry, the Ministry of Planning and Investment. Provinces also have industrial park or zone management authorities, such as HEPZA (Ho Chi Minh City Export Processing and Industrial Zone Authority), BDIZA (Binh Duong Industrial Zone Authority) or DIZA (Dong Nai Industrial Zone Authority). The Department of Planning and Investment responds both to the local authorities and the minister, in what is known as dual subordination. Much of the success of fence breaking has been attributed to the fact that many officials have shown greater loyalty to their provinces, especially the successful ones, as they considered their career paths more directly linked to successful investment promotion than to enforcement of potentially inefficient central government decrees. As a result, provincial officials have been accused of engaging in excessive promotion of their provinces at the expense of policy coordination on a broader, national level.

In reality, the Vietnamese fiscal system makes it very difficult for provinces to take matters in their own hands.[79] To understand the limitations of provincial officials in fiscal matters, a brief summary of the fiscal system is required (based on Martinez-Vazquez 2004; Ministry of Finance 2007). The Vietnamese budget is divided into four levels, but only the state budget (the central level) and the provincial budgets provide spending authority; on the ward and commune levels, budgets are passed down for implementation only. Almost all taxes are collected locally. Revenues are then shared between the center and the province based on a pre-negotiated formula. Some funds are transferred to the center in full (value added tax on imports, customs duties), others stay in the province (housing taxes, land rent fees and land revenue, registration and license fees), a third group is shared (value added tax other than those from imports, corporate and personal income taxes, excise taxes and oil and gas fees). Provinces can set and raise only some fees, such as hospital fees or road tolls. Tax rates, incentives and exemptions are set by Ha Noi.

The rate at which shared revenue is distributed is not specified in the law. Population is an important criterion, and provinces with large *unregistered* migrant populations have to provide services for those workers to keep them in the provinces, but do not get revenue for them because they are counted for residency purposes in the province where they are registered. This creates a budget shortfall for migrant-receiving provinces, especially in the area of social services, for which the center allocates money according to the population to be served. In addition to the population-based allotment

[79] This is the case in Vietnam much more than in China, where reforms gave local authorities more authority to retain locally raised revenue according to a pre-set formula (Vogel 2011).

of transfer funds, provinces present a list of spending items they want and negotiate budget retention rates with the ministry. The center also imposes expense on the provinces, such as programs of national priority. Capital projects are funded by the center by formula, which makes allotment easier, but fails to take into account realistic needs.

This system leads to problems with respect to provinces' ability to provide for the needs of their economy. First, migrants require public goods and social services where they live, but tax allotments go to their province of registration, leading to a social service budget shortfall in migrant-receiving provinces, and a surplus in the sending ones. This helps explain the good performance of some of the poorest provinces in the social service provision data in Chapter 7. Poor provinces with high outmigration rates receive over-proportionally high transfers for phantom populations that do not need the service in their 'home' province.

Second, ports, airports, roads, but also public housing are funded by allocation. Investors clamor for infrastructure, and higher invested provinces are always short of money to provide it. The center recognizes the threat of infrastructure deficiency to Vietnam's standing as an international business location and (a) makes available extra funds for approved projects from the central budget, and (b) allows provinces to issue bonds for capital projects. The central funding of some infrastructure projects leads to over-investment, because every province has an interest in getting such infrastructure investments independent of need. The money comes from Ha Noi, but local politicians can take credit for the jobs and the new road. Lobbying power thus becomes a major factor, at the expense of prioritization and efficiency (Cung 2011). The most infamous example of this inefficiency is Dung Quat refinery. It was placed into a central province far away from both raw materials and markets, due to political rather than economic considerations.[80] After four decades of planning and after several international partners dropped out, the refinery is still not fully operational. In the meantime, Vietnam exports crude oil but has to import refined petroleum products, at great cost to foreign currency reserves and trade balance.

Third, since provinces have very little revenue-raising authority of their own, they want to maximize the revenue from the very limited sources they control, because they do not need to negotiate for them at every budget cycle (known as stability period). As we will see later, one common demand from companies is that provincial governments make available land free of land rent or at reduced prices for the construction of worker housing. Provincial governments are reluctant to comply, given the impact the loss of this province-controlled revenue would have on their budget flexibility.

This intricate budgeting system forms the backdrop against which one must evaluate the bargaining between provincial elites and workers as well the responsiveness of the provincial government to business demands. The responses to the businesses survey show that many managers are not aware of the limitations provincial leaders face. Several respondents suggested the provincial government reduce business taxes or change minimum wages to keep workers happy. Regulations like these are not

[80] It is said that it helped that the country's president at the time hailed from this province.

in the provinces' purview, however. Equally, businesses request more kindergartens and playgrounds for working families to prevent parents – especially mothers – from leaving the job after childbirth. In this case, the province has the authority, but lacks the funds due to the allocation based on registered residents. In light of these bounding realities, we now evaluate the interviews conducted with provincial investment authorities, regulatory agencies and industrial park management.

8.2. Regulators and Industrial Parks

For this section, we interviewed industrial park officials – management and regulatory authorities – to show how provincial political officials and regulators responsible for industrial parks position their province in the competition with others. These local regulators are the personification of the federalist *allocative efficiency* argument, which argues that proximity between users and providers of public goods leads to greater efficiency because regulators are in direct personal relations with their constituents (Tiebout 1956; Oates 1972). Moreover, because smaller units are more homogeneous, local regulators do not have to balance the needs of constituents with widely varying needs (Oates 1972). Finally, small units allow regulators to have their ears on the ground and gain an information advantage (Hayek 1948). Interviews with managers of industrial parks served the purpose of confirming whether the official policies were received by the end consumers in the way intended by policy makers and implementers.

8.2.1. Respondent selection and interview format

To select interviewees, all provincial DPIs received an interview request. All initial respondents were then prodded to grant interviews through additional requests. Twelve interviews were conducted with officials from the following regulatory authorities (listed in order of interviews):

- Long An Industrial Zones Authority (Long An province)
- Ho Chi Minh City Export Processing & Industrial Zones Authority (Ho Chi Minh City)
- Ho Chi Minh City Investment & Trade Promotion Center (Ho Chi Minh City)
- Dong Nai Industrial Zone Authority (Dong Nai)
- Hai Phong Export Processing and Industrial Zone Authority (Hai Phong)
- Management Board of Ha Nam Industrial Zones (Ha Nam)
- Hai Duong Department of Planning and Investment (Hai Duong)
- Dung Quat Industrial Park (Quang Ngai)
- Chu Lai Open Economic Zone Investment Assistance Department (Quang Nam)
- Nhon Hoi Economic Zone Administration (Binh Dinh)
- Van Phong Economic Zone Management Board (Khanh Hoa)
- Binh Duong Industrial Zone Authority (Binh Duong)

Industrial parks were contacted in provinces where regulators agreed to be interviewed. For logistical reasons, selection criteria required that these parks had to agree to be interviewed during the same travel arrangement, generally on the same day as the regulators, and had to be located in the proximity of the regulatory offices. In one case

(Tan Tao industrial park management), an interview had to be postponed and was held at a different day from either of the two interviews with government officials. In Binh Duong, the arranged interview with the government agency had to be postponed at the last moment, but since we were in the province already, we interviewed the two companies on the pre-arranged date. Six interviews with industrial park officials took place:

- Phu An Joint Stock Company, Thanh Duc Industrial Park (Long An province)
- Hiep Phuoc Industrial Park (Ho Chi Minh City)
- Vietnam Singapore Industrial Park (Binh Duong)
- BECAMEX (Binh Duong)
- Tan Tao Industrial Park (Ho Chi Minh City)
- Dinh Vu Industrial Park (Hai Phong)

Phu An is a company that builds and manages infrastructure, including industrial parks. BECAMEX also builds and manages industrial parks, but also general infrastructure, such as roads. It is a state-owned company whose owner is the provincial government of Binh Duong. In addition, interviews were conducted with the Ministry of Finance, the Ministry of Planning and Investment and one private company that is not associated with an industrial park but requested an interview after learning from industrial park authorities about the interviews. We did not tabulate this last interview.

Interviews were semi-structured. All allowed presentations first, since the cultural norm is for the interviewee to begin with an introduction. After the presentation, all interviewees were asked a number of questions, going from general to more specific, with follow-up questions based on responses. The questions for regulatory authorities were:

- What are you doing to attract investment?
- What are the greatest challenges in attracting new investment and keeping existing ones?
- What do you ask the central government in Ha Noi to do to help you provide a better business climate?
- How big a problem is labor?
- Does your province depend on migrant labor for its labor force?
- What are the most urgent issues to provide industry with enough quality manpower?

Industrial park officials were asked the following questions:

- Why did you choose this province to set up your park?
- What procedures were required?
- What are the greatest challenges you see in attracting investors to this park?
- What should the authorities do to improve the business climate in the province?
- How do you evaluate the manpower situation in this province?

To avoid leading the respondent, questions about human capital were asked at the end, unless they were brought up independently in response to more generic questions about challenges or policies. (They were in most cases.) For this study, responses touching on public goods provision, taxation and regulatory changes are evaluated.

8.2.2. Interview summaries and evaluations

Interviews with regulators and industrial park managers are juxtaposed on a province-by-province basis to observe commonalities and differences in perception. Provinces can be grouped in three categories:

(1) the major foreign investment magnets Ho Chi Minh City, Binh Duong and Dong Nai;

(2) emerging provinces that already draw enough investment to face labor shortages, here represented by Long An, Hai Phong and Hai Duong;

(3) provinces that remain net senders of migrants (Ha Nam, Quang Ngai, Quang Nam, Binh Ding, Khanh Hoa).

Interviews covered a range of issues. For this section we focus on the responses to the human resource issues facing provinces and industrial park managers.

8.2.2.1. Category 1 provinces – heavy investment and high in-migration

This category comprises the three southern investment magnets Ho Chi Minh City, Binh Duong and Dong Nai. Government authorities in other provinces with high investment and in-migration did not respond. In Ho Chi Minh City, officials of two regulatory authorities were interviewed, from the Ho Chi Minh City Export Processing and Industrial Zones Authority (Phuoc 2007) and the Ho Chi Minh City Investment and Trade Promotion Center (Dung 2007).

Mr. Phuoc: Approximately 70% of the workers in the industrial parks are migrants whose main motivation is the salary. This forces Ho Chi Minh City to provide both housing and public transportation from housing to industrial parks. The government is addressing the challenge by making available funds for low-income housing and by requiring new developments to provide housing for workers. There are no exact rules how much housing or what form of housing, dormitory or apartment buildings, but investors see it in their own interest and follow the vague requirement in accordance with the spirit of the regulation. The government also makes available land below market cost if it is designated as worker housing, and provides lower rates for water and utilities for dormitories. The government is aware of the challenge of return migration, but government services are not by themselves the main reason. The increasing number of industrial parks around the country makes it easier to find a job closer to the family and in places where housing is cheaper. The reason for return migration is a calculation between cost of living versus income, and the desire to live near the family. In response, Ho Chi Minh City has implemented a policy of no longer licensing labor-intensive projects, and has even created a fund to support companies that want to move out of the city into neighboring provinces. The government also supports subsidies for investment in labor-saving technologies. The expected result is high quality of investment that can operate with a lower number of workers.

Ms. Dung: The reason for the high labor turnover lies in the cost of living in Ho Chi Minh City in comparison to wages. Workers will still come to Ho Chi Minh City, for the salaries, but also because having worked here is helpful in finding work elsewhere. Ho Chi Minh City has a reputation for manufacturing and being trained here is useful for a worker.

Both officials focused on labor issues early on and without prompting. One important point in support of Assumption 4 is that regulations were promulgated that require new developments to build worker housing, but implementing rules were never created because the companies fulfilled the requirement out of a sense of their own interest. Ho Chi Minh City's active attempt to push labor-intensive, low-tech work out into neighboring provinces (an agreement exists with Long An province to integrate infrastructure between the two) shows how seriously Ho Chi Minh City authorities take the threat of declining manpower due to high cost of living. The policy is reminiscent of the flying geese model of East Asia's early developmental states, which also outsourced low-value-added production as soon as their own economies were outgrowing these sectors (Akamatsu 1962).

Two interviews were conducted with industrial park management officials in Ho Chi Minh City. Hiep Phuoc industrial park is strategically located at a navigable arm of the Sai Gon river. It has its own small port and lies far outside the main urban area (the exclusion zone) to be able to attract polluting industries. We interviewed the business development manager (Quynh 2007). The second respondent from Ho Chi Minh City was the chairman of Tan Tao, the country's first industrial park and one of the best financed and proactive. The Tan Tao group is a conglomerate that, among other projects, has built an American-style university campus for business and economics students (Men 2007).

Ms. Quynh: The presentation focused on the attractiveness of the park and its infrastructure, especially port and lower environmental requirements. When asked how the province helps attract workers, she said the government should construct dormitories, because salaries are low compared to cost of living and as a result, living standards are low. The government should increase the minimum wage and invest in quality-of-life amenities, like schools, entertainment facilities, medical and training facilities. While it is still easy to get unskilled labor, workers with skills are becoming scarce. The management surveys the workers in the industrial park annually about their living conditions.

Mr. Men: In the first stage of economic development, Ho Chi Minh City attracted industries with high demand for labor. After one to two decades, investors must upgrade, and labor-intensive industries must move to outlying areas. Tan Tao faces the same labor problem as all regional industrial parks. Companies are advised to provide a good work environment including allowances for living expenses and recreational activities.

Regulators and industrial park managers shared concerns about labor. All sides placed the burden for high enough wages and living allowances on the individual employers, but held the government responsible for providing better housing. Hiep Phuoc's official mentioned increased minimum wage. Every company is at liberty to raise salaries itself, but if the government steps in and mandates higher salaries, companies would be able to pay better without suffering the comparative disadvantage in cost structure compared to companies that pay minimum wage. It appears that the cost of hiring and training new workers is still not as high as the cost of paying higher salaries and retraining the work force in return, at least in the low-skill sectors. Another explanation is that workers turn over even under better work conditions, for cultural and social reasons, as explained above. In that case, companies prefer to keep salaries low and re-hire and re-train rather than raising wages across the board while still re-hiring and re-training a significant portion of their workforce. Hiep Phuoc industrial hosts tenants in the heave industry sector that requires large manpower and is the only respondent that did not refer to the policy of moving to less labor-intensive industries as a matter of policy. The government is discussing this policy with investors, so it may not be coincidental that it is mentioned.

In summary, it is not surprising that Ho Chi Minh City government and industrial park officials are keenly aware of the problems with migrant workers' living conditions and support more investment in increased quality of living. Hiep Phuoc with its labor-intensive tenants was the only one not to mention the need for support for migrant workers or the focus on industrial upgrading to higher-tech, lower labor-intensive business, but supported more focus on supporting migrants when asked.

In Dong Nai, the vice chairman of the Dong Nai Industrial Zone Authority was interviewed (Van 2007). No industrial park managers responded based on the logistical criteria set for interviews, but several companies responded to the survey (below).

Mr. Van: The total workforce in the province's industrial parks is 300,000. Approximately 70% are migrants. Social services are not good. Dong Nai cannot meet the needs due to budget constraints. The central government has sent a delegation to study the situation but has not made money available. As a result, many of migrants return home, especially where new industrial parks are opening and they have employment opportunities closer to home and under cheaper living conditions. The solution is to attract fewer new investment projects and focus on those with higher value added and higher-end technology. The Dong Nai Industrial Zone Authority works on improving living standards through partnering with companies in construction of dormitories and making available public transportation to and from work. The government encourages new industrial parks to include worker housing in the initial planning stage. The New Household Registration Law[81] will create better conditions by providing more freedoms for people. Land purchase will be facilitated.

The official mentioned labor issues without prodding, and elaborated on provincial policies and the Household Registration Law in follow-up questions. Like Long An (see below), Dong Nai is requesting fiscal transfers to address social service provision shortfalls for the large unregistered migrant population. Like Long An, it claims that no funds have been forthcoming, while the Ministry claims it has made extra money available for the southern growth pole provinces (Ministry of Finance 2007). Dong Nai takes a conventional approach to the public goods problem. It works with investors to integrate worker housing into the planning stages of new investment projects and incentivizes doing so, but does not have a grand plan. Like Ho Chi Minh City, there appears to be a mutual understanding that this is in the best interest of investors, so that no binding regulations are necessary.

81 The Household Registration Law required that a person have housing in order to register. Many landlords required registration before providing a lease. Provinces could take an expansive or narrow view of the law and refuse registration without official lease. The amendments of 2007 give local authorities less leeway and require registration based on a wider range of conditions, such as less formal evidence that they are allowed to stay in a house.

Three interviews took place in Binh Duong, with the Binh Duong Industrial Zone Authority (Viet 2007), with a marketing manager at Vietnam-Singapore Industrial Park (Phu 2007) and with BECAMEX, the province-owned infrastructure and industrial park construction and management company (Xuyen 2007).

Mr. Viet: The province has 33 industrial parks, 19 are fully operational with 1,100 projects. Foreign occupation is 70% and $4.8 billion in capital. Per capita GDP is 1.6 times the national average. This has attracted a lot of workers into the province. Some 200,000 work in the industrial parks; the migrant ratio of 85% is the highest in the country. The workforce of the entire province, including outside industrial parks, is 500,000, of whom 400,000 come from other provinces. Provision of social services for these workers is extremely difficult. The authorities encourage the construction of housing. Unlike other provinces, Binh Duong supports not only companies that build dormitories, but also incentivizes construction of housing by third parties to increase the rental stock. For dormitories, land rent is reduced. The central government has mandated Binh Duong to develop a dormitory provision policy and is considering to allow the cost of implementation if the plan, if approved, could be added to allowable provincial expenses in the fiscal transfer negotiations.[82] It would be useful if central regulations could be clarified about land use fees for social housing. Provinces are concerned that they provide benefits that Ha Noi may consider extra-legal. [Viet spoke only about what the province did without reference to the reasons; a follow-up question

82 Refer to the section in the budgeting process (8.1.). Provinces negotiate the amount of money they can retain from the taxes they raise by providing the center with necessary expenses. If Binh Duong can add the cost of implementation of a housing plan into the authorized expenses, it could reduce its transfers to the treasury in Ha Noi accordingly.

about impact of living quality problems on business climate was posed here.] After *Tet*,[83] between one-quarter to one-third do not return to the factory and need to be replaced, with all the costs of hiring and training, and work interruption. As more and more provinces have industrial parks and investment is rising there, workers have more choices to stay closer to their families or live in locations where cost of living is much lower. The new law is a great help for migrants, as it will help improve living conditions. For those who get a registration book, it is easier to get housing. Training, health services, but also avoid paying higher rates for electricity and utilities [as middlemen ask for money to stand in for undocumented tenants]. Binh Duong encourages investment from projects with lower manpower requirement. In return, the province is creating better vocational schools to improve the quality of human capital and attract higher-end investment. Technical schools are managed in cooperation with the Vietnam-Singapore Industrial Park.

