

PROCEEDINGS
FROM THE FIRST HIGH LEVEL
ROUNDTABLE MEETING ON
20 YEAR REVIEW
OF *DOI MOI*



UNITED NATIONS
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EMBASSY OF
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HANOI - 2007

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ACRONYMS AND ABBREVIATIONS

ADB	Asian Development Bank
AFTA	ASEAN Free Trade Area
APEC	Asia Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
ASEM	Asia Europe Meeting
BTA	Bilateral Trade Agreement
COMECON	Council for Mutual Economic Assistance
EU	European Union
FDI	Foreign Directed Investment
HDI	Human Development Index
IMF	International Monetary Fund
MPI	Ministry of Planning and Investment
NGO	Non-Governmental Organisation
ODA	Official Development Assistance
PMRC	Prime Minister's Research Commission
SME	Small and Medium Scale Enterprises
SOE	State Owned Enterprise
UNDP	United Nations Development Program
VASS	Viet Nam Academy of Social Sciences
WB	World Bank
WTO	World Trade Organisation



INTRODUCTION

In preparation for the Tenth National Party Congress in early 2006, the Communist Party and Government of Viet Nam plan to undertake a thorough review of the *doi moi*, or “renovation” period since 1986. Led by the Steering Committee for the Review created by the Party, a broad based national consultation process is being launched involving all provinces and major cities to collect national perspectives on the success and failures of *doi moi* to help point the direction for further success. At the same time, the Party and government are keen to consult with the foreign community for their comments and suggestions for the Review.

The “Assistance to the 20 Year Review of *Doi Moi* in Viet Nam” project is a joint initiative by the United Nations Development Program (UNDP) and the Viet Nam Academy of Social Sciences (VASS) intended to complement the national consultation process by supporting VASS in three areas. First, the project will contribute to new research of critical aspects of *doi moi*, economic transition and other related policies. Second, the project will help to widen participation in national consultations to include all interested sectors of society. Third, the project will strengthen national capacity in research management, applied policy research and policy advocacy.

The First High Level Roundtable Meeting was held in Hanoi on 12 January 2005 gathering some 160 participants (90 from Vietnamese institutions and 70 from international organisations). Most of the Vietnamese institutions involved in reviewing the *doi moi* process in preparation for the next Party Congress and working on Viet Nam’s development strategy were present at the meeting.



Among the list of 160 participants, the roundtable meeting benefited from the presence of H.E. Mr. Nguyen Tan Dung, Member of the Political Bureau of the Communist Party of Viet Nam and First Deputy Prime Minister of the Government of Viet Nam; Mr. Jordan Ryan, Resident Representative of UNDP in Hanoi; Professor Peter Nolan, University of Cambridge; Professor Do Hoai Nam, Member of the Central Committee of the Party and President of the Viet Nam Academy of Social Sciences; Professor Tran Xuan Gia, Head of the Prime Minister's Research Commission (PMRC); and, Mr. Hong Ha, General Secretary of the Theoretical Council of the Communist Party of Viet Nam.

The First High Level Roundtable Meeting aimed, first, to delineate the areas for contribution to the national consultation process of reviewing 20 years of *doi moi* in Viet Nam and, second, to propose new areas for further and new research on different aspects of *doi moi* relevant for policy decision makers.



EXECUTIVE SUMMARY

For the Tenth Party Congress, the Communist Party and the Government of Viet Nam are preparing the next Five Year Socio-Economic Development Plan (2006-2010), by the completion of which Viet Nam should no longer be a low-income developing country. All relevant Party and government agencies have been mobilised to produce an accurate assessment of the *doi moi* reform process and to draw lessons for the next stage of development.

In his opening address to the First High Level Roundtable Meeting on the 20 year review of *doi moi*, H.E. Nguyen Tan Dung, First Deputy Prime Minister presented some lessons learned over the last 20 years that need to be absorbed:

- Persevere in the goal of national independence and socialism;
- Be comprehensive;
- *Doi moi* must be based on political and social stability;
- Serve the interests of the people, rely on the people and be responsive to new ideas;
- *Doi moi* must be based on domestic resources and, at the same time, make the best of outside resources;
- Uphold the leading role and capacity of the Communist Party of Viet Nam; and,
- Bring into full play the strength of the whole united nation.

An accurate assessment of the *doi moi* period must extend beyond a review of domestic economic achievements and challenges to encompass the complex relationships among the economy, government, Party, state and society, as well as the processes of globalisation.