Mr. Phu: There is so little space left in neighboring Ho Chi Minh City that location is a major competitive advantage for Binh Duong. We need to provide a good environment for both workers and investors. Workers need housing, but also leisure opportunities to be productive. Binh Duong builds townships adjacent to industrial parks. In future projects [VSIP was constructing several new parks at the time of the interview, which are now operational], VSIP will itself construct worker housing. The total number of employees in VSIP Binh Duong is 50,000, and turnover is a big problem. There is no shortage of unskilled labor, but the cost of hiring and training is

83 The Vietnamese New Year, the most important holiday of the year. Workers receive one month's worth of bonus before Tet, and few leave before collecting this money.

significant. The Vietnam-Singapore training school, initiated in 1998, tries to prepare qualified workers. Qualified workers earn more money and are more stable. Binh Duong understood the need for migration early and takes a proactive stand on registering them.

Ms. Xuyen: The main advantage of the province is the proactive stand the government takes to the needs of investors. Every month on the 13th, the governor meets with investors to discuss their concerns. BECAMEX builds industrial sites, not only parks and factories. Every factory needs infrastructure, and every worker needs a social environment. The company adds markets, kindergartens, schools and hospitals, sports fields and theaters. Workers come here when they are young. Once they get married, if they cannot find a social infrastructure, they cannot continue to work here. To keep workers longer, a province, an employer needs to provide favorable social conditions. BECAMEX allows the construction of dormitories inside the industrial park, and offers lower land rent for companies that wish to do so. It has learned from China's experience with job hopping. If workers have no social live to fix them into their community, they change jobs even for a minimal increase in salary. Workers who are part of their community have additional considerations to make before the decide to move away. The three respondents share the same views on the importance of maintaining workers in the province. The reason is likely to be two-fold. First, the high ratio of migrants and their propensity to be unstable in their jobs has cause transaction costs to increase, which has hurt business climate. Second, the three respondents work closely with each other and coordinate policy. BECAMEX is owned by the provincial government and its job description is to improve the business infrastructure. VSIP is a perfect example of the tension in allegiance between center and province. VSIP is set up as a collaboration by the governments of Vietnam and Singapore, and responds directly to the prime minister. Nonetheless, VSIP cooperates with the local authorities on training and supports the province's policies on improving social services. This represents the harmony of interest we discussed earlier in the section on fence breaking. VSIP may be a central government concern, but it is a for-profit company and its fortunes are tied to the business climate in and reputation of the province(s) in which the company operates. BECAMEX is most sophisticated in articulating the problem of turnover. When companies refrain from raising salaries even at the expense of high turnover, they implicitly suggest that turnover may occur anyhow, regardless of wages. Vietnamese have a strong, traditional attachment to their ancestors and their families. Living away from ancestral lands and their extended families represents a substantial transaction cost that higher salaries can hardly compensate. Integrating migrants into a new social network can reduce the pain of separation and shift the cost-benefit ratio of living apart. Education and success at work are highly prized in Vietnamese culture. If a worker obtains training, can show personal improvement in addition to higher income (and the ability to remit money to the family) and has a social network outside work, the pressure to return home may be reduced.

8.2.2.2. Category 2 provinces – catch-up investment and future in-migration

In this category, provincial authorities from southern Long An and northern Hai Phong and Hai Duong responded. We also interviewed industrial park management officials from Long An and Hai Phong. These provinces form a second tier of investment attractors. All are strategically located. Long An bordering Ho Chi Minh City to the south has a cooperative agreement with its neighbor. Under its terms, Ho Chi Minh City assists with the construction of an infrastructure network that integrates Long An with Ho Chi Minh City to facilitate the migration of labor-intensive factories to cheaper and less populated Long An. Hai Duong and Hai Phong line the highway between Ha Noi and the port of Hai Phong, one of Vietnam's major ports. These provinces are beginning to attract regional migrants, and their governments are planning for future needs under the assumption that the growing investment will outstrip local manpower – and especially local skills – in the near future. In Long An, the chairman of the Long An Industrial Zone Authority (Phi 2007b) and the sales manager for the Phu An Infrastructure Investment and Development Joint Stock Company (Chinh 2007), which is building the Thanh Duc Industrial Park, responded. In Hai Duong, we interviewed division director of the Department of Planning and Investment's Foreign Economic Relations Department (Doan 2007). In Hai Phong, the chairman of the Export Processing and Industrial Zone Authority (Thuyen 2007) and the marketing manager of the Dinh Vu Industrial Zone (Huyen 2007) agreed to be interviewed.

Mr. Phi: Long An does not have a particular policy to attract workers, but human resources are a big problem. Companies build dormitories and provide allowances to workers. At the moment, these are mostly internal migrants [from the rural parts of Long An], but in the future we need to attract workers from neighboring provinces. Dormitories and training programs will be necessary. A new contractor for Nike is building a factory for 20,000 workers, more than the population of the district where it is located. The footwear sector offers low salaries, and the workers cannot afford to get housing on the free market if prices go up when they all come in. The province needs to help. Unfortunately, there is no budget from the central government for that. At the moment, the provincial authority strongly recommends companies to provide good salaries and to offer housing. The province has set up vocational schools to give workers better training, which leads to higher salaries. That can mitigate part of the problem. Long An also provides land for free when the investor builds dormitories on it. Officials would like to see new rules from Ha Noi that give the province more flexibility to provide their own incentives where they are needed.[84]

Mr. Chinh: The development of Thanh Duc Industrial Park is taking place under the agreement between Ho Chi Minh City and Long An to shift labor-intensive investment to Long An. Land is about 30% cheaper, but it is in close proximity to the infrastructure of Ho Chi Minh City, like port and airport. The management is setting land aside for dormitories. The expectation is that the companies in the park will employ between 30,000 and 40,000 workers, half of whom will need housing. The

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84 Setting tax or financial incentives is not in the provincial domain. Some fence breakers have done so, but the center has reigned them in, based on our discussion of the harmony of interest earlier. The reason provinces get so much leeway in matters of economic development is because the center makes good money as a result of growth. If provinces reduce their income by giving it away in incentives, the center loses out on transfers. Hence, Ha Noi has let a lot go, but pushed back against provinces' extra-legal provision of fiscal incentive policies.

decision to invest in housing comes from the marketing division. There is a belief that when Phu An’s industrial parks become known for good conditions and low levels of social tensions, the company will obtain licenses to develop more facilities with less difficulty elsewhere.

Mr. Doan: At the time of the interview, there were eight active industrial parks in Hai Duong, but more are in the planning stages. Every district plans at least a small one, a Taiwanese company wants to build a larger one. At the time of the interview, 40,000 workers worked in industrial parks. Land rent is low in Hai Duong. The province is already trying to lure workers who have migrated to the South of the country back home. In Hai Duong, there is less a lack of manpower than skills, and workers with experience in the southern growth pole could fill a hole in this respect. There is already a small net in-migration at this point, but not enough to fill the need for qualified workers. The province does provide social services, like hospitals, but also a new township to improve overall living conditions.

Dr. Thuyen: Hai Phong benefits from the port and the direct sea lanes to China and Japan. At the time, there are four active industrial parks and 16,000 workers. Almost 90% of them are in manual labor positions with only a high school diploma. By 2020, the province expects 14 more industrial parks to be built. [When asked about social issues and the new Household Law:] The new law does not affect workers much. The local authorities must support them with or without permanent resident status. As the third-largest city in Vietnam, Hai Phong attracts workers from other provinces, and the government is trying to build adequate social housing. There is also a health care center program around industrial zones. And private parties are encouraged to build housing for rent. When a new park is developed, the province reserves the appropriate amount of land for housing in the vicinity.

Ms. Huyen: Presentation is about competitive advantage due to the port and proximity to China and Japan. [When asked about workers:] The attitude of workers is changing. Known as docile in the past, the number of strikes is up and workers leave the job easily when they feel they are not treated well. To improve housing conditions, the management reserves land for dormitories.

These respondents share a general concern for the need to attract workers, as they expect an influx in the near future. They all use the three investment magnets of Ho Chi Minh City, Binh Duong and Dong Nai as their development models and study their problems. Especially Long An, next door to Ho Chi Minh City, follows the neighbors path closely. Many residents of Long An have made the move north to seek work, and the cooperation agreement with Ho Chi Minh City binds Long An to Ho Chi Minh City. Most strikingly, Phu An's policy of building worker housing as a matter of good marketing for future license applications is a recognition by business that the housing crunch represents a social problem that provinces will factor in when licensing new developments. Being seen as proactive is good business – a good example for the race to the top in a harmony of interest between local government and business. Hai Duong's and Hai Phong's regulators say the same things as do those of Long An, but with less urgency. Regulators in Vietnam are officially subordinate to the Ministry of Planning and Investment *and* the province. Hence, they receive information, documentation and regular training from the ministry. It is not surprising that they share the concern about worker housing and social problems. In terms of policy, they follow the proven path that comes from what counts as ‘best practices’ in Vietnam: provide reduced land rent for worker housing, encourage new developments to integrate dormitories in the master plan. Beyond that, there is little original thinking. The goal is to catch up with the success stories, get investment, first in the labor-intensive, low-skill industries, provide worker housing and move to the next stage later, when appropriate. This strategy may be appropriate given the stage of development. Dinh Vu Industrial Park was most concerned about the attitude change of workers, who are striking more rapidly nowadays when not treated well. The park has reserved land for worker housing, but was not visibly interested in the topic. It was only mentioned when asked specifically. Reserving land is the generalized recommendation that trickles down from Ha Noi to the provinces (or probably up to Ha Noi from the southern growth trio, and then down again to the rest of the provinces via the line ministry’s provincial departments). Phu An and its marketing view stems from the fact that it is not a Long An firm, but does business in other provinces and understands the cost of carrying the reputation of bringing social strife with one’s projects. None of the responses suggests a regulatory race to the bottom where provincial business and political elites collude against workers. On the contrary, it is observable, and in line with the theory, that concern for good living conditions becomes more prominet as manpower needs rise in the wake of increasing numbers of investment projects.

8.2.2.3. Category 3 provinces – low levels of industrialization

The third group of provinces is comprised of those that are building industrial parks but have so far not attracted the amounts of investment to face or foresee labor shortages. In these provinces, the main issue is the absorption of the local labor oversupply. Nonetheless, almost all officials mention that they are modeling themselves after Ho Chi Minh City, Binh Duong or Dong Nai. Terms like master plan are used regularly, but often no such plan can be described. On the positive side, because these provinces want to follow the model of the success models, they are already adopting the rhetoric about migration, housing and social conditions and may have a heads up if and when these problems come to the fore. In this category, regulators from Ha Nam (Han 2007), Quang Ngai (Nam 2007), Quang Nam (Hung 2007), the Nhon Hoi Economic Zone Administration in Binh Dinh (Toan 2007) and the Van Phong Economic Zone Management Board in Khanh Hoa (Phi 2007a) have consented to interviews.

Mr. Han: The province of Ha Nam [south of Ha Noi on a good road, but inland and some way from Hai Phong] has 830,000 inhabitants, but 2 million people live in a 50 km radius. Of the 12,000 workers in industrial parks, about 80-85% are local. Workers used to move away, but in Vietnamese culture, the birthplace is important and people will return when it is possible. The province offers easy access to land rights so that migrants, especially return migrants, can build a home. [When asked about the Household Registration Law amendments:] The law does not affect Ha Nam much. There is space, the province has experienced out-migration and is happy to receive in-migrants. The province sets aside land for worker housing to support low-income migrants. Industrial parks are required by the province to set aside some land for housing. Other social services must be provided by the investor, who is required by law to provide health insurance and social insurance [retirement, invalidity].

Mr. Nam: Dung Quat is a very large industrial zone under central government control. It harbors Vietnam's first refinery[85] and is built for polluting and heavy industries. The refinery alone has 15,000 workers, another 3,000 work in shipbuilding and approximately 7,000 in the active factories. When the zone is fully operational, it is expected that between 30,000 and 40,000 workers will be employed, 70% of whom skilled. Dung Quat includes an urban zone with TV station, housing for workers and expatriate managers, training schools, a hospital and sports and recreational facilities. This urban zone is funded by the central government. [Follow-on question about migration.] Because of low salaries, it is difficult to find qualified workers. To attract more, salaries must be raised. Some 70% are from other provinces and the Dung Quat park authority has asked to province to build worker housing. Dung Quat also rents out land to build such housing.

Mr. Hung: Quang Nam province wants to invest all the revenue it is allowed to raise independently, land transfer fees and port fees, into infrastructure, but changes in the laws have reduced this revenue. Many decisions about local infrastructure are therefore made by Ha Noi.[86] The majority of workers are local, but skilled workers

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85 The story of the refinery is related elsewhere, but it is one of the most egregious examples of government planning gone wrong. With the refinery 40 years in the planning (and construction) and still not fully operational, the government is trying to make the best of the situation and use it as an anchor for a large industrial area for heavy industries.

86 Ha Noi seems to generous, though. Tam Ky is a sleepy central Vietnamese town where a few bicycles have the rule of the four-lane boulevards that come with planted medians. There is also a local airport.

come from Ha Noi or the South. Only 4,000 people work in the industrial zone, but by 2020, when the construction is fully completed, it is expected that the zone will employ between 50,000 and 100,000. The province will build the backbone infrastructure and also provide land free of cost for companies that build worker housing. The province will reserve land exclusively for worker housing. Companies have to build it, but because of the subsidized nature of that land, the land use right will not be transferrable (sold or exchanged). The important task is to make life acceptable for skilled workers. There is a large pool of unskilled workers available locally.

Mr. Toan: The population in Binh Dinh province is scattered. This makes land clearance easier and cheaper. Nhon Hoi is a special economic zone designated by the central government, which grants investors special tax benefits. About 10,000 workers will work in the zone, and the province has 1.7 million people of whom 55% are in working age. The demand for labor can be filled locally. The problem in this province has been brain drain, but workers who received training in the South are moving back because there are now jobs available closer to the family. Living conditions are much harder for them in the industrial parks in the South. The province supports housing needs for workers, but companies have to provide their own incentives to attract manpower.

Mr. Phi: Vang Phong is a vast special zone [150,000 hectares in Khanh Hoa province] benefiting from central government tax benefits. The zone will house shipyards and other labor intensive investors and jobs will have to be filled with migrants. It is easy to find workers, the management advertises on television. Provincial authorities will provide training.

No industrial park managers or investors responded to interview requests (although the Dung Quat and Van Phong authorities acted like a park manager more than a regulator, possibly because they are central government projects managed by the local authority and regulated by the central government). Investment in these areas is recent and marketing is in its infancy. Parks in this category are often managed by the province, because few private investors have yet developed an appetite for these parts of the country. Many have very few active factories. Unlike VSIP or Phu An, which are sophisticated profit-making ventures that understand the value of giving interviews, there is little public relations savvy in these industrial park authorities yet. Translators often speak sketchy English and Power Point presentations depict entire townships (the concept from the southern growth pole) with shiny high-rise apartment buildings, but officials cannot say how many workers they expect. When questioned how they can build a township for workers without knowing how many to expect, they refer to the master plan which will be developed by the investors, or refer to the experiences of Ho Chi Min City. In one exception, a recent graduate from a U.S. university assisted the respondent in fluent English with an understanding how to portray Quang Nam province, had answers to questions and a plan that seemed to be adapted to the needs of the province rather than just a copy of the master plan of Ho Chi Minh City. Generally, however, there is a tendency to talk in generic terms about cheap land rent and cheap labor (adding that the salaries are a problem and need to be raised) and then to show slides about some master plan that is not to be implemented by the authority but by some to-be-found investor. In many cases, specifics must be coaxed out with direct questions, and the responses are generally from the script of the southern provinces, where the problems tend to be rather different. Not surprisingly, migration is an issue on the reverse side of the coin when compared to the highly invested provinces – will the province need it and how can it get migrants to move in.

8.2.2.4. Analysis

Surprisingly, the proposed solutions to the manpower challenge are the same in the growth poles and in the third category of aspiring industrializers: cheap land for housing and setting aside land for dormitories in the planning stages of developments. This is an appropriate strategy in dealing with a surplus of migrant workers, but less effective when one wants to attract returnees who have a family home in the province. Nonetheless, the fact that the discourse has trickled down and is accepted by provincial leaders suggests these provinces will behave like their models once in-migration is picking up. (Of course, once these third-tier provinces need substantial amounts of in-migration, one has to ask where it comes from. At that time, all but some mountainous provinces will have industrialized, and with jobs distributed across the country, the need for large-scale migration should disappear.)

The interviews in the growth poles and the rising second tier point to the harmony-of-interest theory. Political leaders and businesses share a common vision of addressing the manpower problem in their provinces. None of the interviews suggested an attempt of companies to push government toward a position of cutting services in order to reduce tax rates. The high cost of inaction on the manpower front and the primacy of embedding workers into a social network to keep them productive and local are widely accepted. The practice of building dormitories started with companies and made it into government plans subsequently (Hai 2007).

The rhetoric between regulators and businesses is so similar as to make it obvious that it has not developed independently. Few would claim that – one claim to fame in the most developed provinces is the close cooperation between provincial elites and investors. The Department of Planning and Investment is not just a regulator, but a marketer for the province. Consequently, the relationship between DPI and investment zone authorities on one hand, business on the other is not controversial but collegial. The way in which companies add to the general rhetoric (such as Phu An's sophisticated analysis of the long-term repercussions of reputational issues resulting from social tensions) and over-fulfilled requirements (which often do not even have the force law) indicates that there is agreement, not just obedience.

In the category of low-invested provinces that are just starting to market themselves, the interviews were inconclusive, because no companies have been interviewed, and we cannot check whether industry follows the lead of the political elite. These provinces are often true laggards where development comes in the form of a central government special zone decreed and funded from Ha Noi and managed by a local special authority that responds to the prime minister. The environment in such cases is different from that we have studied so far. Moreover, Assumption 4 is geared toward the relationship between investors and their workers via the local government. We could have left out the third tier of industrializers altogether. What the interviews in the third tier tell us is to what degree elites in these provinces are preparing for the future and whether we can expect a similar path as in the growth poles. Nothing suggests that Quang Ngai will upset our hypothesis for the successful provinces, if its attempts at catch-up industrialization (as a goose in the third line of flying geese) turns out successfully.

For the already heavily invested provinces and those on the path to high investment and in-migration, the interviews have supported Assumption 4: Regulators and businesses, such as industrial park operators, see manpower issues as a transaction cost. They want to improve the livelihood of their workers to keep them in the province. The hypothesized race to the bottom has not taken place. While workers in Vietnam are still badly paid and their social situation often precarious, this is not a consequence of a concerted effort by political and economic elites to collude against them, but a growing pain of development which Vietnam has mitigated better than many other countries. The next section analyzes the survey responses to examine whether they support the emerging picture or whether a different methodology leads to different results.