Looking at the experience of neighbouring China, Professor Peter Nolan spoke of the immense challenges that China faces as it enters the twenty-first century and are working extremely hard to meet those challenges and produce a sustainable and socially just development path. First, China's ongoing integration with the world economy and its ability to absorb huge amounts of foreign investment is producing growing inequality in the form of clusters of modern businesses and residential areas isolated and protected from the surrounding mass of poor people. Second, after two decades of cautious system reform, there are serious concerns about the competitiveness of Chinese businesses as China possesses few companies that can compete equally with global business leaders as systems integrators or as supply chain leaders. Third, China's environmental situation reflects the intense pressure of a huge and growing population upon China's already fragile natural environment and the impact of high-speed industrial growth. Fourth, as the market economy has developed there is a need to reinvigorate the Chinese state as its capability to extract taxation has declined and corruption both within the country and within the Party is rising. Finally, in China the interrelationship between the Communist Party and the financial system is far from resolved and waiting in the wings are multi-national financial institutions that are keen and able to increase their presence in the Chinese business system.

After two decades of successful reform China finds itself at a crossroads and must decide which path it takes. First, China could proceed with modernisation and deal with issues of social justice in the future. Second, the Communist Party could divest its monopoly on power, beginning a democratic process. Third, China could return to the Maoist development path. Fourth, China can "use the past to serve the future", turning to its own history for inspiration. For 2000 years Chinese political economy has been characterised by a vibrant market and state built on strong ethical foundations. China must decide whether it wants to maintain a powerful role for the state to ensure positive freedoms for all citizens, or accept the free market model with all of its consequences.

The collapse of the Soviet Communist Party, the Soviet economy and the rise in poverty and inequality in the former Soviet Union had an immense impact on the way in which China has approached its reform



efforts. China is now wrestling with globalised materialistic individualism and its contradictions and is trying to look at its own history and the relevant strands of global history to try to produce a sustainable and socially just society. China's reform strategy is 'groping for stones to cross the river'. This continual experimentation is the most important characteristic of reform in China, and is completely different from the process in the former Soviet Union and Eastern Europe.

Regarding Viet Nam's proactive economic integration, John Kurtz of A.T. Kearney remarked that impressive export growth has been largely due to trade liberalisation, suggesting greater integration with the global economy. However, if the effects of trade liberalisation are not fully anticipated, further liberalisation could damage vulnerable areas.

In light of many Latin American countries' integration experience, Viet Nam should analyse the causes of integration without growth. In the 1990s, Mexico was thought to be a success story; trade liberalisation was a path to growth and prosperity for its people. However, foreign investment did not have the intended effect in that region. Most manufacturing inputs were imported. By 2000, foreign direct investment (FDI) net inflows had increased impressively but GDP growth actually fell. Mexico became a low cost assembler, a political target for US labour unions, and had moved backward rather than forward.

Latin American countries' integration experience teaches us that:

- Liberalisation can be disappointing if the necessary enablers are not in place;
- The industrial strategy and exchange rate policy must be supportive of the liberalisation process;
- There must be an appropriate balance between a country's exports and imports at the capacity growth rate (as determined by labour force and productivity growth);
- Investments in intangibles such as R&D and education result in more sustainable development; and



- There is a need to establish strong development strategies and ensure strong linkages between foreign direct investment and domestic industries.

When thinking about competitiveness, Viet Nam should avoid equating exports with competitiveness because of the danger of being caught in the low cost trap. East Asian economies are distinguished from Latin American economies not by levels of export growth but by the rate of investment, which is linked to domestic savings. East Asian economies were also very successful in moving up the value chain, from low cost labour to higher skill inputs.

Being competitive in the global market is not about running fast; it's about running faster than others. Although Viet Nam has been very successful in a number of reforms, there is still much to be done. First, Viet Nam has received a lot of official development assistance (ODA) and remittances, but there has been a slow inflow of FDI. Second, the country improved significantly in the provision of basic infrastructure although there remains significant work on core infrastructure, growth and access. Third, Viet Nam's per capita spending on education is among the lowest in the region. Finally, while innovation is not a core concern today, Viet Nam will have to build a foundation for the future.