8.3. Company Surveys

Following the interviews, we asked industrial park managers and provincial investment authorities to distribute a survey to companies in the business parks. In total, 30 companies replied to the survey. In the case of Nike, the country headquarters replied and distributed the survey to its contract factories. Responses come from companies of all legal forms of registration, foreign invested, private domestic, joint stock company and state-owned. Most respondents were in the light manufacturing sector, but one steel factory replied as well. Respondents were located in the Southeast (Ho Chi Minh City, Binh Duong, Dong Nai), the Mekong Delta (Long An) the Central Coast (Da Nang), Red River Delta (Nam Dinh). Several companies identified their national origin; all of them were Asian. Although the focus of this study is on foreign investment, all responses were counted.[87] Of the 30 respondents, 23 were foreign-owned and two were joint stock companies. Four more were domestic private and one state-owned.

The state-owned company confirmed the selection criterion for foreign investment over all investment. In Chapter 5, we argued that only foreign investment is fully mobile and thus a better indicator for our assumptions than domestic investment, which may be bound by other considerations than market signals. In response to the question why the company chose the province where it is located, the state-owned enterprise responded that as a provincial SOE, it had no choice in the matter of location.

We suggested that the responses be treated confidentially and that companies print them out and mail them to the author. In all cases, the respondents ended up emailing them to the authority that had sent them out (and to Nike in the case of Nike contract factories). In some cases, we received responses with company name addressed, in others, they were anonymous for the author but obviously had an email

[87] We used the responses from domestic companies to verify our original selection criteria, namely that domestic companies are on average less mobile than international ones and therefore do not reflect the contestation argument as well as international capital.

address attached when they were sent to the authority that sent the surveys out and collected the responses. It is impossible to say whether the knowledge that the regulatory authority would be able to read them influenced the responses. Table 8.1. reproduces the questionnaire.

Table 8.1. Survey questionnaire

(1) Data on investors

(a) Province(s) you operate in
(b) Product/Sector
(c) Ownership – state-owned, private domestic, joint venture, foreign-owned
(d) Turnover
(e) Committed capital
(f) Main markets for your products
(g) Export turnover
(h) Exports as percentage of total turnover/sales
(i) Number of employees

(2) Choice of IP/EPZ

(a) Why did you choose this IP/EPZ? List all reasons.
(b) What IP/EPZ are you in now?
(c) Did the province the IP/EPZ is located in influence your choice (i.e.: did you choose the province before the IZ/EPZ)?

(i) Which other provinces did you consider before choosing this one?
(ii) List the reasons for choosing this province over others. (What are the advantages of this province?)
(iii) Do you have factories in other provinces, or in other IPs/EPZs?

(3) Human capital formation

(a) How does your company attract qualified workers?
(b) How does your company improve the human capital it has – training, cooperation with schools?
(c) Do you depend on migrant workers? What percentage of your workers are migrants?
(d) What does the provincial government do to attract qualified migrant labor?
(e) What does the provincial government do to train workers for the investors' needs?
(f) What do you do to retain workers, i.e.: to reduce turnover?

(i) What is your turnover rate, i.e.: what percentage of workers leave every year and need to be replaced?

(g) What does the provincial government do to help workers to stay on the job for a longer time?

(4) Policy evaluation

(a) (FOREIGN-owned or partly foreign-owned companies only) What was your main reason to invest in Vietnam?
(b) What do you consider the best policies by the provincial government to help you attract workers?
(c) What do you think the provincial government should improve to attract more investors – what new policies are needed, which old ones should be changed?
(d) What do you think the provincial government should improve to attract more qualified workers – what new policies are needed, which old ones should be changed?

(e) What could/will you do yourself to attract more workers?
(f) What could the IP/EPZ do to improve your business conditions?
(g) What policies should Vietnam implement nationally to improve your business opportunities/your Vietnamese affiliate's opportunities?

Any additional comments you wish to make about
Investment policies
Competitiveness
Migration and its impact on competitiveness

On some questions, responses are all but unanimous. Almost all foreign respondents said they invested in Vietnam because of political stability. Most mentioned cheap labor. Some mentioned incentives and helpful local government, and a few listed Vietnam's status as an emerging economy with future potential as a cause to invest in the country. One respondent mentioned universal education as a reason to come to Vietnam. Criteria for choice of province were less uniform. Proximity to good infrastructure was mentioned most often, but provincial proactive attitude and ease of licensing were mentioned frequently as well. Labor availability was mentioned, although ambiguously. While some companies sad that the concentration of footwear and garment factories assured a stream of workers, others argued that their province needed to diversify to reduce the pressure on labor demand in their own sector. Two companies, both from Binh Duong, said that the support for worker housing was a factor in choosing their location.

We already mentioned that many companies are not aware of the way revenue and spending authority are distributed in Vietnam. The same can be said about other policy areas. Several respondents said the province should raise the minimum wage or change taxes and incentive structures (central prerogatives). In such a case, we re-categorized the response to apply to the correct branch of government. Some responded that provinces should no longer license labor-intensive projects to reduce pressure on existing factories. This is a policy already being implemented and it is likely that the companies are repeating policy they have heard from officials in meetings, or that the policy of upgrading the quality of foreign investment emerged in cooperation between government and investors.

Some respondents provided minimalist responses, with only ‘objective’ questions being answered (how many employees do you have, where are you located). Others gave lengthy narrative replies to questions about opinion (what should the province do …). Also, two respondents replied twice, but in the name of different companies. These were apparently companies that owned several factories (as ascertained in the response to the question whether the company also has factories in other parks or provinces). These (identical) responses were only counted once. We simply eliminated the second response (in the order they arrived) from the tally. In the following, we list the responses classed in general categories.

Table 8.2. lists a summary of relevant responses on issues related to our research question: do companies support a race to the bottom by lobbying for lower labor standards and lower taxes, or do they see a harmony of interest between their corporate interests and the living conditions of their workers? Responses are unclear in distinguishing between what the government actually does and what companies suggest it do. Both categories in the questionnaire respond to the same question, first “what policies of the government do you support” and second “what new policies would you support,” we have lumped the responses to these two categories together.

Table 8.2. Tabulation of survey results

What the company does to hire and retain workers:	Responses
• Pay relatively high wages	24
• Adjust wages to cost of living	1
Pay childcare allowance	1
• Organize social activities	5

Provide benefits to families of workers	(Dong Nai) 2
• Provide allowances and benefits	17
• Improve living conditions	3
• Provide workers with job stability	2
• Improve the work environment	8
• Make work conditions safe and healthy	3
• Feedback/cooperative management/fairness	7
• Build dorms for workers	3
• Provide transportation for workers	2
• Build teams of workers	1
• Offer extra holidays	1
• Work with a supermarket for a worker discount scheme	1
What the province does/should do to help with manpower needs (selection of responses relevant to Assumption 4):	
• Has created abundant labor supply	14
• Organize social events	2
• Supports investors who build worker housing	(Binh Duong) 2
• Offers cultural activities for workers	1
• Supports worker housing	4
• Improve conditions for migrants	1
• Build dormitories and worker housing	5
• Sell land cheaply for worker housing	2
• Assist workers to buy housing	1
• Provide kindergartens	4
• Create worker entertainment	2
• Help with public transport	(Long An) 1
• Build training facilities	1*
• Stop approval of labor-intensive factories	(Dong Nai) 2
• Diversify to other industries	2
• Conduct tougher inspections to avoid labor abuses	(Dong Nai) 2
• Improve public safety around industrial parks	2
What has influenced your choice to invest in Vietnam:	
• Stability	6
• Cheap and abundant labor	11
• Skillful workers	6
• Universal education	1
What does Vietnam need to do to improve its human capital:	
• Should Control/prevent/repress strikes	10

• Create unions that really represent the workers	1
• Change tax code to allow tax deduction of fringe benefits (→ wants to give benefits for social life improvements to workers)	1
• Adjust minimum wage to cost of living proactively	8
• Eliminate the 300-hour per annum overtime limit	2
• Check inflation	2
• Improve labor situation for workers	2

** This category came in a wide variety of responses from almost all respondents, because one question specifically asked about training. One respondent mentioned it in a general question prior to the direct reference to training in the questionnaire.*

Companies' first line of defense against loss of manpower is higher salaries paired with living allowances. A total of 24 respondents said they pay high or above industry standard or above minimum wage salaries; 17 more grant allowances, a few mentioned specific benefits like childcare assistance. Eight respondents added that they would pay even higher salaries if they could do so without fear of competitive disadvantage. They urged the government to be proactive and raise the minimum wage *before* inflation becomes a problem. This indicates that companies are willing to pay more, but that competitive pressures make it difficult for them to do so unilaterally. If one company increases its wage rate, the increase in production cost could be substantial. Some garment or footwear companies employ more than 10,000 workers. By asking the government to raise the minimum wage, these companies indicate that they want to pay their workers, but on a level playing field with the competition. Two foreign-invested Dong Nai companies suggested that authorities ought to engage in tougher inspections of companies to make sure they meet legal labor standards. This seems like a highly unorthodox request, but goes back to competitive advantage, similar to the demand to raise minimum wage. As these surveys show, many companies are perfectly aware of the cost of high turnover and want to reduce it. But as long as other companies engage in practices of requiring unpaid or under-paid extra time or flout the maximum overtime regulations, they may get a competitive advantage, at least as long as the cost of turnover does not exceed the benefit from the illegal behavior. This may be the case in industries that require mostly low-skill labor. The companies that want to work differently need to be sure that their adherence to the rules does not lead to a competitive disadvantage. It is typical that both companies that mentioned more thorough inspections are from Dong Nai, where competition is fierce. The fear of these companies is that competitors in other provinces get a leg up on cost if they can get away with illegal exploitation of their workforce.

In a reaction to recent events, seven companies said management feedback, a system to air grievances and the perception of fairness are important factors in reducing turnover. In recent years, since inflation has begun to eat away the purchasing power of wages in 2005, strikes have increased significantly. In most cases, management practices were the cause – not low wages but overtime without wages, or harsh conditions on the work floor. Good and fair worker management is a reaction to these events.

Interestingly, while almost all companies had some policies in place to attract and retain workers, constructing dormitories, assist with housing or land use rights access for workers is not as prominent as it was in the interviews. Adding up the categories associated with housing, 17 companies mentioned that it does or the government should do something about it, but suggestions varied, while among regulators and park management, land rent and the construction of dormitories was present in almost every interview. One reason may be that the latter two groups discuss policy more regularly, while factories tend to get involved less frequently. They are less involved in the theoretical discussions and more interested in immediate action. For a company, paying an allowance is easy and pleases the workers, who after all migrate for the income. Dormitories seem the ideal solution, but some research has shown that workers dislike living in them, especially if they are in the immediate vicinity of the factory. When living on company grounds, it becomes much more difficult to reject demands for night shifts, overtime or weekend work (Hai 2007). Two companies put checking inflation into their list of requests from the government. Inflation hurts workers more than exporters (who get paid in hard currency). Putting a lid on inflation is a way of reducing tensions with workers.

In the category of allowances, companies had more or less creative ways of distinguishing themselves from the competition. Most firms in Vietnam pay a food allowance or make free canteen lunch available. Housing allowance or transportation allowance in the form of a cash payment on top of the salary is also common. In that fashion, companies can pay extra without conceding general wage increases. When oil prices spike, they can temporarily increase the motorbike fuel allowance. They can provide bus tickets for bus commuters, or supplement rent only for those who live in rental units. Allowances are more easily adapted to immediate needs than salary increases, which, once granted, become the new norm and are virtually impossible to reverse.

Building kindergartens (four mentions) or entertainment facilities (two mentions) is a concern for employers, who appear to understand across the board what the BECAMEX development company (see above) expressed so clearly: when workers are embedded in a social network, they are less likely to pack up and leave on a whim or for a minute increase in salary elsewhere. Two Dong Nai companies put an interesting new spin on this idea. They provide allowances to the families of the workers rather than (or on top of) the workers themselves. The worker has a strong social obligation to remit money to the family and accept great deprivations to avoid disappointing family members. But sending a part of the already meager salary home every month must be a difficult and not a pleasurable experience. When the factory provides allowances directly to the family, the frustration that comes with losing part of the paycheck every month is reduced, the family obligations met and the worker gets a sense of accomplishment when the family believes that s/he has become so important to the factory that it is willing to support the family. Furthermore, quitting would mean not only giving up one's own income, but also cutting off a steady income flow to the family.

The last point that elicits a commentary concerns strikes. Ten companies suggested to government that strikes be prevented or dealt with more strictly, and one said the government should create unions that truly represent the workers.[88] The

[88] This could imply two things: First, current unions are just rabble rousers, or second, if unions were stronger, they could make reasonable demands early on, wage levels would be adapted and companies would not always face difficult decisions about raising wages and allowances at the risk of falling behind less generous competitors. Unions in Vietnam are extremely weak and fully under the control of the Fatherland Front. Strikes are illegal and never called by unions. The second interpretation is thus the more likely.

suggestions about higher wages and more social services conflict with demands to oppress strikes more severely, but are regularly made by the same firms. One can presume that the companies are willing to pay their workers a better wage and higher allowances and are asking government to regulate in that direction, but in exchange for a tougher government response when things go wrong. Since numerous companies mentioned stability as a major reason for Vietnam's attractiveness as a business location, it follows that companies dislike the insecurity of wildcat strikes numbering in the hundreds. We discuss the issue of strikes in the concluding section, which looks at the results of interviews and survey through the angle of the reality on the ground in Vietnam.

8.4. Conclusion – Social Reality

As we have seen, the perceptions of priorities are closely aligned between regulators and industrial park operators, and vary slightly between the former two and factories in the industrial parks. This is probably due to their level of contact and their interests. Regulators and park operators depend on the reputation of their province for success, while factories have shorter-term and more individual, less province-spanning profit motives. As a result, regulators and park operators are in closer and more constant contact and elaborate strategies together – at least in the most successful provinces. It is no surprise, then, that they read from the same script. All three interest groups depend on social realities on the ground, and these realities have been identified by all three.

Workers come to the investment poles for work. There is little illusion about the quality of life they will find. A survey finds that 40% say their housing conditions are worse after migration(GSO and UNFPA 2005: 3-4), but most liked their job and income situation better in the industrial areas, as Table 8.3. shows.

Table 8.3. Selected results of the living conditions survey

Working Conditions		Income	
72%	working conditions better	73%	income has improved
7%	working conditions much better	6%	income improved a lot
3%	conditions became worse	4%	worse income
13%	conditions stayed the same	13%	income stayed the same
Housing Conditions		Education	
37%	housing situation say worse	24%	education improved
2%	much worse	65%	education stayed the same
33%	housing has improved		
2%	much better		

Source: UNFA 2006: 61-62

A study of the garment and footwear industry found that workers stay in their jobs for an average of five years (ActionAid 2005: 1). In the same study, 25% of workers in Ha Noi and 30% in Ho Chi Minh City indicated they would like to return home in the near future (Ibid: 19). Following the research for this study, inflation picked up significantly in Vietnam, and the social conditions changed as wages were eroded by increasing prices, which were most pronounced for food items. Naturally, since migrants moved not for the overall improvement in quality of life but for the job and the income, erosion of income gains also reduced overall satisfaction with the move. The result was a sudden and significant uptick in strikes. In spring of 2007, 30,000 workers went on a series of strikes (Agence France Press 2007). In the spring of 2008, with inflation near 10%, tens of thousands of workers struck again in wildcats strikes. The newspaper Lao

Dong (Labor) reports 1,000 strikes between 1995 and the end of January 2006, and 541 strikes involving over 350,000 participants took place in 2006 (Lao Dong 2008b: 4). Inflation kept rising, and in May 2011 reached 17.5%. The number of strikes for the first quarter of the year was 220, compared to 216 for the entire year 2010 (Agence France Press 2011). Companies then told newspapers that they were concerned with the decline in business-labor relations and that double-digit wage inflation and increasing risk of labor action are undercutting the reasons why they invested in Vietnam in the first place – a low-cost, low-risk business environment.

The most revealing result of these strikes is the reaction of the authorities. The state union represents all workers and authorized strikes are non-existent. Instead of cracking down on the strikers for upsetting social peace and the cherished stability, the government reacted by first standing back, then raising the minimum wage in foreign-owned companies repeatedly, from VND540,000 to VND800,000, from VND580,000 to VND900,000 and from VND620,000 to VND1,000,000, depending on their locations[89] (Lao Dong 2008a). Similarly, the government altered its position on providing services to workers long considered to be a government prerogative. According to the United Nations Development Program at the time, Vietnam's government used to discourage companies from building worker housing. Unlike China, the Vietnamese government tried to stay in control of housing construction, possibly to limit the control of foreign businesses over their citizenry (Pincus 2007). As the previous sections have pointed out, this attitude has been completely reversed. The

89 Foreign firms are obligated to pay significantly higher wages than domestic ones, and legal minimum wage levels vary regionally by cost of living.

social reality in Vietnam includes a high concentration of formal-sector jobs and under-employment in rural areas. This leads to migration – voluntary in the sense that migrants make their decisions based on a cost-benefit calculus, reluctant based on cultural norms that value proximity to family and birth place. Vietnam's boom has caused significant inflation,[90] which is eroding the financial gains from migrating. Migrants need to be able to afford to live in the investment magnet provinces. Political leaders on the national and provincial level recognize this reality, as do businesses and business park operators. Interviews and surveys indicate no race to the bottom in which elites try to appropriate surplus while short-changing workers. At least in provinces with strong investment performance, the need to improve public goods provision and social services is recognized, as is the need for all actors to do their part. Laggard provinces are less focused on a problem that they do not yet have and that, after all, is to their near-term benefit. Assumption 4 focused on the relationship between investors and their workers in rich provinces, and the interviews and survey substantiated the claim that a harmony of interest between workers and employers exists, which leads to better voluntary provision of benefits and active lobbying for more worker protection and social services, not less.

Implementation of the commonly agreed principles is uneven. All reported strikes hit East Asian companies, and American and European chambers of commerce have reported that none of their members have been affected. Cultural reasons are the likely causes – Asian companies demand more submission to the common good and are

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[90] Inflation has passed 20% in early 2011 and is considered the most pressing issue in Vietnam. Most analyses consider the cause for inflation the excessive investment in inefficient state-owned enterprises.

“harsher” to their workers (in the words of one Asian survey respondent) than their Western counterparts. Most strikes were over both salaries and working conditions, such as overly demanding (and even brutal) foremen. The knowledge that workers are needed paired with the fear of a competitive disadvantage from unilateral wage increases or improvement of conditions in a very competitive export processing sector have led to the counter-intuitive calls for more government regulations, higher minimum wages and stricter inspection regimes. Obviously, entrepreneurs understand the need to be protected from their lower instincts. A race to the bottom seems perfectly within the nature of the economic system, but the harmony of interest among interest groups in the current economic conditions is, so far, prevailing. As one early study has pointed out, Binh Duong pioneered worker housing *after* it became a pole for foreign investment in the 1990s, and has been pushing this and similar pro-worker policies since (Vietnam Investment Review 1999, in Malesky 2004b).

In the next chapter, we evaluate the last remaining harmony of interest, that between local and central political elites. We started our investigation with a puzzle: Why would a strong one-party state voluntarily reduce its power? After explaining a number of important economic reasons why changes became necessary, we discussed the dual subordination problem. The next chapter shows that there exists a harmony of interest not only between elites and citizens and between political and economic elites, but also between elites at various levels of government.

CHAPTER 9: CENTRAL-LOCAL HARMONY OF POLITICAL CONTROL

In Chapters 5 through 8, we have proposed a harmony of interest between investors and local governments in both investment-rich and investment-poor provinces, between workers and their home province, between workers and the immigration-receiving provinces, and between workers and investors. What remains to be explained is why the central and local governments do not rapidly develop competing interests, as political theory predicts. Rich provinces, bolstered by their economic power, should demand increasing autonomy to the point of secession[91] (for example Bebler 1993). The center, fearing the loss of control over increasingly autonomous provinces, could be expected to rein in the fence breaking which, as we have seen, is the root of much of the provinces' increased autonomy. On the other side of the coin, why do provincial leaders self-limit their push for autonomy at the same time as central leaders self-limit their desire for control? It would appear that both sides act irrationally in giving more than needed as far as the center is concerned, and in not taking as much as possible from the provinces' point of view.

In response to these questions, we have formulated Assumption 5, which proposes a harmony-of-interest that makes it in fact rational for both sides to limit their powers in the short run for benefits in the longer run. Assumption 5 states:

Politicians in provinces with high levels of tax transfers to the central

91 It could be objected that secession is an extreme form, and 'centrifugal forces theory' or 'autonomy theory' would be more accurate. The end point of a continuum between central power on one end and increased autonomy on the other is, however, secession. Hence, secessionist theory is the appropriate term.

> *government enjoy better career opportunities regardless of their obedience to central government rules.* The central government grants autonomy to successful provinces that pay into the federal budget. The center then uses the surplus provinces' money to allocate resources to laggard provinces to assure political peace. This indicates that the center recognizes the harmony of interest in the 'autonomy-for-transfers' trade, since it accepts and even rewards successful rule breaking rather than obedience to central government edicts.

Since the poor provinces enjoy political power (greater numbers), they will allow their rich counterparts increased autonomy only as long as the rich are willing to provide the money for fiscal transfers to the poor. Since the center depends on the surplus provinces for its income and its ability to pay off poorer provinces, political leaders in surplus provinces can successfully claim autonomy and career advancements in return for continued or increasing revenue transfers to the center, which passes them on to the poor provinces. The rich provinces provide benefits to themselves, the center and the poor provinces, making it in everybody's interest to allow them to do well. This 'autonomy-for-transfers' trade is bounded on both ends. If a province demands too much autonomy and is no longer useful for the center, its leaders have lost their influence. When the center cracks down on successful provinces and reduces their competitiveness in the process, the center hurts itself as much as it hurts the provincial leaders. Table 9.1. charts the mutual benefits for all parties in one matrix. The harmony-of-interest theory predicts that political leaders from rich provinces will defy central government doctrine and become more influential in the central government, thus bringing about permanent change in center-periphery arrangements, but without the centrifugal or even secessionist tendencies that theory predicts.

Table 9.1. Harmony of interest among political elite groups

		provides to		
		Central Gvt	Rich Provinces	Poor Provinces
obtains from	Central Gvt	--	tax transfers allegiance	allegiance (through fiscal transfers)
	High-Investment (Rich) Provinces	autonomy political protection (against poor province demands)	--	migrants
	Low-Investment (Poor) Provinces	fiscal transfers	*fiscal transfer (via center)*	--

In the following, we discuss (section 9.1.) the theory on the political repercussions of uneven economic growth, provide (section 9.2.) a Chinese case study to illustrate what the secessionist theory holds, and analyze (Section 9.3.) how Vietnam holds up in light of the competing harmony-of-interest and secessionist views.

9.1. Devolution and Political Control

In Chapter 2, we introduced the literature on decentralization and devolution, federalism and the game-theoretical approach by which behaviors of self-interested elites can be modeled. Here we apply this literature to the investigation why political elites do not see it in their interest to defect from the bargain they have with other, competing elites at different levels of government. Theory predicts that as a country opens to international trade, some regions gain (both in absolute terms and relative to others) while others lose (if not in absolute, so at least in relative terms). As these regions earn more money on international markets, they become less dependent on other domestic actors. Therefore, successful international economic integration is hypothesized to lead to centrifugal forces that reduce the power of the central government and *can* in extreme cases lead to the disintegration of the state, as the periphery spins out of the orbit of the central government (Alesina and Spolaore 1997; Hiscox 2003). Recent research on China, however, contests this assumption. Sheng (2007) suggests that Beijing has maintained control through its power to promote and demote. The central government may depend economically on successful provinces for its fiscal well being, but local officials remain dependent on the center for their careers. The central government's ability to make or break career advancement is a powerful incentive for provincial leaders to toe the Party's line, not least because rent-seeking opportunities are directly associated with political government positions controlled by the central government.

Sheng's analysis is, of course, not the only possible response to the puzzle why Beijing managed to stay in control. We use it here because it represents the opposite view of the one proposed in tis study. Sheng's describes a principal-agent problem, in which the principal, the central government, tries to control the agents, who in turn attempt to carve out autonomous space for themselves. This is a conflict-of-interest view, in which power is used to impose one's will over other agents. By contrast, the harmony-of-interest perspective envisions not a center imposing its will by promoting only obedient leaders to higher positions; instead, the center maintains a credible threat of punishment but exercises its powers only where fence-breaking reforms fail or the fence breakers move outside the bounds within which all sides win. Where they succeed and contribute to the common good in the process, the center enshrines successful fence breaking into law, legalizing it *ex post*. Most importantly, in Vietnam, successful fence breakers were elevated to the country's top political positions. By letting local leaders experiment without central participation,[92] failure could be blamed on a wayward local leader who was in breach of the Party's guidelines and official doctrine. Failed fence breakers are routinely demoted.

The already discussed devolution of political power to the provinces is key to understanding the harmony of interest between the Party structures in Ha Noi and the provinces. Vietnam's political unipolarity contrasts with economic decentralization. Provinces act as agents for the central government in law enforcement and tax collection, but they also make a large number of independent decisions in the economic realm. Most significantly, the licensing process for foreign investment has progressively been taken over by the provinces, first in extra-legal fence breaking, which was later legalized in various decentralization laws. In their latest iteration, decentralization rules give the province full authority to license any investment project without capital limits as long as the project is not part of a short list of central prerogatives.

The next section will provide an overview over the fence-breaking activities that led to this decentralizating changes initiated by entrepreneurial local leaders in defiance of existing law and Party doctrine. Thereafter, we discuss Sheng's analysis of China's mechanisms of central political control, since it represents the counter-hypothesis to the harmony-of-interest theory that we advance. We contrast Sheng's conclusions[93] to the situation in Vietnam, with emphasis on the political success of fence breakers in provincial governments. This contrast allows us to evaluate the plausibility that the

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92 This is a key difference to China's reforms, which were centrally managed by the center in the early stages. See Chapter 4 for more on this difference.

93 We do not discuss Sheng's position in the Chinese context. His work is only used as a contrasting hypothesis for the harmony of interest we hypothesize in Vietnam.

principal-agent view, which is based on a conflict-of-interest foundation, applies in Vietnam, versus the harmony-of-interest assumption this study has put forward. We show that in Vietnam, *provincial officials can push for autonomy without paying a political price, but only as long as they can make a credible case that the center and the other provinces are also benefiting from the increased autonomy of some*.

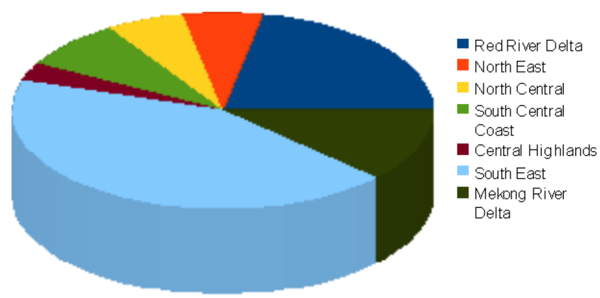
9.1.1. Regional differences and shifts in political influence

Due to the uneven development strategy of *doi moi*, which favored some regions over others, regional income differences are stark. The average difference between the richest region (Southeast) and the poorest (Northwest) grew from 2.1 times in 1996 to 2.5 times in 1999 and 3.1 times in 2002 (GSO and UNFPA 2006: 10). The reason for this policy is that Vietnam's government began to court foreign investment shortly after initiating the *doi moi* reforms, first to produce goods for which a domestic shortage existed, later for export production. The country had neither the resources to develop infrastructure evenly, nor could it build industrial clusters all over the large country from the outset. The focus on a few early investment poles proved a successful approach. Within a decade of *doi moi* reforms, foreign direct investment flows increased from virtually inexistent to $8.6 billion in 1996, making Vietnam the world's second-biggest recipient of foreign capital by share of gross domestic product (World Bank 1997). Commitments between 1988 and 1998 totaled $35 billion for over 2,500 projects (Mai 2004: 22).

As a result of this intentional policy of regional focus, economic success, and particularly success in attracting foreign investors, is highly concentrated. Between

1988 and 1998, Ho Chi Minh City in the Southeast region and Ha Noi and the port city of Hai Phong in the Red River Delta region received a cumulative 54.7% of committed foreign investment capital. Binh Duong and Dong Nai, two provinces adjacent to Ho Chi Minh City in the Southeast region, were investment poles as well. The other five regions combined received less than 20% of foreign capital, and the Central Highlands received 0.2% (Mai 2004: 101-4). This economic strength and concentrated tax contributions gave provincial leaders influence in Ha Noi.

Figure 9.1. Distribution of Industrial Parks by Region



Red River Delta	22%	Central Highlands	3%
Northeast	6%	Southeast	43%
North Central	6%	Mekong River Delta	12%
South Central Coast	8%		

Source: Ministry of Planning and Investment 2007

The second decade of *doi moi* brought with it a significant acceleration of economic performance. Total stock of committed foreign investment between 1986 and 2008 had grown to some $98 billion, across 9,800 approved projects (Kieu 2008); 8,600 projects were operational (Chinanet 2008). In 2008 alone, the country expected $20 billion in new commitments prior to the onset of the global financial crisis.[94] This decade is also

94 The 2008 global economic crisis has made a dent in implementation of committed funds. This is the case around the world, and Vietnam has fared better than many others. It's economy grew at just over 5% in 2009, while Malaysia's for example, contracted by a similar percentage. Since the global

associated with export-oriented foreign investment, improved regulations and tax incentives for exporters and the creation of dozens of export processing zones. At the end of 1999, 14 export processing zone projects had been approved (Mai 2004: 43); today they number is over 100. Figure 9.1. (also shown in Chapter 6 in different context) shows the concentration of these zones graphically.

A comparison of investment capital concentration in Figure 9.1. and tax contributions in Table 9.2. shows a clear correlation between these two variables. Eleven out of 63 provinces sent money to Ha Noi, while the rest retained their tax revenue and received various amounts of transfer payments to balance the provincial budget. These payments are not strictly formula-based, but negotiated with past economic performance and future expectations in mind. The retention rates are based on projections which themselves depend on longer-term numbers. As a result, provinces that obtain one mega-project (often in resource extraction, or petrochemical plant, or infrastructure) may retain 100% of their tax revenue in spite of an impressive investment capital in one year. Moreover, these numbers reflect licensed projects, some of which will not materialize. Yet it is clear that the consistent top performers, Ho Chi Minh City, Ha Noi, Binh Duong, Dong Nai and Ba Ria-Vung Tau, also deserve credit for most of the central government's tax revenues (and indirectly for the fiscal transfers the poorer provinces receive). Beyond the numbers, Ha Noi is the political capital that draws much of its investment numbers from political power (financial services, for example, incorporate in Ha Noi to be close to the regulators, then conduct their business

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economic crisis is a non-systemic event and unrelated to Vietnam's economic policies, its impacts are not analyzed in this paper.

in the financial center of Ho Chi Minh City).

Table 9.2. Foreign direct investment and tax revenue retention rate of successful provinces

Province	# of projects/$mio 2008	2008 % of tax revenue retained in the province		Province	# of projects/$mio 2008	2008 % of tax revenue retained in the province
Ha Noi	218/3,151	31		Quang Nam	0	
Vinh Phuc	18/154	67		Quang Ngai	1/2,460	
Bac Ninh	31/984	*		Binh Dinh	1/<1	
Quang Ninh	11/181	76		Phu Yen	1/4,346	
Hai Duong	40/367			Khanh Hoa	2/127	53
Hai Phong	31/311	90		Ninh Thuan	2/9,800	
Hung Yen	24/97			Binh Thuan	9/435	
Thai Binh	0			Kon Tum	1/67	
Ha Nam	2/30			Gia Lai	0	
Nam Dinh	3/22			Dak Lak	0	
Ninh Binh	4/39			Dak Nong	0	
Ha Giang	0			Lam Dong	18/84	
Cao Bang	1/4			Binh Phuoc	1/1	
Bac Kan	0			Tay Ninh	16/113	
Tuyen Quang	1/20			Binh Duong	127/1,026	40
Lao Cai	3/11			Dong Nai	45/1,929	45
Yen Bai	1/3			Ba Ria-VT	4/9,276	46
Thai Nguyen	0			Ho Chi Minh	418/9,072	26
Lang Son	2/31			Long An	65/929	
Bac Giang	11/66			Tien Giang	2/14	
Phu Tho	0			Ben Tre	2/8	
Hoa Binh	6/13			Tra Vinh	2/17	
Dien Bien	0			Vinh Long	0	
Lai Chau	0			Dong Thap	0	
Son La	0			An Giang	1/2	
Thanh Hoa	5/6,211			Kien Giang	2/2,304	
Nghe An	0			Can Tho	4/540	96
Ha Tinh	1/7,879			Hau Giang	0	
Quang Binh	0			Soc Trang	1/5	
Quang Tri	0			Bac Lieu	0	
Thua Thien-Hue	12/1,096			Ca Mau	0	
Da Nang	17/602	90				

Sources: Statistical Yearbook 2008 (investment), Ministry of Finance (tax retention)

* Retention is 100% where blank

Ho Chi Minh City, Binh Duong, Dong Nai and Ba Ria-Vung Tau were granted the earliest investment licenses and have as a result incurred the greatest risk of jealousy by other, less fortunate provinces. Fiscal redistribution in Vietnam is a highly political dance that aims at maintaining a balance between economic privilege and the responsibility to share with the rest of the country. By funding the central government, investment-rich provinces have more bargaining power when they push for more autonomy or policy changes. Provincial policy autonomy was not given by Ha Noi but taken by provincial leaders. Provincial leaders have wrestled away *economic* decision-making powers from the center as their economies grew and provided more resources to the central state. The early success stories pushed the envelope, with the support of foreign investors, who enjoyed the improved business climate. The argument was that since investors like what they get, any push-back from the center would lead to reduced competitiveness not only of these provinces, but of Vietnam overall.

In the following section, we look at the history of fence breaking and show that it is a bottom-up activity initiated by local leaders with an interest in improving their position. We see that the central government is inherently not favorably disposed toward local leaders who break the rules of the Party, but where the overall aim of the Party is furthered (reducing dissent, staying in power), the Party tacitly accepts the rule changes and even promotes the successful fence breakers. As these fence breakers move into positions of power, they bring their ideas with them and tolerated but illegal policies are sanctioned by law *ex post facto*. The harmony of interest between successful leaders in the province and in the center is shown by the fact that the center tolerates and even promotes the fence breakers who provide more fiscal transfers to the center, as long as they do not challenge the political supremacy of the Party. The provincial leaders have no interest in challenging that political supremacy, from which they get their coercive power.

9.1.2. Fence breaking

In the beginning of this chapter, we have juxtaposed a principal-agent view, which is based on a conflict of interest between central and provincial political leaders, and the harmony-of-interest theory. Before we compare and contrast the Vietnamese and Chinese cases further, Vietnamese fence breaking needs to be described in order to support the claim that in Vietnam, provincial economic policy autonomy was *not granted* by the center, but *taken* by entrepreneurial local officials.

One of the earliest known examples of fence-breaking reforms dates back to 1962. Local district officials in Kien Thuy (Kien An province) introduced an illegal contract system for agricultural products to improve food availability. When the provincial leadership learned about it, it first forbade it, but then decided to let the 'experiment' continue. As success became evident, the experiment was legalized by decree. Policy followed success, and doctrine took second stage to the market (Phong 2004: 29).

In 1978, Ho Chi Minh City ran low on food, and officials wondered why nearby An Giang province, a rice basket, was not sending more rice to the city. The People's Committee Chairman and Politburo member Vo Van Kiet sent a procurement official, Nguyen Thi Thi (who became famous under the nickname Ba Thi – grandmother Thi) to An Giang. She reported that she could obtain more rice, but not at the purchase price set by law. Kiet reportedly told her to get the rice; should she be sent to prison, he, Kiet, would bring her rice to her cell. Ho Chi Minh City received the rice, its population was fed, Ba Thi stayed out of jail, Kiet became prime minister and a chain reaction ensued, with rice being sold everywhere at the new price that Ba Thi had been paying in An Giang (Ibid: 30-1).

In 1977, local leaders in Long An province found the two-price system cumbersome and wanted to pay market prices only. But the Politburo member in charge of the province refused. Later, provincial leaders lobbied a higher-level official, known to be more pragmatic, and got his consent. Nearly all goods in Long An were henceforth sold at market prices, effectively abolishing the state price system. Other provincial leaders visited to study Long An's experience. Because of that countrywide interest, even the conservatives had to let the experiment go forward. As hardship increased and problems seemed to be solved best by innovative ideas, these ideas took over and more and more leaders changed their position. The rest were removed (Ibid: 33-5).

At the Sixth Party Congress in December 1986, key reform policies were now written into national law, including the principle of a multi-sectoral economy, the acceptance of private enterprise[95] and foreign investment, a market economy for a number of commodities, and concentration on certain spearhead sectors of the economy where great need existed. But fence breaking did not stop there. It continued into the

95 This is not to say that these communist officials were inherently advocates of capitalism; yet they understood the shortcomings of the existing system and were pragmatic in trying new approaches in solving the problems they faced.

new economy, where officials now pushed for autonomy on how best to navigate the new, competitive environment and make the most of the opportunities it provided.

Following the Chinese model, the government first restricted the free market model geographically to the southern part of the country, far away from the political center. The Southeast had a fairly recent history of capitalism and could be blamed for reactionary tendencies in case the experiment failed. In the early stages of *doi moi*, the central government licensed all new investments, and placed the vast majority of them in Ho Chi Minh City and the adjacent provinces of Binh Duong and Dong Nai. Provinces had no say in the matter of licensing and locating projects, and could at best lobby the investors to request being located in one province rather than another. After initial success, these three main beneficiaries of foreign direct investment began to push the envelope and started to license investors themselves. Ha Noi had become accustomed to the revenue from the southern growth triangle and refrained from cracking down. Policies like 'one door – one stop' for licensing began as extra-legal experiments in Binh Duong province and Ho Chi Minh City. Neighboring provinces complained about the competitive advantage Ho Chi Minh City and Binh Duong enjoyed with foreign investors and began to license projects illegally as well. Ha Noi first criticized this fence breaking in the official newspapers, but then legalized it in Ho Chi Minh City in 1994. Now at an official disadvantage, Binh Duong continued licensing investors without Ha Noi's permission. Later, the law was changed to let all provinces license investment up to a certain capital threshold. The *New Foreign Investment Law* of 1996 authorized Ho Chi Minh City and Ha Noi to license projects with a value of up to $10 million directly; other provinces could license projects worth up to $5 million. Again, licenses for larger amounts were granted. Also in the South, some provinces violated customs laws to provide intermediary goods for manufacturing firms. No leaders were punished (Malesky 2004a: 181-82).