If a national economy wants to obtain rapid gains in competitiveness, it must put in place several building blocks such as:

- A supportive environment, both in terms of macroeconomics and political stability;
- Better access to capital;
- FDI policy must not only attract required funds, but also drive technology transfer, and training and management expertise;
- Development of physical infrastructure to reduce logistical costs and lower transaction costs; and,
- Innovation and development of specific human capital.

From a policy perspective, the key issue is to identify growth sectors, both industries and sub-sectors. Policymakers should determine in



which part of the value chain Viet Nam should compete. First, the government can identify primary industries in which firms and industries could become suppliers rather than producers, which industries are threatened by global giants, which are the industries where Vietnamese firms can compete and so on. Second, ministries can make a significant contribution by developing effective plans. Experts and officials should work independently and free from political interference. The state has a key role in providing information to firms to enable them to move ahead in particular industries.

Professor Melanie Beresford noted that in the successful industrialising East Asian economies, investment decisions were influenced directly by politics so that the decisions of the private sector were not dominant during the early stages of industrialisation. The policy rationale for maintaining state owned enterprises (SOEs) in Viet Nam has been the state's ability to influence long-term structural change and achieve its goal of a socialist-oriented market economy.

In the 1990s, the Vietnamese government continued to support SOEs, providing them with subsidies. Unfortunately, many became increasingly dependent on credit simply to maintain their enterprises, rather than upgrading to become more competitive in the global market. The decisions of foreign investors rather than the SOEs themselves have led to the changes in the Vietnamese economy in the 1990s.

Although *doi moi* focused on transforming the heavily subsidised command economy into a socialist-oriented market economy with various forms of ownership, the success of *doi moi* can be attributed to the gradual but unmistakable changes in the role of government and the relationship between state and society.

In the future, the state has to identify the changing aspirations of the population as it becomes wealthier, and respond in a timely and appropriate manner. It is necessary to determine what constitutes the kind of participation that contributes to social cohesion. There will be also a need to create a stronger public service ethic. Issues of leadership, example, education, the use of the stick as well as the carrot are



important. In the end it is about implementing a deeply held belief in the duty to serve.

In analysing state-private sector relations, Western economists have underestimated the role of social networks - the so-called "Guanxi" - in Western society as well as their successful operation in East Asia economies. The distinction between the state and the private sector is in fact extremely blurred suggesting that a state-private dichotomy is not a useful way to understand the business sector in Viet Nam.

Professor Luong Van Hy observed that an important issue in Viet Nam is the extent to which specific parts of Vietnamese society have been exposed to significantly different degrees of risk in an increasingly globalised economy as well as the extent to which they have different risk-coping strategies and opportunities for economic mobility and human development.

He emphasised social relations as extremely important for Vietnamese people from all walks of life, particularly with regards to economic mobility and human development. Thus, identifying those excluded from social networks rather than categorising people as ethnic minorities or as other vulnerable groups is a useful way of understanding why people struggle to escape poverty.

There is a common assumption that urban poverty is much less a phenomenon than rural poverty. However, urban poverty has been vastly underestimated. Different local socio-cultural dynamics may affect urban poverty, and a better understanding of such dynamics would allow Viet Nam to deal with the issue much more effectively.

Once an inspiration to women around the world, Vietnamese women have been forced to retreat into the household because of obstacles to their participation in the country's professional and public life.

Finally, the research agenda for a 20 year review of *doi moi* and its implications for policymaking should follow an inter-disciplinary approach involving social scientists working across the boundaries of economics, sociology, political science and anthropology.



For the last 20 years *doi moi* has focused on transforming a command economy into a socialist-oriented market economy and the first research question on the government and the state should examine the extent to which such a transformation has happened. The first question is: how much has the delegation of public services and the scope and scale of government intervention in the market actually changed? Second, where is the public sector working well and how can public institutions work together? Finally, managing the social change that will come with economic development requires the state to identify the changing aspirations of the population as it becomes wealthier, and respond in a timely and appropriate manner. Up to what point are the Communist Party of Viet Nam, the Government and the State of Viet Nam capable of organising social transformations?

Looking at the development of the market economy in Viet Nam, the research questions relating to the quality of investment and growth focus on three main aspects. First, what variables affect the increase in corporate and household savings in Viet Nam and the link between them and investment? Second, how can Viet Nam link savings to productivity enhancement avoiding non-productive investment such as speculation in land or corruption? And third, to what extent are land speculation and corruption a problem? Regarding private sector development, another three research questions were presented. First, how could the informal sector organise itself to join the process of global integration? Second, what are the barriers limiting the development of large private sector companies? And third, how can the state support SOEs in ways that are beneficial to society without degenerating into cronyism?

The proposed research agenda on proactive international integration focused on three main research questions. First, given its short-term commitments in terms of bilateral trade agreements (BTAs) and accession to the World Trade Organisation (WTO), how much policy space does Viet Nam have to develop an industrial policy aimed at creating vigorous industries that can achieve economies of scale, acquire new technology and compete in new international markets? Second, bearing in mind it is time for Viet Nam to move from a factor driven economy to an investment driven economy, how effective are Viet



Nam's competitiveness enablers and which industries should grow or be sustained? Finally, what should be the role of the state in defining industrial policy and up to what level can it adopt East Asian style industrial and development policies?

The broad topic of culture and society in the research agenda should look at how Viet Nam can achieve an equitable and civilised society. The research agenda should pay more attention to local socio-cultural dynamics underlying migration, urban and ethnic poverty groups and regional dimensions of social change. Finally, the research agenda should bring light to the reasons behind the step backward taken by Vietnamese women under *doi moi* and improve our understanding of the relationship between law and society at large and not simply the law and the state.



PROCEEDINGS

OPENING CEREMONY AND KEYNOTE ADDRESS

<i>Time:</i>	08:30 - 10:30
<i>Co-Chairs:</i>	Professor Do Hoai Nam, Chairman, President Viet Nam Academy of Social Sciences Mr. Jordan Ryan, Resident Representative UNDP Viet Nam
<i>Opening Address:</i>	H.E. Nguyen Tan Dung, First Deputy Prime Minister of Viet Nam
<i>Keynote Address:</i>	Professor Peter Nolan, University of Cambridge

WELCOMING STATEMENT BY PROFESSOR DO HOAI NAM

Professor Do Hoai Nam opened his speech by expressing a warm welcome to all participants.

At its Sixth National Congress in 1986, the Communist Party of Viet Nam initiated *doi moi*. **Initially *doi moi* focused on transforming the heavily subsidised command economy into a socialist-oriented market economy with various forms of ownership.** In the last 20 years, the *doi moi* process has recorded comprehensive, important achievements.

To draw lessons from the past and prepare for the next stage of development following the decision of the Political Bureau of the Party, a "20 Year Review of *Doi Moi*" has been carried out under the direct guidance of H.E. Nong Duc Manh, General Secretary of the Communist



Party of Viet Nam for the last two years. **All relevant Party and Government agencies have been mobilised to produce an accurate assessment of the *doi moi* reform process and to draw lessons for the next stage in preparation for the next Party Congress.**

“The Assistance to the 20 Year Review of *Doi Moi* in Viet Nam” project is a joint initiative of VASS and UNDP. **The project will collect comments and recommendations from international organisations and researchers, and conduct discussions between foreign and Vietnamese scholars and policy makers on 20 years of *doi moi* in Viet Nam.** The focus of the project will be on:

- The transformation from a command economy to a market economy and other related development issues, such as fast and sustainable development for the next five years;
- Issues related to the development of culture, society and human resources in Viet Nam;
- The reform of the political system and the state, with a focus on administrative reform and the implementation of democratisation at the grassroots level; and,
- International economic integration.

Professor Nam pointed to possible areas of work for the project:

- Quality of investment and growth;
- Private sector development for employment generation;
- Poverty alleviation;
- Competitiveness and sustainable development;
- Opportunities and challenges in the process of socialisation;
- Transparency and accountability of local government;
- IT and communication for development; and,
- Corruption.

Based on the results of the research, policy recommendations will be made to relevant government agencies.



Professor Narn expressed sincere gratitude to UNDP for this initiative and to the participants for attending the roundtable. He then declared the roundtable open.

WELCOMING STATEMENT BY MR. JORDAN RYAN

Mr. Jordan Ryan said that the presence of H.E. Nguyen Tan Dung, First Deputy Prime Minister of Viet Nam, highlighted the importance that the Vietnamese Government attaches to the “20 Year Review of *Doi Moi*”.

He said *doi moi* has been one of the most successful examples of economic transformation in recent history, opening the way to new forms of economic organisation and management that have contributed to an historic improvement in the material well being of the Vietnamese people. Almost every aspect of economic life has been affected in some way by *doi moi*. Mr. Ryan said that **the success of *doi moi* can be attributed to the gradual but unmistakable changes in the role of government and the relationship between state and society.** Thus, from the outset, the reform programme has contained an explicit political dimension.