More obvious an indication that success leads to enhanced bargaining power is associated with land sales in the early 1990s. Land availability represents a bottleneck for development and a large source of rent for local officials. When local officials converted agricultural land to industrial purposes, some leaders were punished; others got away with it. Yet all of those punished were from economically less successful provinces, while similar activities by officials from Ho Chi Minh City, Song Be (now Binh Duong) or Dong Nai were not pursued (Ibid: 176).

The history of fence breaking and the spotty record on cracking down indicates that the center recognized its interest and put pragmatism over doctrine. The Party may not have appreciated the devolution of power, but it recognized that it was in their own interest to accept the rise of the province. Successful provinces paid the taxes that allowed the Party to make the transfer payments that maintain social cohesion and keep the population content. The Party has bet its legitimacy on improving regular people's lot, and the successful fence breakers had given them the means to do so.

This harmony-of-interest explanation of Vietnam's power relations between center and province is diametrically opposed to the conflictual view Sheng (2007) offers in his case study on China. He argues that in China, the provinces are kept in line through central government power – the power over appointments and careers of local officials. We review his argument in the next section. Finally, we compare Sheng's proposition to the situation in Vietnam.

9.2. The Principal-Agent Approach – China's Case

In his research on Beijing's means to maintain control over the rapidly developing coastal provinces, Sheng (2007) starts with the theory that in a period of trade opening, regions that are successful in trade and investment integration will seek more autonomy from the center, on which they now depend less. The interest of the province is to gain increasing amounts of autonomy (the ultimate, if hypothetical, end stage of which would be independence). The interest of the center is to maintain as much control as possible. This is a classical principal-agent situation, comparable to the imperial form of control, where the center maintains control by sending mandarins into the provinces to enforce the emperor's will against local groups whose interest diverges from that of the court in the capital.

In the modern world, the center equally relates to agents whose interests do not converge with those of the central elite. The principal imposes himself, in Sheng's view of the Chinese case, by its power of promotion and demotion. Sheng proposes a concept of "bureaucratic integration," which holds that Beijing sends officials with strong ties to the center (through past assignments, for example) to the wealthy provinces. These officials see their fate intertwined more with careers in the central Party than in a province to which they have little allegiance. He tests this hypothesis by assigning a "bureaucratic integration value" to provinces depending on the level of experience in central government by the provincial leadership. The assumption is that leaders with a close relationship to Beijing will do Beijing's bidding, and that Beijing will thus send most integrated leaders to the provinces that are most likely to seek more autonomy – in our case the provinces that are most internationally integrated.[96]

Sheng identifies three actors: winner regions that gained from economic opening, loser regions and central government. Winner regions strive for more independence in order to keep more of their monetary benefits from economic growth in the region, loser regions for more policy authority to return to a more protected market again in which they no longer would be losers relative to the others. The center's interest is in maintaining power over a unified country Sheng tries to show that Beijing sends officials with strong ties to the central government to the wealthiest, most internationally integrated coastal provinces, because they are best positioned to ignore the wishes of the central government, thanks to their new wealth and the benefits they draw from the world market rather than the central treasury. These coastal provinces correspond to the investment poles around Ho Chi Minh City and the Ha Noi-Hai Phong corridor in Vietnam, plus the emerging success story of Da Nang in the center. If Sheng's divergence-of-interest hypothesis is correct, Ha Noi would be sending officials to these provinces that have a strong preference for Ha Noi's interests over those of the province. The section on fence breaking has already shown that this is not the case. Provincial officials put the interest of the province over that of the center on many

96 The assumption that having worked in Beijing creates loyalty toward the central government is assumed, but never tested. It is conceivable that an official who has worked in Beijing and did not like his experience (for example for being sent out to work into the province again) may feel antagonism toward the central bureaucracy. In the United States, for example, it is frequently a winning political argument for elected officials in the federal government to express dislike for it.

occasions. They may be doing so for a variety of reasons: to save face in the eyes of their constituents, to stay in power, or to maintain social peace, which is a prerequisite for political promotion. Moreover, more and more rent is to be gained locally, especially since land transfer fees are a major source of legitimate and illegitimate funds for local governments and their officials.

The shift in how rent can be obtained – from a central Party position or from working in a successful province, has also been evaluated in the China case. A study finds that while Sheng's conclusions have held earlier on, a realignment has taken place in more recent years. This study shows that over time, the success of the special economic zones aligned interests of actors and created an equilibrium among central government, coastal and inland provinces in which no one had a strong interest in changing the *status quo*. Simultaneously, the composition of the central party leadership changed in the 1990s. The wealthy coastal provinces began to send more officials to the top positions in Beijing as their economies took off and it became obvious that their experiments were successful. Until 1992, officials from the three municipalities Beijing, Shanghai and Tianjing as well as the biggest inland province, Sichuan, regularly served in the Politburo. Since then, the coastal provinces of Guangdong and Shandong have gained access, while Sichuan has lost luster in the central government's halls of power (Zheng 2009: 16-17). This conclusion follows closely the hypothesis we have proposed for Vietnam. It appears that in the Chinese case, the principal is becoming less and less a unitary actor, but instead agents are gaining influence within the core of the central government as their economic gains translate into a gradual increase of political power.

This is what we have proposed for Vietnam. Provincial officials act in their own interest when they engage in fence breaking; central officials act in theirs when they look the other way. The main difference to China is that China started out differently. Reforms started from the center and were managed by the center. Only slowly, over time and with significant pushing from Deng Xiaoping – for example with his Southern Tour – did reform opponents (the anti-localists) have to step back and local leaders gained more influence and became significant players in their own right. In Vietnam, by contrast, the center started reforms whose implementation was almost immediately usurped by local leaders.

This process leads to the last question in the harmony-of-interest equation, which is whether provincial officials have to pay a political price for their independence. In the next section, we investigate the career paths of the most independent-minded Vietnamese local leaders.

9.3. Political Careers in Province and Center

In contrast to the principal-agent approach, in Vietnam's harmony-of-interest scenario, economic success promotes political careers at both provincial and central levels. As the theory suggests, leaders of successful provinces push for increased autonomy, but are limited in how far they can go. As long as their success serves the interests of the less successful provinces *and* the central state as well as themselves, no group has an incentive to push back against the winning provinces, nor do the winning provinces demand more radical change. The winners can only engage in fence breaking because they know that the poor provinces and the center need them. As soon as they no longer serve the interest of the other actors, their power ends. Their fence breaking is *tolerated* because it serves the greater good of all actors – excessive demands (let alone secession) would be a break in the harmony of interest and provincial officials would be punished, as were those who broke central rules without concomitant economic success.[97]

Mygdal made the point that every state's ultimate goal is to ensure its subject's obedience; only the means to achieve this end vary (Mygdal 1997: 223). If a state can best achieve this goal by cracking down on fence breakers, it will do so. If, on the other hand, a state has bet not on repression but on legitimacy through success through steady economic improvements, the state promotes social harmony above and beyond blind obedience. In other words, it tolerates increased provincial autonomy as long as that serves its ultimate purpose: regime survival. Provincial leaders know that they can raise the stakes as long as they can demonstrate that there is a harmony of interest in which the center benefits from the arrangement. As soon as that is no longer so (as would be the case if wealthy provinces try to break away, or refuse to contribute to the central treasury), the center will see it in its interest to crack down, and the majority of poor provinces would not object, since they no longer gain from the growth of the few reform winners.

Foreign investment works as a bargaining chip for sub-national jurisdictions. Provincial leaders benefit from increased economic activity in their province in a

[97] We should note that there are other reasons than the harmony of interest why secession is unlikely. States are normative structures as well, based on historic and cultural factors.

variety of ways. They can skim wealth off the top, in the form of bribery, but also legally in the form of taxation.

Table 9.3. The Career Paths of Vietnam's Top Party Brass

Prime Ministers (between 1976 and 1992 called Chair of the Council of Ministers)		
Name	Year	Notes
Ho Chi Minh	*1954-1955*	
Pham Van Dong	*1955-1987*	
Pham Hung	*1987-1988*	*Southerner*
Vo Van Kiet	*1988-1988*	*Acting*
Do Muoi	*1988-1991*	*Doi moi leader*
Vo Van Kiet	*1991-1997*	*Doi moi leader, Southerner, HCMC Party Chair 1967-1981, reformer, turned into Party critic*
Phan Van Khai	*1997-2006*	*Fence breaker; HCMC mayor*
Nguyen Tan Dung	*2006-*	*Southerner – one of the few who spent the war years in the South*
Presidents (between 1981 and 1992 called Chair of the State Council)		
Ho Chi Minh	*1954-1969*	
Ton Duc Thang	*1969-1976*	
Ton Duc Thang	*1976-1980*	
Nguyen Huu Tho	*1980-1981*	*Acting*
Truong Chinh	*1981-1987*	
Vo Chi Cong	*1987-1992*	*Southerner*
Le Duc Anh	*1992-1997*	*Conservative*
Tran Duc Luong	*1997-2006*	
Nguyen Minh Triet	*2006-2011*	*Born in Song Be (now Binh Duong); key fence breaker; HCMC Party Chairman; stayed in South during war*
First Secretaries/General Secretaries of the Communist Party		
Tran Phu	*1930-1931*	
	1935-1936	
Le Hong Phong	*1936-1938*	
Ha Huy Tap	*1938-1940*	
	1941-1956	
Nguyen Van Cu	*1960-1986*	
Truong Chinh	*1986*	
	1986-1991	*Northerner, doi moi leader*
Le Duan	*1991-1997*	*Doi moi leader*
Truong Chinh	*1997-2001*	
	2001 -2011	*Modernizer*
Nguyen Van Linh		
Do Muoi		
Le Kha Phieu		
Nong Duc Manh		

Sources: various

They can maintain their positions of power if they are seen as successful administrators of their province. And they can obtain promotions to central level positions thanks to their performance at the provincial level. The center gains because of its ability to maintain social peace owing to its increased capability to transfer surplus money from the successful provinces into the hinterland. Local success strengthens the hand of these reformers in the provinces, but also allows reformers at the center to make their case more forcefully (Malesky 2004b: 9). The harmony of interest changes the relationship of different levels of political leadership from a classical principal-agent relation to one of game-theory partners. Neither side coerces the other to abide by rules – the rules enforce themselves as cooperation is the most beneficial outcome for all sides.

Although provinces have achieved a significant amount of economic autonomy, fence breaking continues as local officials experience problems with central regulations that are maladapted to local economic conditions. For example, provinces are pushing the envelope with respect to migration regulations. A number of provincial leaders in Ho Chi Minh City, Binh Duong and Dong Nai are outspoken in the need for updated rules to allow provinces to take the lead in improving worker housing.[98] The 'usual suspects,' that is, the most successful provinces with the bargaining power to stand up to Ha Noi and get away with it, are in the lead. Binh Duong, a province with a massive influx of migrant labor and increasing problems with rising cost of living, has piloted worker housing improvements without waiting for the center (Malesky 2004a). Other

98 Several provincial officials told the author in interviews in the fall of 2007 about the urgent need for updated legislation with respect to social services for migrants, and a couple of the high-investment ones indicated that their province was "working on the issue" although no satisfactory legislation had been passed. In a less economically powerful neighboring province, an economic official was clearly more cautious, saying that the province is urging the central government to act, but that at the moment there was nothing the province could do.

provinces in the southern growth pole are also engaging in regulatory re-arrangements that are not fully sanctioned by law or pushing against more restrictive interpretations of implementation decrees. This is happening particularly in problem areas associated directly with investor and workers satisfaction, such as infrastructure shortage and social problems of unregistered migrants (see Chapter 7 for more on the harmony of interest between local government and workers with respect to provision of social services).

Clearly, Vietnam has a strong governing party. Its power (and a strong historical narrative of central power and national unity) assures that local interests cannot entirely override national prerogatives. On the other hand, principal-agent theory and its diverging-interest view does not express the situation in Vietnam accurately. The assumption that career advancement will keep local cadres in line with central policy is not observable. On the contrary, central government careers depend on local success, but success is defined in terms of maintaining social peace and order, and paying into the central government's treasury. The most successful risers in the ranks were not those who defended Ha Noi's traditional line while on duty in the provinces, but those who challenged it effectively and achieved results that were in the interest of center and province. Recent examples include president Nguyen Minh Triet (who retired at the Party Congress of 2011 due to the legal age limitation), who started out as Party leader in Song Be province (now Binh Duong), before taking over the same position in Ho Chi Minh City. Under his reformist, fence-breaking leadership, Song Be turned from the rural hinterland of Ho Chi Minh City into one of Vietnam's top manufacturing and investment attracting hubs. Another fence breaker was Vo Van Kiet,[99] Party leader in Ho Chi Minh City. He was one of the main supporters of *doi moi*, and served as prime minister from 1991 to 1997.[100] Of the five Party leaders of Ho Chi Minh City since unification, only one, Vo Tran Chi, did not move on to a leading position in the central government. Chi, a conservative critic of market reforms, retired after his term in Ho Chi Minh City ended (Gainsborough 2004: 264). The career paths of successful officials in Vietnam follow Zheng's view (appointment to central positions of power *after* success in the province) rather than Sheng's (successful central figures are sent to the province to enforce central doctrine). The Vietnamese evidence supports the harmony-of-interest position rather than the divergence view.

Riker (1964) and Enikolopov and Zhuravskaya (2007) are correct in pointing out that a strong governing party is important to provide coordination and enforce the rules of the game (as the Party in Vietnam did when provinces began to write their own rules on tax incentives, since those would have reduced the money available for fiscal transfers). We should add the importance of a strong national purpose, which in Vietnam stems from the tumultuous history that pitted the ethnically rather homogeneous country against constant foreign invasion. But in the Vietnamese case, the pathways of control between center and province are reversed. Based on the strong sense of nationalism, all politicians must support the nation. How they do so is more a function of success in keeping their province quiet and their citizen content than a result of coercive discipline by central Party bosses. The fact that the most successful reformers are located in just a

99 Refer to the story about rice procurement, above.

100 He became a critic of the lack of political reforms – in addition to economic ones – after his tenure.

few provinces and that the national leadership has gravitated increasingly toward successful reformers has increased the power of the southern provinces in the central government. As a result, reformist ideas are taking over from two angles. First, as reforms are successful in the eyes of the people, reformist ideas cannot be brushed aside even by doctrinaire Party conservatives. But on a second front, as reformers get promoted and increasingly displace the old guard, there are fewer conservatives in the central Party to push back against reforms. As a result, Vietnam's system is likely to change. The harmony of interest that drives decision making from a purely game theoretical, self-interest perspective may give way to a more normative preference for reforms.[101] As more leaders have an international education and the dominant discourse shifts from Marxism towards market freedom, interest group calculations dynamics are likely to shift.

It is ironic for a country that has forged such strong rhetoric about the primacy of ideology that in the end, Vietnam appears to be *governed very pragmatically by success.* This is, however, the outcome predicted by the harmony-of-interest hypothesis. Following the metaphor of China's main reformist leaders, Deng Xiaoping, nobody will kill the cat as long as it catches the mice.

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[101] The harmony could be threatened if enough Party officials believed that continued economic reform will end the political primacy of the Party. The 2011 Party Congress was said to be a slide backwards toward more doctrinaire control. But the Party still believes that only continued material improvements will give them legitimacy to rule, and reformist Prime Minister Dung was re-elected by the new National Assembly.

CHAPTER 10: LESSONS FOR THEORY AND PRACTICE

Every academic study aims at informing theory and practice beyond its immediate context. Its goal is to infer from data we know information we do not know (King et al.: 46). Without such an attempt to engage in inference, empirical investigation would be journalism – a descriptive account of what happened in one unique context. A case study, then, should try to move from theory to empirical observation and back to theory, to relay an account to a broader categorization of knowledge. In this chapter, we draw lessons from the Vietnam study for political economy theory and economic development practice.

(1) We first *recapitulate* the findings from the tests of the five assumptions and place them *in the broader context* of the overall research question of this study.

(2) Second, we discuss the *generalizability* of the findings from the Vietnam case. Every case is unique, but if we ever want to build theory, we need to be able to identify what lessons can reasonably be applied beyond the immediate context in which they were identified. In this section, we also take a look at longer-term historical forces that drive our findings.

(3) Next, we move from theory to practice and discuss how Vietnam can *inform development policy* – both domestically as the country moves forward in its ongoing transformation, and in other transitional economies whose leaders and donors want to base their economic development policies onto findings from other, comparable cases.

(4) Lastly, we return to the theoretical and evaluate the impact of our findings on theory.

Since this study began with a theoretical literature on which we based our research question and our assumptions, we place our findings back into that literature and see whether and how the lessons from Vietnam can inform the various theories on which this work was built.

10.1. What the Data Show

This study is based on two initial questions: (1) does economic opening provide incentives for the coercive elites to limit predation against business, and (2) how does economic opening impact the non-elites, the working classes? In Chapter 3, we laid out a research question and formulated a hypothesis, which we then tested in Chapters 5 through 9. The research question asked how a strong state like Vietnam's could offer investors credible assurance that its coercive elites would reduce rent seeking to an acceptable level and to engage in "good enough governance" (Grindle 2004) for businesses to come, stay and strive. We hypothesized that such an outcome can only be brought about when actors (in the form of interest groups) find it in their interest to limit their rent seeking voluntarily. For this to happen, the benefits of reduced rent seeking must be distributed across all (elite)[102] interest groups in society. By contrast, in a zero-sum game, one group's gain would be another's loss, and losers would, in game-theoretical terms, defect. Each group's gains must be associated with cooperation from and with all other groups, in what amounts to a harmony of interest among these groups. Any defection must penalize the defector(s).

[102] Ideally amont all interest groups, but since elites call the shots, at least they need to benefit.

In addition to elite interests with either economic or coercive (political) power, mobility to exit (to exchange one elite for another) gives bargaining power to the non-elites. The result is that even non-elite interests have a seat at the (fictitious) bargaining table as their actions enter into the harmony-of-interest equation. The result, we have argued, is that the often assumed collusion among elite groups against the interests of the non-elites will not take place in a harmony-of-interest scenario.

The harmony of interest among interest groups was tested across five assumptions (see Chapter 3 for a list, and Chapters 5 through 9 for the tests). First, in Chapter 5 we found strong support for a *harmony of interest between political and business elites in provinces with strong economic performance*. Political elites in these provinces – that is, elites with coercive powers – are willing to limit their rent seeking in order to offer the credible commitment to good governance that investors demand in return for investing in a jurisdiction. While this sounds tautological at first, the data show a complex relationship. The provinces in highest demand from investors are not those with the across-the-board best levels of governance. If provinces reduced rent seeking as much as possible – the endpoint would be no rent seeking at all – there would be no harmony of interest, but zero-sum game in which capital wins and political power loses. Harmony of interest, by contrast, means that both parties to the game win. Capital wins by obtaining the public goods it finds most important, while political power holders are able to charge a ‘fair’ price for the provision of these public goods. According to the *Provincial Competitiveness Index*, capital wants quality governance (as measured by the index), wealth in the jurisdiction (measured in gross domestic product), larger surface area and quality infrastructure. Surface area is not controllable by government, and wealth is associated with investment not in a cause-and-effect, but in a circular way: more investment means higher gross domestic product, which leads to more investment, and so on in a self-reinforcing spiral. Governance and infrastructure are functions of political will, however, and it shows that the top-invested provinces tend to be in the upper part of the governance and infrastructure ranking. We also find indicators of path dependency. Once a province attracts a lot of investment, it can engage in more rent seeking without losing investment. No province at the bottom of the governance ranking receives high levels of investment.

In Chapter 6, we investigate the assumption that *proximity* between laggard and successful provinces *will force the laggards to reform to avoid out-migration* of their citizens, workers, taxpayers and entrepreneurs to the more successful, better governed neighbors. In the analysis, clusters of good governance are visible around the southern growth pole of Ho Chi Minh City, Dong Nai and Binh Duong, the northern investment magnet of Ha Noi and increasingly around the central province of Da Nang, which leads the governance rankings and is beginning to attract investment. Moreover, the time series comparison, although available for the short period of the annual publication of the *Provincial Competitiveness Index* between 2006 and 2009 only, shows clear evidence that proximity to provinces that attract investment early on leads to reforms in economic governance among neighbors (see Figures 6.7. and 6.8.). While we have hypothesized the causal links between catch-up reforms and proximity, the data are not sufficient to make a clear determination about the rationale for changes. The harmony of interest in this chapter is between provincial elites in laggard provinces – those that have not attracted much investment in the early reform years – and their residents. Assumption 2 states that elites do not want to see their residents leave to a wealthier province and will do what it takes to prevent massive outflows. The closer a laggard province is to a successful one, the lower are the migration costs of migration, and as a result proximity to a successful province will lead to a need to reform in the laggard province as well.

While this assumption remains entirely plausible and consistent with the data, alternative possibilities exist. The Vietnamese fiscal system rewards provinces with phantom residents (those who are registered in a province but live and obtain social services elsewhere). Such a transfer system weakens the interest of a laggard province to catch up, at least with regards to the cause provided in the assumption: the prevention of out-migration. Another possible explanation is that laggards near a successful province do not reform to retain residents, but in the expectation of attracting overflow investment from the neighbor. In either case, the data show clearly that the reforms in laggard provinces occur in the way predicted by the theory, and that migration follows the predicted patterns.

The data also imply a problem with multicollinearity, insofar as poor provinces are often poor *because* they are far away from early growth poles. Any analysis of distance and quality of governance is complicated by the associated correlation between distance and poverty, with poverty itself correlated with lower likelihood of governance reforms. This problem will be discussed further in 10.2.1.

In Chapter 7 we tested the assumption that *provincial elites in provinces with high investment would support their working classes* (rather than engaging in predation against them) to *assure an adequate supply of labor in the province*. The data show that indeed, more investment is associated with less poverty among all social strata. Such an outcome is consistent with the harmony-of-interest assumption, but could be caused by other factors as well. Not in keeping with Assumption 3, quantitative data on social service provision show that some of the provinces with high governance scores in the *Provincial Competitiveness Index* provide fewer public goods than those scoring lower on the PCI. Such an outcome suggests a race to the bottom, in which businesses in government collude against non-elite interest groups to gain rent at the expense of the rest of society. The data show, however, that low population density is associated with *both better social service provision and lower PCI score*. Controlling for population density, a higher PCI score in densely populated provinces is associated with better social services, as our hypothesis implied. It appears that the government provides quantitatively more social services in provinces with dispersed populations; that these provinces are also poor; and that these poor provinces with low population density also exhibit a lower quality of governance. Low population density and poverty tend to go hand in hand, and predate low quality of governance. It is thus likely that causality runs from low population density to poverty to high quantity of social services, without intervention by quality of governance.

To add to the discussion of causality, we added another test, a survey of residents in which they are asked about their perception of the quality of social services. The

Provincial Governance and Public Administration Performance Index 2010 aims at identifying the subjective perception of quality of governance similar to the *Provincial Competitiveness Index*, but from the point of view of regular citizens, not entrepreneurs. *If collusion between business and government took place to allocate resources away from regular citizens, we would have to see perceptions of the quality of governance diverge starkly.* Entrepreneurs, who are colluding and benefiting from the collusion with the governing elites, would have to rank the quality of governance highly, while regular citizens should feel dissatisfied. This is true for the case of Da Nang, which is top-ranked for business climate, but ranked lowly by its residents. Overall, however, the correlation between PCI and PAPI is positive, indicating that residents and entrepreneurs generally agree on the quality of governance in their province.

Importantly, the sub-index on infrastructure is very highly correlated. This is a sign that the surveys are indeed measuring quality of governance in a comparable manner, for the following reason: It is possible that a province extends good services to businesses while wrapping its regular citizens in red tape. On the other hand, it is difficult to imagine how a province would provide quality roads only for business. Infrastructure is an indicator measure, and the similarity in responses in the two surveys suggests that their methodologies are compatible.

Chapter 8 adds more qualitative testing. It evaluates, through interviews and surveys of businesses, business park operators and the provincial officials charged with promoting investment how they perceive the factor labor and what policies they propose with regards to attracting and retaining workers. Assumption 4 says that under the harmony-of-interest theory, *employers would not push for the lowest labor standards, wage levels and social wages* (which have to be paid by taxes, in the end). Instead, they *should understand the mutual interest in providing workers with livable conditions* (another form of "good enough") *to maintain quality and quantity of human capital*. The interviews and surveys show that Assumption 4 holds.

In Chapter 9, finally, we investigate what *devolution of power* does for the *cohesion of the national government and the ruling party*. Technically, the chapter tests the hypothesis made in political science that international trade integration can reduce the power of the central government, as local political elites in globally integrated jurisdictions depend less on the center and more on the benefits they reap from foreign investments and international markets for their rewards.

The chapter also ties together the harmony-of-interest assumption that was advanced in the foundation of this study. The spark for reforms, the first active decision taken by the one dominant actor at the beginning of the game (in this game-theoretical approach), is the decision by the all-powerful central government to let fence breaking happen. The center saw it in its interest to let provincial leaders forge ahead – and also sideways, outside the bounds of the law. Provincial leaders would not have broken fences had they not considered it in their interest to do so. Hence, the harmony of interest between central and provincial leaders should be considered the first move in the game which is the theoretical foundation of this study.

The evidence in Chapter 9 is unequivocal. Investors, business park managers and government officials charged with investment support are aware of the importance of the factor labor in the economic development of the province and are pushing for policies to improve workers' living conditions. The responses also make clear that they do so not out of humanitarian sentiments, but based on self interest. Companies ask for increases in minimum wage and better government social services, but they are not willing to provide benefits without government requirements. Doing so could put them on a competitive disadvantage compared to companies that do not follow suit.

In final conclusion, the harmony-of-interest theory is supported by the data, although not all causal chains can be substantiated. Looking across sub-indices, the picture is mixed, but supportive of the assertion made in the theory: *elites self-limit their predatory powers out of self interest*. They want to obtain rent from their behavior, hence, when the situation is conducive, they will engage in rent seeking. Governing elites always want a pay-off. They make choices as to how to obtain it, and whether they feel better served by long-term or short-term predation. One logical consequence is that over-performers are not least corrupt. Leaders want to be compensated for their good performance, and investors are willing to pay for it. Grindle's "good enough governance" (Grindle 2004) is a good representation of Vietnam's reforms. The model provinces are models of enlightened, pro-business policies not in absolute terms of perfect governance, but only in comparison to other jurisdictions and to their own past. The success of Vietnam's model is that it has reduced rent seeking enough to keep all parties happy, as evidenced by the self-limitation of powerful coercive elites on one hand, and the willingness of investors to keep putting their money into certain locations on the other.

The often predicted race to the bottom is not taking place. In the richest provinces, elite groups do not collude with each other against non-elite interests. Public goods provision and social services are better there than in the poorer provinces when controlled for other factors, like population density. A recent trend adds to the evidence. Obesity, not a problem in the past, is becoming a health concern that has sparked research. The highest obesity rates are found in Ho Chi Minh City (32.5%) and regionally in the Southeast (13.7%), the highest rates among the regions. Surveys have shown that these rates are the result of recent increases in the consumption of meat, which for cost reasons used to be limited to rare or special occasions (Vietnam News Agency 2007).

One more explanation why a race to the bottom would not be beneficial for Vietnam lies in its fiscal arrangements. Provinces cannot set tax rates, hence they are not able to offer tax incentives or tax holidays above those decided by Ha Noi. In the United States, for example, where states have broad taxation authority, some states are offering substantial tax holidays to investors. Revenue losses must then be made up by the rest of the taxpaying public, lest they lead to a reduction in public services. The Mercedes automobile plant investment in Alabama, for example, cost the state $300 million in tax revenue in special incentives, while Alabama paid for infrastructure for the factory. Opponents have claimed that the state as a result had to reduce education outlays (Biglaiser and Garland 2009). Since in Vietnam's fiscal system such an outcome is not possible, good business conditions must be created *by racing to the top* by cutting red tape and providing proactive support services, *not by racing to the regulatory and* *tax bottom*.

Most of the tests have provided the results that were expected. Where they have not, plausible alternative explanations have been provided. In this context, it is of great importance to be aware of the *common confirmation bias* in the social sciences. In Chapter 7, for example, we have made an attempt to provide plausible explanations for the divergence in perception of the quality of governance in Da Nang in the PCI and the PAPI. These alternatives have, we hope, followed what Roy Bhaskar (1989) called a "progressive program shift," one where outliers are not explained away, but where the unexplained cases invite new research along the lines of possible alternative explanations. The province of Lam Dong has so thoroughly eluded explanation due to its consistent outlier status that we could only recommend a separate case study. In other cases, the conclusions of this research can also only point in the direction of additional investigations.

The end goal of any case study must be to explain and, hopefully, find evidence that can be of use for other cases as well. Categorization of knowledge is the goal of all scientific inquiry. In the next section we address the always contentious question to what degree any knowledge gleaned from one case, here that of Vietnam, can be generalized more broadly to inform theory and practice elsewhere.

10.2. Learning from the Vietnamese Case

The social world is made up of individual cases; theory then attempts to go beyond knowledge of the particular and make sense of a collection of data for a more general understanding of social processes. Although the social world lacks unit homogeneity, social science tries to generalize from the particular to the general. This Vietnam study, like all studies of individual countries in their geographical, historical and political context, has limited generalizability. The *doi moi* reforms are embedded into unique material conditions, which were laid out in Chapter 4. Understanding how these conditions impacted Vietnam allows us to venture hypotheses for comparable cases. King et al. have pointed out that even unique events can be studied in comparison to others. One aspect of good social theorizing is to determine where generalizability is possible and where it is not (King et al. 1994: 43).

For one, Vietnam's case shows that universalist claims of the race-to-the-bottom theory cannot be sustained in the context of opening an economy up to trade and investment. The withering state theory with its focus on hypercompetition (for a description of this view see, for example, Mittelman 2000) can not be confirmed by the case of Vietnam. The country fulfilled the conditions of the critics of globalization – poverty and dependence on foreign capital leading to low bargaining power with international investors – but managed to engage with the forces of the international market in ways that allowed it to gain substantial benefits from trade and foreign capital. Vietnam shows that domestic policy that gives labor mobility and allows it to engage in the same competitive migration as capital, can level the playing field and give labor enough bargaining power to engage with elite groups in avoiding a race to the bottom. In that sense, it is arguable that the critics of trade- and investment-based development got their causal variables wrong. If more factor mobility contributes to a harmony of interest among *all* groups, then the global economy may be too limited in terms of mobility, rather than too open. To this extent, Vietnam's lessons are exportable, as factor mobility can be created in many developing economies.

This is not an argument for neo-liberal economics, however. The government's strict imposition of basic rules of the game – policies that support general welfare even as a good business climate is promoted – has played a substantive role in Vietnam's development model. In this respect, Vietnam follows the East Asian developmental state model, which also promoted industrialization as a national priority policy to serve the common good rather than as a collusion between economic and political interest groups. We return to this issue in Sections 10.4.1. and 10.4.2.

Vietnam's case also shows that elite self limitation is not limited to constitutional democracies with legal and political checks and balances. While some have argued that only democracy and the associated legal, constitutional and electoral checks on power holders can bring about self limitation (Deese 2003; Ramaswamy and Cason 2003), the evidence here shows that the incentive structure that leads to a preference for limited predation is based on contestation for benefits in a market, not on courts or ballots. Foreign capital is the benefit that no elite, however powerful, can command, but must attract with credible promises of self-limitation and good governance. While antecedent conditions may play a role in the degree to which a political elite can be credible in such a promise (see the comparison to Africa below), in theory at least many, if not most, countries can create conditions of market openness and competition for its benefits.

It would be difficult to glean an argument for authoritarian government from our data, either. The argument that authoritarian rulers have a longer time horizon may be accurate in some contexts, but mostly, the Communist Party has been beholden to short political time horizons. It has followed the five-year schedule between Party Congresses comparable to many liberal democracies. The Party is accountable to the citizenry only to the degree that it can assures a quality of life good enough to avoid open dissent. The Party leadership, by contrast, has to fear removal from power at every Party Congress, where power struggles are fierce. Following the 2008 international economic crisis and the subsequent payment problems at the large state-owned Vinashin, the hotly debated policy issue is that of the state-owned sector. Most people agree that it is highly inefficient and the main cause for the high levels of inflation that plague the economy. The prime minister has pledged to speed up privatization and to take a tougher line on loss-making state concerns. As a result, he faced a leadership challenge at the 2011 Party Congress. Although he was confirmed in his position, opponents of his policy course were elected to the highest Party gremiums as well. Political bets are being taken whether the next five years will be a fierce fight between factions over privatization, or a stalemate between progressive and conservative forces with little action taken throughout the next legislative period. This discussion could have been copied from U.S. newspapers. Vietnam's system is remarkably similar to liberal democracy, with the exception that the "win coalitions" required for "political survival" are smaller (Bueno de Mesquita et al. 2003).

We have pointed out that the Vietnamese model is bounded by certain conditions

– economic growth with increasing demands for labor, and a consensus within the elite group that economic growth is a *conditio sine qua non* for staying in power. In that respect, Vietnam was lucky to be located in East Asia. While there is no incontrovertible evidence that Egypt, for example, could not reform its politico-economic system similar to Vietnam's, early investors in Vietnam were probably swayed by Vietnam's cultural affinity with other East Asian success stories, and the belief that Vietnamese leaders are likely follow the same path. Not surprisingly, early investors – those who took the deepest plunge in terms of risk, prior to the self-sustaining virtuous circle of investment and incentives for attracting more investment – were from the East Asian developmental states as well. One lesson from Vietnam thus is that the neighborhood matters, and that a newly reforming country should try to start out working with neighbors who share and understand their culture.

Vietnam also shares the societal cohesion of the East Asian development model. When society cannot readily be divided into in- and out-groups, a policy of redistribution is much more difficult to argue than in a country where natural ethnic, religious or class divisions create fertile soil for a policy of 'othering.' African countries with their multi-ethnic societies and their history of inter-group animosity will not as easily be able to convince investors that they are committed to growth instead of redistribution.

We can conclude that the Vietnam model cannot be universally applied, given the need for specific conditions at the outset, but that it is one that can inform a number of late-developing countries. Since the conditions under which the harmony of interest holds are self-reinforcing (they depend on, but also lead to, growth and high demands for labor throughout the catch-up phase of industrial development), the model is of use in informing policy on economic governance for an extended period of early industrialization.

10.2.1. The longue durée view

This study has focused on a game-theoretical approach in which actors make decisions about reaching desirable outcomes under very specific conditions: a market-preserving federal political economy and the presence of foreign investment under conditions of strong economic growth. Yet there are other factors as well that set a society on a path which is difficult to alter in a later stage. We have found in Chapter 7 that the pathways of economic development are impacted by events and processes which the French historian Fernand Braudel called the *longue durée* (Braudel 1980). Population density has emerged as a significant causal factor for the poverty of provinces. The pathways of development appear to be determined by *longue durée* history: geography, through remoteness or low carrying capacity of the land, influences population density. Fewer people translates into less development, as cities develop where density is higher. Industries arise in cities and transportation nodes. Industries give coercive elites incentives to improve the business climate in return for financial and political rent, which in turn brings in more industries.

In Vietnam, we can observe that foreign investment and the quality of governance measured by the *Provincial Competitiveness Index* are closely associated.

Both foreign investment and governance are consequences of larger populations. Once dense populations and human capital have allowed markets and industry to arise, the rest follows. We have laid out the forces that push coercive elites to improve governance in response to demands from business. Without that initial spark of investment, even excellent governance will not lead to the same results. Lao Cai, a province that is very well governed but remote and with low population, receives more investment than other provinces in the same situation, but it remains orders of magnitude behind the top investment attractors, even those that govern less well. The data in Table 5.14. indicate that provinces that do significantly better or worse in attracting foreign direct investment than their governance score would suggest can largely blame or credit the vagaries of geography for their situation. The 12 provinces that attract less investment than their good governance ranking would account for are located at a driving distance of almost one-and-half times farther to the growth poles than the most over-performing provinces; driving distance to the nearest port is approximately 25% longer. (Without the unexplained eternal outlier Lam Dong, the numbers would be even more pronounced.)

The *longue durée* matters, and it may be extremely difficult to overcome. On the other side of the coin, bad governance can ruin even the best hand a jurisdiction has been dealt by geography. Obvious examples of the importance of governance on the international level are the dramatic difference in economic performance between North and South Korea, which can hardly be blamed on natural endowments or on cultural or long-term historical differences. In Vietnam itself, we can think of the vast gap in economic performance before and after *doi moi*. The most important change between those two time periods is governance, not any marked change in resources.

10.3. Policy Implications

Vietnam's reform path has been impressive and all strata of society have benefitted from growth. Today, however, Vietnam is showing growing pains. The first stage of development in *doi moi* required industrialization and the transformation of the heavy-industry-focused state-owned enterprise economy to one that emphasizes private light manufacturing for exports. The policies that Vietnam used have been described: unbalanced development that focused on a small number of provinces, inter-provincial competition to create contestation for scarce factors of production, and a quasi-federal economy to assure that no early winner can impose limits on further innovation and competition. After two decades of this development model, a qualitative change is required, and early strains are showing. The harmony of interest we have hypothesized and demonstrated is based on the model that has prevailed under *doi moi*. Vietnam's future depends on the question whether the country can maintain a harmony among interest groups while making strides into a new economy.

In the near future, Vietnam needs to temper inflation and speculative bubbles, deal with the state-owned enterprises, balance its development and adjust its fiscal system to the realities of a country in which some provinces attract migrants in large numbers while others send them out. All of these tasks imply infringing on the perks of some interest groups, which in turn means upsetting harmonies that exist at the moment.

Inflation is a natural by-product of steady economic growth. Vietnam's population growth requires approximately 7% growth to absorb the new entrants into the work force (Manyin 2010). To maintain social peace (the harmony of interest between workers and provincial elites in job-poor provinces, but also between political elites in rich provinces, poor provinces and the center), the government cannot cool economic growth. It has begun to reduce money supply, but only at a moderate rate that has made a minor dent into inflation. It is widely agreed that the best approach would be to cut the state-owned enterprises lose. The incremental capital output ratio (ICOR) – how many dollars of investment need to be made for one dollar in economic growth – for the state-owned sector is 17.55, compared to the domestic private sector for 4.62. That means that the state-owned sector is four times less efficient in absorbing capital than the private sector, but it receives preferred credit from state banks, for a total of some 40% of total investment in Vietnam (Brown 2011). Vietnam has promised a much faster disinvestment from its state-owned sector, but strong interests persist in keeping it close to government. Part of it is the ability to reward allies and friends with lucrative positions, another the strategy of creating large, strategic conglomerates like Korea's *chaebol* or Japan's *keiretsu* as a next step of Vietnam's economic development. The Vinashin scandal in the wake of the global economic crisis, in which one of these conglomerates caused colossal losses and almost brought down the re-election bid of Prime Minister Nguyen Tang Dung, may have put a damper on this strategy. Nonetheless, a rapid privatization or closure of loss-making enterprises would ruffle many feathers and upset the harmony of interest among elite groups.

Following the logic of the harmony-of-interest approach, we need to ask whether this problem can be solved within the parameters of the theory. Who benefits, who loses from the continuation of a preferential capital allocation system that leads to sub-optimal returns on investment and higher inflation? Clearly, the central provincial leaders who are in control of state-owned firms can use them to grant rents to supporters. On the other hand, the Party has made the bet that only continued economic progress for a broad segment of the population can keep the Party in power by giving it legitimacy through success. The Party has shown before that it is willing to sacrifice short-term rent for long-term survival. It happened when *doi moi* was decreed, and again in the 2008 crisis when the Party sided with workers who engaged in illegal strikes and raised their salaries, rather than cracking down on the strikes in support of investors. Moreover, in 2005, when the real estate bubble threatened to burst, the Party changed rules on mortgages and collateral to make it harder for speculators to obtain loans for real estate purchases. Since many – probably most – speculators are close to the Party, this move hurt Party cronies most of all. Nonetheless, the Party again made the decision to reduce short-term rent-seeking opportunities in exchange for its long-term grip on power. State-owned enterprises are another means by which to reward supporters and provide leaders with rent. If the sector, however, drags down the economy overall, the Party may follow precedent and decide that this short-term rent is not worth the long-term loss of legitimacy. The fact that workers, domestic and foreign businesses, expatriates, donors and local politicians speak about inflation as the country's number one problem (and the media are allowed to report on it) indicates that the Party is ready to make another long-term investment in its legitimacy – and the country's economic success.

Continued inflation would undermine the harmony of interest on almost all levels. Workers would no longer feel that working in the industrial parks improves their lives. The interviews and surveys in Chapter 8 have shown that businesses already feel that inflation is eroding their interest in Vietnam. Poor provinces would lose remittances if workers returned in large numbers, and rich ones would lose investment if human capital was getting scarce. The resulting social problems in both rich and poor provinces would not benefit the central government either. A harmony-of-interest calculation could therefore well be the spark for central and provincial governments to get serious about privatizing (or equitizing, in Vietnamese parlance) the state-owned sector with greater fervor than has been the case in the past.

With regards to migration and the harmony of interest between poor and rich provinces, the current fiscal system allocates transfer funds from surplus provinces (the 11 richest) to the rest based on a number of criteria. One of the most important is population (see Chapter 8). The poor provinces send migrants to the rich provinces, but due to the archaic household registration system, many of these migrants never bother to register there. They stay on the official books at the sending province, which receives not only remittances, but also fiscal transfers for social services which in reality need to be rendered where the migrants really live, not where they are registered. This system causes great problems for the most heavily industrialized provinces which attract large numbers of migrants, as the interview responses in Chapter 8 have impressively shown.

But politically speaking, the numbers are in favor of the sending provinces. Changing the system by allocating transfers to provinces where people really receive services would benefit only 11 out of 63, while hurting the rest. Too many in the Party's 'selectorate' would not stand for such a change. The harmony of interest between rich and poor provinces in the context of fiscal allocation is based on continuous transfers, and a dramatic change in allocation rules would upset this harmony.

On the other hand, insufficient social wages in the migrant-receiving provinces would have the same effect. Federalist theory has pointed out that rational agents vote with their feet after making cost-benefit calculations. If wages are eroded by inflation at the same time as investment-rich provinces cannot provide basic public goods and social services, the cost-benefit calculation for staying in the industrialized province far from home will shift in favor of returning (or not making the trek in the first place). This is already beginning, as data on return migration show. In such a scenario, poor provinces (a) lose remittances which sustain a good amount of rural life in Vietnam (Deshingkar 2006); (b) will see fiscal transfers diminish as the rich provinces' economies decline and they no longer contribute as much to the central treasury; and (c) have to pay the social services for the residents who return and then are truly living in the province. Based on the harmony-of-interest calculations these provinces make, everybody is better off if the investment magnets keep making money and send large percentages of it on.[103]

The Household Registration Law was changed in 2007 to facilitate registration

103 Ho Chi Minh City, for example, retains only 34% of its tax revenue, Ha Noi 31% (Ministry of Finance 2007).

in the province where a migrant works. This is a first step that reflects an understanding of the problem by the central government. It is not a solution, for the migrants will only be registered as temporary residents, while tax allocations continue to be based on permanent residents. But receiving provinces will be able to make claims about their needs for social service provision based on official numbers when they negotiate their revenue retention rate (Lan 2007). All sides have an interest in maintaining the system that has served them well in the past. In the future, as inflation erodes purchasing power further and hits hardest in the cities, rural provinces are likely to see the wisdom to open up more to changes in the system. Allocations could be shared between provinces where a migrant is registered permanently and temporarily. As soon as the harmony of interest between the rich and the poor provinces is threatened, for example by declining revenue in the rich provinces followed by declining fiscal transfers to the poor, we can expect change to occur.

The harmony of interest between rich and poor provinces is based on the rich provinces' need for political support for the reform policies from the poor ones; and on the poor provinces' dependence on rich province performance for fiscal transfers and remittances. Among the rich provinces themselves, however, there is little harmony of interest in fiscal matters. The system in which the center pays for capital improvement projects (or at least authorizes them during the revenue retention negotiations), gives an incentive to build as much infrastructure in one's own jurisdiction as possible. The result is an over-investment in provinces with higher lobbying power at the same time as the country overall suffers from a dearth of well-integrated infrastructure. The policy discourse has been shifting toward "too much [inter-provincial] competition, not enough coordination" (for example Cung 2011). The argument is that competition creates inefficiencies in public investment, and that a stronger intervention by Ha Noi could render the economy more 'rational.'

The argument is, however, at best incomplete. History has shown that central government projects have been extremely inefficient (like the Dung Quat refinery already mentioned in Chapter 8.1.). Moreover, the fiscal transfer system that causes the excessive competition for capital projects is a product of central coordination – the provinces receive money for which they have lobbied from Ha Noi. Since Ha Noi pays for the seaport, airport or road, the provincial leadership has no incentive to exhibit restraint. On the contrary, not lobbying for the spending would reduce central government transfers without any alternative benefit.

The data in this study have made it clear that rich provinces have done very well where they had to compete with each other. They have over-consumed where consumption was paid for by the central treasury. The solution to this problem, then, should not be more coordination, but more and smarter competition. Federalist theory has argued that good fiscal transfer systems are always formula-based, to avoid political maneuvering in favor of connected or more powerful jurisdictions (Bird and Smart 2002). The current system of allocation represents a form of central coordination, as Ha Noi decides who gets a seaport or a new highway. Formula-based block grants give provinces incentives to spend money efficiently. Such grants have been tested in experiments with good results (Bartholomew et al. 2005). Provinces could also be granted increased revenue-raising authority, with the understanding of the risk that provinces that can set their own tax rates are more likely to be tempted to a regulatory race to the bottom. As long as all players in the game have an interest in the stability of the system, they will not defect. The so-called defections in the competition-versus-coordination debate are in reality competition for benefits for which the incentive structure is set by the central government in an inefficient way. The solution should be a fix for the incentive structure, not a change in the way the game is played.

A last lesson in relation to the uneven development model that flows directly from this study relates to catch-up development by laggard provinces. The uneven development model recognizes that an under-developed country does not have enough money to improve infrastructure for the entire territory. Instead, it builds up some promising areas, attracts investment there and transfers part of the benefits to the rest of the country. As economic growth occurs, the goal is to spread economic growth, not only fiscal transfers. The Vietnamese government has done so actively by giving special tax breaks and making infrastructure investments in laggard areas in order to attract investment there. In addition to such active central government policies, there are market incentives to the same effect. As we have seen, the cost of doing business increases in the most invested provinces, and investors whose primary interest is low cost go elsewhere. As cost increases, it becomes impossible to compete on low labor rates; these early developers must move up the value chain. The interviews in Chapter 8 have shown that the three investment magnets of Ho Chi Minh City, Binh Duong and Dong Nai are actively engaging with this need by pushing low-value-added industries into other provinces. In this sense, Vietnam follows the East Asian 'flying-geese' model (Akamatsu 1962) in which early developers must interact with their poorer neighbors in search of human capital, but later pass benefits of growth down to the latecomer developers. Not only do second tier provinces begin to attract labor-intensive, low-added-value business, but the first tier provinces actively assist their companies in these sectors to move away. The goal is to reduce the pressure on social services, housing and transportation infrastructure, and cost of land and labor in the most invested areas. Instead, these provinces invest in improving human resources, training mid-level engineers, improving science standards and making the province more attractive to the higher-level industries they now need to attract to maintain economic momentum.

The data in Chapter 6 on catch-up reforms among provinces in proximity of the early success stories support the assumption that the fear of out-migration leads to better governance, which later allows these provinces to compete for the industries that the early movers no longer want. The flying-geese model works from two ends: One, the rich provinces want to reduce pressure on labor, infrastructure and land and actively move out labor-intensive investment. Two, the reforms push laggard provinces toward better economic performance, so that they can compete for investment even without active assistance from the richer provinces. These are not outcomes planned by central or local governments; they are a serendipitous result of the incentive structures that prevail under conditions of contestation. Contestation itself is created by trade opening and focus on attracting foreign investment. The center did not want to lose power to the provinces; provincial governments did not set out to give more bargaining power to investors and workers; investors did not plan on making common cause with workers in pushing for more public goods. In this sense, the government did not plan out its development policies. It set the country on the course it took merely by creating the incentive structures that come with contestation among interest groups.

10.4. The Vietnam Case and Theory

This case study allows the drawing of lessons for Vietnam and the generalization to comparable cases. The systematic analysis of a case also allows for theory building, which was done here with the harmony-of-interest theory. A theory is a speculation about the answer to a research question and a logically consistent explanation why this answer is correct (King et al. 1994). In this study, we have provided a speculation about the question why the Vietnamese governing elite limited its power (seemingly voluntarily) and why it did not reverse its self-limitation as conditions changed. The harmony-of-interest theory explains under what conditions it is rational for self-interested actors to abstain from seeking short-term rents and instead to cooperate (to use the game-theoretical term) with other interest groups. Hence, the theory explains why and when to trust a powerful elite in its claims that investment is save from policy reversal and internal strife.

Case studies serve a second purpose: theory testing. Theories make broad claims about relationships among causal variables. No supporting finding can *prove* a theory (there can always be another explanation that leads to the same outcome), but data that confirm predictions strengthen the theory. A case study that falsifies predictions can spell the end of a theory or at least require re-thinking of the connections between explanatory variables. The Vietnam case study has touched on a number of theories. The results of the study can therefore validate or weaken theoretical claims, and inform further research. In this last section, we discuss the *withering state* theory advanced by critics of economic globalization. We question whether Vietnam's state – still accused of excessive control over its citizens and of violations of civil liberties – has become a weak billiard ball in the grander game of global capitalism. We relate the findings of the Vietnam case study to the "mutual hostage situation" between state and the dominant industries that was suggested in the East Asian development model (Kang 2002). In this context, we evaluate *whether the Vietnamese case is an instance of the East Asian developmental state model, which theorized how a strong state can reduce rent seeking credibly in the early stages of industrial development*. Next, we return to the question of *credible commitment through decentralization* seen through the lens of the (market-preserving) federalist approach, and return to the race-to-the-bottom view and put it in the context of the harmony-of-interest theory that we investigated in Vietnam.

One introductory remark about the question of agency versus structure as the main explanatory factor in the Vietnam case: In Vietnam, the paramount leader Le Duan, the last personal comrade of Ho Chi Minh, exercised a strong influence on the direction of the nation. As Chapter 4 has briefly explained, only Le Duan's death allowed reformers to step to the front of the political scene. How and why one man could yield such influence is unclear – and given some of the evidence the question could be extended to *whether* he really could. But our story is about the reform era, and here, no strong-willed leader emerges who sweeps away the sclerotic structures of Vietnam's communist system by means of new ideas and personal charisma. The absence of a charismatic leader is advantageous from an analytical point of view, since personalities tend to muddle the waters of systematic analysis. Personal leadership qualities and individual character traits, while real and influential in history on occasion, do not lend themselves to theory-building. They are solipsistic and not amenable to systematic categorization. The changes in Vietnam occurred because agents found themselves confronted with incentives and constraints. Those are structures that impact whether or how these agents – individual as well as collective ones, such as interest groups – can expect to achieve their goals and pursue their interests. The preferences of actors shaped their goals; structural forces shaped their perception of how to achieve them. As a result, we can analyze actors' decisions based on their interest in relation to constraints, and evaluate what decisions led to the desired ends under which constellation of constraints. This allows us to analyze what behavior is likely to succeed and generalize beyond the given case, whereas decisions taken by a charismatic leader who is able to bring his or her constituents along would be linked to the person and not offer wider lessons for theory building.

10.4.1. The withering state

Critics of trade- and investment-based development strategies have argued that when a country opens itself up to the forces of the global economy, it loses its ability to enact domestic rules and regulations, because it has to bow to the demands of the overpowering forces of global capitalism. This is known as the withering state view (for example Falk 1997; Drezner 2001). This view implies a benevolent state whose aim is to protect its citizens against the vagaries of the market. We have discussed throughout this study that such a positive view of the state may be misplaced – the exercise of power is linked to the goal of attaining rent (Rodden 2003; Rodden and Rose Ackerman 1997). If this view of the rent-seeking state is correct, then its withering would be a positive outcome. Reduced rent seeking would lead to higher efficiency and a more equitable distribution of resources in society. This is, in the end, what this study finds.

The evidence does not, however, support the withering state assumption. The Vietnamese state did not lose its coercive powers when it was faced with the demands of international capital. Instead, it transformed itself voluntarily to offer a better environment to international investors for its own sake.[104] Vietnam's elites saw it in their interest to open the country up to trade and foreign investment. They never lost their coercive powers; they had to make rational, interest-based decisions when and how to use those powers. The discussion about illegal strikes in Chapter 8 is a case in point. A government under the thumb of investors would have repressed those labor actions. Instead, it tacitly supported the strikers by standing aside first, and by raising minimum wage levels repeatedly later. Clearly, the government had made a decision as to what it considered in its own best long-term interest. (The decision is consistent with

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104 For a discussion of the state's ability to make and enforce the rules of the game, see Jandl (2009). The state shapes its engagement with the global economy and can reverse itself, as it sees fit. Malaysia's former Prime Minister Mahathir, for example, was strongly pro-investment until he saw it in his interest, during the 1998 financial crisis, to portray himself as a protectionist. Malaysia's position on globalization, trade and investment was shaped by the elites' interest at the moment, not the preferences and demands of global capital.

the harmony-of-interest assumptions. The central government uses investors as a means to gain political rent – legitimacy and social peace through a growing economy, jobs and increasing incomes. Once that social peace is threatened, the government will side with those interest groups it considers more important to re-establish it. Investors are only a means to the end of staying in power – their bargaining power stems from their utility to the political elite. If workers are unhappy on the job, the legitimacy of the governing elite is weakened and investors no longer serve their purpose. As a result, investors have to accept higher wages; their bargaining power with the government passes through workers and their happiness.)

Mancur Olson pointed out that rent seeking was an inevitable part of governance, since interest groups always have an interest in shifting benefits to themselves as long as the societal cost incurred by the inefficiencies that come with rent seeking are borne by society as a whole (Olson 1982; see Chapter 2 for more detail). The only way of limiting the cost of rent seeking on an economy is to create what he calls “encompassing interest groups” (Ibid: 90-1). When interests groups represent a large segment of the population overall, the share of the cost of inefficiency caused by rent seeking would have to be borne to a large extent by the members of that interest group. Encompassing interest group representation, like in some European countries where only a few mandatory unions represent all citizens – workers, employers and the self employed – thus have least interest in seeking rent and most interest in growing the pie for all.

Whether Vietnam is such a country is an interesting debate for another study, for which we may have been able to lay a foundation. Rent seeking and corruption are still endemic. The state-owned enterprises, as explained above, remain a major source of rent for political supporters. Importantly, the competition for capital projects paid for by the central government among the provinces creates interest-group competition along the lines of what Olson describes: Each province has a strong interest to lobby for as much as it can get. Every project obtained represents a benefit to the recipient province, while the whole country has to chip in for the cost. In all these respects, Vietnam does not have encompassing interest group representation. On the other hand, the harmony-of-interest theory allows us to see aspects of encompassing interest groups in most aspects of economic policy making. If the five groups we have identified – central government, rich province governments, poor province governments, investors and workers – collectively are responsible for the incentive structures within which policies are made, then each group has an interest in overall economic growth rather than solely redistribution. The harmony-of-interest matrix in Chapter 3 reads like an encompassing interest group chart. Each actor benefits from overall growth, each pays dearly in case of decline. There is no "tragic brilliance" mechanism, in which the loss of society is the gain of one actor (Diaz et al. 2008). Re-phrasing Olson, each group seeks rents, but excessive success would cost even the winners too high a price to make it worthwhile. If, for example, workers were to gain very large salary increases, investors may see it in their interest to leave Vietnam. On the other hand, if investors extracted concessions of extremely low taxes from the government, the government could no longer build infrastructure and assure human capital availability. Every significant victory of one interest group over another would be Pyrrhic.

David Kang called the relationship between state and industry a “mutual hostage situation” (Kang 2002: 17-8). Writing about the East Asian developmental state model, he argued that the Korean *chaebols* and Japanese *keiretsus* co-existed with the government in a symbiotic relationship. The companies depended on government largesse to strive, but the government, for its part, could not cut them lose because of the large number of employees who would lose their jobs and the social safety net that these corporations provided. In Vietnam, the situation is becoming increasingly similar. As companies not only provide jobs, but also housing, transportation, lunch and health care, the government depends on them as much as they depend on a cooperative government. An excessively predatory policy would send foreign investors packing, ending the good times for Vietnam’s economy and cut a large number of workers off their jobs, but also their social services. The state, and particularly the local state, needs the foreign companies to thrive. The foreign companies thus have influence, but only to the degree that they do not demand so much from the state that they lose their utility for the elites. An overly pushy foreign-invested sector would reduce its utility to the state and reduce incentives for the state to support the foreign sector.

Mutual hostage situation may be a less optimistic term for harmony of interest in broad terms, but Vietnam’s situation remains different because there are more interest groups involved. Korea and Japan were central states where a technocratic bureaucracy cooperated with government-supported businesses to strengthen the economy. Labor was generally oppressed, and with little or no mobility, it could not gain the bargaining power that workers in Vietnam enjoy. In Vietnam, with more pluralistic contestation within the country, the situation is different and harmony of interest remains a better metaphor than mutual hostage situation. Workers can play competing provinces against each other through migration. They also lack the cultural preference for employment stability that is very strong in Northeast Asia. Businesses in Vietnam, especially foreign-owned ones that do not depend on government money, have alternatives to bowing to state demands as well. They can leave the country, give it a bad rap and hurt its attractiveness for future investors, or shop around domestically for better conditions. This alternative to the state as a partner is one distinguishing characteristic between Vietnam and the East Asian developmental state. It is to that theory and its relevance to the Vietnam case we now turn.

10.4.2. Vietnam and the developmental state

Vietnam exhibits a number of differences in its antecedent conditions in comparison to the East Asian developmental states. It cannot be the goal of a concluding chapter of a Vietnam case study to adjudicate the developmental state literature and to fit Vietnam into it. Yet the question whether Vietnam's development model has some elements in common with the East Asian one must be posed on a base level, hopefully to inspire additional work. Vietnam (like China) is a state-led development model. Vietnam is a latecomer industrializer that has navigated the pitfalls of coming late to a game in which both capital and markets are out of its own political control. Where dependency theory has passed the damning verdict that such a latecomer can never catch up due to structural forces inherent in the global economy (see for example Cardoso and Faletto 1979; dos Santos 1970), Vietnam seems to be doing just that. It has entered middle income status in a record time, pulled large numbers of its people out of poverty and is now moving up the value-added ladder in the international supply chain. A brief evaluation of this instance of state-led development in East Asian comparison is thus in order.

The literature defines a developmental state[105] as a state whose elites focus on economic development through industrialization to assure that they can obtain legitimacy and fight off foreign threats through a strong economy and military. In the process, they create a hard state with weak interest groups, and a strong interventionist policy through which the state provides industry with support in return for reaching state goals. The literature sees equality at the outset of development as crucial, to assure that the only path towards legitimate rule is economic growth, not redistribution from the majority to a narrow win coalition. A weak resource base helps in focusing on human capital. Crucial are governed markets, where the state guides the economy by controlling money supply, market entry and resource availability, and hard budget constraints that assure that rent seeking cannot undercut the development policies (Johnson 1999; 1995; 1987; Amsden 1985; 1989; Deyo 1987; Wade 1990; Öniş 1991; World Bank 1993; Leftwich 2000; Stiglitz and Yusuf 2001; Kohli 2004).

Looking at Vietnam at the beginning of *doi moi*, it starts out as a hard state and

105 The developmental states are Japan, South Korea and Taiwan, plus in some accounts Singapore. The latter is a city state without urban-rural dichotomy and does not lend itself to comparative evaluation. Japan is technically also not a good example, because it starts out as a country devastated by war, but with a history of industrial economy. The literature is highly *ex-post* focused, and represents more an account of *what* happened than a theory *why*.

little domestic opposition. The focus on development begins with fear of loss of elite legitimacy, although the rationale is not a foreign threat, but domestic economic calamities. Initial conditions of equality exist, but the country is rich in resources and has soft budget constraints. The question about developmental state theorizing is whether these criteria are theoretically necessary or just a list created by scholars as they compare what the (pre-determined) developmental states have in common. Foreign threat, for example, is not a necessary condition. A threat of invasion was hypothesized to be necessary to keep the government honest and to reduce rent seeking (Öniş 1991). In reality, the fear of losing power did the trick – in the case of Taiwan and South Korea, that fear was based on a threat of foreign invasion. In the case of Japan, as Johnson points out, the government had to re-establish legitimacy after the catastrophe of World War II (Johnson 1995). At stake is not foreign threat, but the need to maintain legitimacy. Vietnam's Communist Party falls squarely in this category. While the literature is surely correct in arguing that fear of mainland China or North Korea pressured the Taiwanese and South Korean leaders into pushing for economic growth and military strength, the fear of domestic economic collapse and revolt did the same in Vietnam.

Vietnam is rich in resources, but that alone does not prevent a state from focusing on human capital. The theory applies the resource curse view indiscriminately. In Vietnam, resources may have been available, but they were not used efficiently enough to allow for rent seeking or economic growth. A resource only turns into a curse if it can be easily monopolized and thus reduce the incentives for the elite to focus on other economic sectors. Vietnam could never use its resources in a way to allow the elite to benefit from an extractive industry alone, and focus on human resources was a necessity in spite of the resource base. As for initial conditions of equality, they forced the elite both in the developmental states and in Vietnam to engage in growth, since no distributional argument could be readily made, nor was there much to distribute in the first place.

Vietnam was a hard state that brooked no opposition. It also had a highly interventionist government. The difference to the developmental state literature was that the hard Vietnamese state *ran* the planned economy, rather than guiding it with the help of market mechanisms prior to *doi moi*. After the reforms, market mechanisms took over in economic policy making, but at the same time the state softened, as provinces took a lead in pushing change along, sometimes in keeping with Ha Noi's goals, sometimes diverging from the central government's guidance. The reason for the hard-state criterion in the developmental state litertature is the need for the government to insulate itself against claims for immediate gratification by the rest of society. That was the case in Vietnam. Under the harmony of interest among interest groups, no group could engage in excessive rent seeking or demand instant pay-offs. All the interest groups gained their bargaining power from aiming at the same goal, economic growth. Moreover, the hard state was required in the developmental state literature to assure that the state could maintain control over the economy. In other states that tried state-guided policies, such as Mexico or Brazil, business gained too much power and began to dominate the relationship, diverting rent from the social good to its own benefits

(Haggard 1990). The difference with Vietnam lies in the size of the foreign projects. While in Latin America, the government invited in huge corporations that began to dominate the relationship and capture the regulatory system, Vietnam bet on a large number of small companies, none of which could dominate and whose interests diverged too greatly to unite. The fact that these investors interacted with provincial governments, not the central ministry, also fractured the potential lobbying power of these companies. Working with different counterparts, they could not make common cause against one government. Finally, in the few instances where industry made common cause (for example in demanding that the government deal more firmly with strikers), the government showed that it still was a hard state, that its goal was not investment for its own sake but for the sake of regime survival, and that it would not be pressured to deviate from the policies it considered best to achieve this goal.

The developmental state literature needs a theoretical broadening to turn from an *ex-post* description to a predictive, explanatory theory. Such an endeavor is not within the purview of this study. We can only show that Vietnam has used state power to spark a guided market process in which all interest groups have limited their rent seeking to pursue a common goal, economic development, which they all considered to be in their interest. This is a standard that could be a starting point for turning the developmental state literature into a true theory. To be sure, there are aspects of Vietnam's development that conflict to some degree with what the developmental state literature identifies as causes for the East Asian success story, such as corruption or the support for inefficient state-owned enterprises. But all theories are idealtypical in their assumptions of purity.

In the real social world, categories are, in the words of Charles Ragin (1987), always "fuzzy." Vietnam's development model of a strong, interventionist state whose elites embark on self-limitation for the sake of maintaining legitimacy to rule thanks to economic growth falls squarely within the general topic statement of the developmental state literature. Further development of this theme can be undertaken based on this study.

10.4.3. Decentralization, federalism and the race to the bottom

In the literature review in Chapter 2, we have laid out the state of the debate on decentralization and federalism. We have focused on the competitive aspects of devolution of economic governance, in what is generally considered under the term federalism. Critics of a this inter-jurisdictional competition have argued that the smaller the unit of governance, the more power business elites have and the more likely a race to the bottom will take place. A federalist structure would allow business to use their mobility to play one jurisdiction against another and get the best deal at the expense of non-elites. Our study has not confirmed that claim. The Vietnam case shows that under two conditions, all groups benefit from the inter-group contestation that comes with a federalist structure. First, labor has to be as mobile as capital. When workers can vote with their feet, they gain bargaining power and avoid a race to the bottom. Second, basic rules of the game must be enforced. The fact that in Vietnam provinces cannot go into debt (with the limited exception of infrastructure bonds), that they have to play by the same rules on taxes and minimum social protections, is useful in focusing on improving conditions rather than colluding in a downward spiral. These minimum rules, however, are not the result of a benevolent, enlightened government in Ha Noi, but of the harmony of interest that pushes the central government toward certain standards in order to maintain social peace and get its part of the bargain, namely to stay in power.

Applying Vietnam's lessons to the global economy, trade agreements that allow the free flow of capital, goods and services but restrict free flows of labor disadvantage the factor labor. Vietnam's harmony of interest includes non-elite interests because workers can migrate and find the basket of costs and benefits that suits them. A more restrictive migration system would upset the system and allow for collusion between businesses and local political elites at the expense of captive workers. The second aspect, minimum rules for international trade agreements, is hotly disputed. Should one country be able to prohibit child labor or environmental destruction in another in return for free trade? In Vietnam, no province can do so, only the center can set rules that all jurisdictions have to follow. The lesson from the Vietnam case study (and others) is that when trade is internationalized, it requires an international regulatory body. Obviously, reality is not likely to catch up with this lesson soon.

We found that predictions of competition among jurisdictions leading to excessive corporate power are unfounded. Just like in the global economy, corporations do not take "random walks" (Weiss 1997) to hop from one location to the other to find the cheapest labor and weakest regulations. Vietnam's provinces compete on a variety of variables, cost of labor and regulatory standards among them. Ho Chi Minh City has become one of the most expensive locations in Vietnam, yet it remains the most popular. Few companies want to leave, and so many more want to come that the provincial leadership is getting picky with licensing. If capital mobility were indeed to lead to a race to the bottom, we would need to see a decline in living standards in and around the industrial zones, where the international (and thus most mobile) companies are located. Our study has shown the opposite to be the case. Not only are salaries there higher, but so are social services and the percentage of workers with health insurance. Voluntary company benefits are more common and generous in those zones than in the parts of the country where local companies with less mobility dominate the economy (GSO 2006).

Crucial to the Vietnam case is market-preserving federalism. In this view, economic inefficiencies arise from rent-seeking elite policies that inhibit the free flow of technology, best practices, human capital, goods, services and capital among jurisdictions. Since elites have a vested interest in benefiting from the technologies, factories or practices they have sunk money in, they will actively restrict innovation and new entrants, at the expense of overall efficiency and societal welfare. The rules of the game in a federalist structure prevent such restrictions of free flows of goods, services or technology. They also allow free flow of people, adding the pressure of "voting with one's feet." According to market-preserving federalists, market efficiency should be increased and rent seeking opportunities reduced by such a system, and overall welfare should increase as a result. Not least, the ability to walk away from a badly governed jurisdiction creates an incentive for the elite to provide a credible commitment against arbitrary predation.

Our study has provided strong confirmatory evidence for this assumption. We have shown how the contestation among provinces for the best business climate has made Vietnam a top investment attractor among developing countries; how inter-provincial competition under quasi-federal conditions has improved business climate; how provinces in vicinity of the most successful ones have engaged in reforms of their own to avoid losing their residents to the successful neighbors; and how migrants have not suffered from a race-to-the-bottom scenario thanks to the exit options the federalist structure affords them. And Vietnam has gained a reputation for the credible commitment of its elites as far as the safety of investment is concerned. It is not that Vietnam's elites are exceptionally benevolent personalities, but that the system has provided them with incentives to reduce predation to an acceptable level. Domestically, provincial leaders have to respond to the conditions in neighboring provinces. The already mentioned mobility of citizens and capital is important.

The importance of research like the *Provincial Competitiveness Index* should be mentioned. First, by publishing a well-respected, officially sanctioned and widely distributed report on the quality of governance and its change over time, local officials are rated and the results of their policies made visible, for citizens (the publication of the PCI is an annual media event), investors and government officials in Ha Noi alike. The latter is of great importance. Careers may be advanced or broken by performance on the PCI. Since the PCI measures governance *not related* to natural endowment, local leaders have no excuse when the rating is bad. Lao Cai, a remote, mountainous, minority-dominated province is evidence for the ability to achieve good governance under adverse conditions. Second, we have discussed the wisdom of negotiated fiscal transfers (or lack thereof) from rich to poor provinces via Ha Noi. Reform of this system is under discussion and necessary. One way of determining formula-based block grants to provinces is to make them contingent on quality of governance, with the PCI a possible determinant.

Decentralization is often credited with better relations between government and citizens. Governments are closer to the governed, and smaller units are more homogeneous in their needs than large states. Local governments in Vietnam are indeed closer to their constituents – albeit mostly corporate ones. Provincial leaders are working closely with foreign investors, who group themselves in industrial parks. Park management in turn acts as the interlocutor with the provincial Department of Planning and Investment. These departments are subordinated to their line ministry as well as the governor, but since their job is to support investment in their province, their job evaluation depends more on the success of the province than that of the national economy. DPI officials exhibit a strong sense of competitiveness *vis-à-vis* competing provinces and see their work very much in terms of improving their province in ways that will bring investors to them rather than neighboring provinces. This attitude reflects the predictions of market-preserving federalism and its emphasis on commitment through inter-elite competition.

Lastly, this study has added to federalism on a theoretical basis. Federalism suggests a realignment of agents with different preferences, a sorting of citizens and companies in accordance with their preferred goods baskets in relation to the cost they have to pay for them in taxes and rents. Federalists expect different policies in different jurisdictions and migratory flows of people and investors to those locations where cost and benefit match their preferences. Our test shows that exit options increase the bargaining power of subordinate interest groups, as Tilly and Jones have argued (see literature review, Chapter 2). The Vietnamese harmony-of-interest structure within the quasi-federal framework thus allowed residents – elites and non-elites – not only to move to a place where the conditions most closely matched their preferences, but also to bargain what policies should be on offer. In other words, citizens can not only pick from a menu of choices, but they are active partners in the creation of the menu itself. Supporting the hypothesis, our data show that new coalitions of convenience emerged, and a harmony of interest among capital, labor and provincial elites and residents developed along the lines of certain issues.

10.5. Conclusion – A Summary Evaluation

Vietnam reformed its economy out of rational considerations. The economy was at the verge of collapse and the governing elite foresaw its demise unless it could change course. Actors acted in their own benefit under material constraints. In the process, incentive structures emerged that created a harmony of interest among the main interest groups in society. Success was serendipitous. It has its origin in the decision to begin reforms in a very small number of provinces. The resulting inter-provincial contestation for more market reforms and their benefits set Vietnam on the course that this study describes.

The central government never planned this outcome. It was a byproduct of other considerations. That makes Vietnam no less of a model. Knowing about the power of inter-jurisdictional contestation allows other developing countries to emulate the policy. Initial conditions are never identical and the global politico-economic situation varies over time. Adaptations need to be made in following Vietnam's model, but learning from it is possible. At the moment, Vietnam needs to learn from its own success model as it continues its transformation. With a stalling global economy, soaring inflation and the need to move up the value chain, Vietnam needs to remember that the development path was made possible above all because the dominant elites – first the central Party, followed in time by provincial officials – saw it in their interest to limit their own powers in exchange for a more efficient economy. Cutting investment into state-owned enterprises is a *condition sine qua non* to bring inflation under control. Such a cut mirrors the choices the Party has made before – a limitation of its own powers and rent-seeking opportunities for its own long-term legitimacy. The alternative, propping up an inefficient state sector to reward Party cronies, would represent a break with the harmony-of-interest structure that has made the reform a success.

The harmony of interest in Vietnam's reforms also explains why no race to the bottom has taken place. Leaving out one segment of society in the reform process would open a gap between the elite and the rest of society. That would be antithetical with the government's main goal, staying in power. In Vietnam, trade and investment opening did not happen *in spite of* the state, but *with* its active participation. The elites' interests are not compatible with a race to the bottom. What we found in this case study is that where labor *and* capital (in addition to goods) can move, it is in the interest of business to support better conditions for workers to improve human capital, reduce turnover and subsequently cost. In other words, without labor mobility it is much more likely that an equilibrium is found between capital and politics that is not in the interest of workers. Where workers can vote with their feet, the equilibrium position between economic and political elites will much more likely also satisfy the preferences of workers. This lesson is exportable to other political systems or international trade agreements.

Lastly, Vietnam teaches a lesson to those deliberating the impact of neo-liberalism and state-guided development. On one hand, Vietnam's success is one of the market over the plan. On the other, it is not one of a neo-liberal utopia in which the government withers and the market works its magic. The post-communist-transition[106] literature has focused on the dysfunctional nature of the emerging regimes. In Vietnam, economic governance was dysfunctional *before* a foreign firm or an official from the International Monetary Fund first set foot in the country. Governance actually improved with international integration, since foreign investment inflows gave the elites a reason to change their ways. Investment – and the benefits to the elites that came with it – thus was the main driver for institutional change. Good governance, after all, does not come with regular elections, but with the institutions that serve as the foundation for the body politic. Scholars of the Eastern European post-communist transformation have argued convincingly that lightning-speed political transformation toward a shell of democracy

[106] Vietnam is part of this transition, since its ruling party is communist in name only. A major distinction from Eastern Europe is that Vietnam has not transitioned rapidly to a liberal polity.

did not create the incentive structures for good governance and credible commitment. As transformation occurred at a rapid pace, insiders could easily appropriate the wealth that resided in the state's domain. No other social groups were empowered enough to hold their own in a bargain, even as the political system veered toward liberal democracy. As a result, state structures decomposed (Ganev 2007). In Vietnam, as in much of the rest of the successful East Asian countries, the state stepped back and let the market create wealth, but stayed in the game of governance, setting and enforcing the rules of the game, providing public goods and determining the broad outlines of desired social outcomes.

Much of the debate over development has been ideological rather than pragmatic: the need for neo-liberal markets and liberal democracies versus the horrors of globalization and free trade and investment. Vietnam, with the luck of early decisions that just happened to come out right, has set out on a middle course. Ironically, a Party that still engages in ideological rhetorical flourishes of Shakespearian proportions at official events has steered the country through its reforms in the most pragmatic of ways.

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