He stressed that **an accurate assessment of the *doi moi* period must extend beyond a review of domestic economic achievements and challenges to encompass the complex relationships among the economy, government, Party, state and society, as well as the processes of globalisation.** Understanding *doi moi* and its implications for policy making requires an inter-disciplinary approach involving social scientists working across the boundaries of economics, sociology, political science and anthropology. It will also require a willingness to ask difficult questions and confront the evidence in an objective and rigorous manner.

The reassessment of *doi moi* comes at an important policy juncture as the Tenth National Congress, due to be held in 2006, will reconsider the country’s recent economic, social and political progress and chart the course for the next five years. The coming years will witness profound economic, social and political change as the processes of



industrialisation and urbanisation accelerate. This will demand that the government and other institutions develop flexible and pragmatic responses to economic, social and political change, and that today's policy makers innovate and experiment every bit as much as their predecessors of two decades ago.

Mr. Ryan said *doi moi* is a truly Vietnamese articulation of Keynes' idea that the socialism of the future 'will emerge from an endless variety of experiments directed towards discovering the respective appropriate spheres of the individual and the social'. The challenge of the next 20 years is to extend and deepen the *doi moi* process to encompass the democratisation of social, economic and political life.

To conclude, Mr. Ryan expressed special thanks to VASS and partners in the government, the Party, the research community and other development partners in responding to the initiative and said that he hoped to work more closely with the latter as the review process unfolded.

OPENING ADDRESS BY H.E. NGUYEN TAN DUNG, FIRST DEPUTY PRIME MINISTER OF VIET NAM

On behalf of the Government of Viet Nam, H.E. Nguyen Tan Dung warmly welcomed the participants and said he highly appreciated the initiative of VASS and UNDP in organising the workshop.

He pointed to the comprehensive and important achievements of *doi moi*:

- Viet Nam successfully emerged from a socio-economic crisis;
- High economic growth between 1991 and 2000 when Viet Nam doubled its GDP with an average annual growth of 7.5 percent;
- Improved infrastructure and livelihood of the people;
- Socio-political stability;
- Expanded international relations and Viet Nam's enhanced international standing; and,



- Poverty has decreased from 58 percent in 1993 to 28.9 percent in 2002 and the Human Development Index (HDI) has increased from 0.610 in 1990 to 0.691 in 2002.

H.E. Nguyen Tan Dung attributed these economic achievements of the reform to the following factors:

- A successful transformation from a centrally planned and command economy to a socialist-oriented market economy;
- An appropriate FDI promotion law and policies that have successfully attracted remarkable amounts of FDI. At present, over 5,000 projects with FDI are in operation with a total registered capital of more than USD 45.5 billion. In 2004 alone, FDI enterprises accounted for nearly 15 percent of GDP, 30 percent of export volume and 4.9 percent of total tax collection;
- The gradual formulation of socialist-oriented market institutions and an accompanying legal framework;
- The successful transformation from a closed and import-substitution economy into an open and export-oriented economy, which is gradually integrating with the regional and world economy. Viet Nam has developed trade relations with 165 countries and signed trade agreements with 72 countries. Viet Nam has become a member of the Association of Southeast Asian Nations (ASEAN) Free Trade Area (AFTA) and joined the Asia Europe Meeting (ASEM) in 1996, Asia Pacific Economic Cooperation (APEC) in 1998 and will soon be a member of WTO;
- Economic growth accompanied by social progress, equity, and improved human development. Great efforts have been made to create employment, alleviate poverty, and develop education, sciences, health care and culture; and,
- A step by step reform of the political system focusing on: improving the capacity of the leadership of the Communist Party of Viet Nam; building a law-governed socialist state by and for the people; developing the role of civic organisations; pushing the process of democratisation and accelerating administrative reform.



Apart from the achievements there are also weaknesses, shortcomings and limitations:

- *Economics*: The growth rate is below its potential; the quality of growth and the competitiveness of the economy are low; the market mechanism is far from being comprehensive; macro balances are not solid and the process of international economic integration still lacks government initiative and a strategy.
- *Human resources*: The rate of poverty alleviation is falling; the rate of recurring poverty is still high; the income gap among various regions and strata of the population is growing; the quality of the education and health care systems is low; scientific and technological standards lag behind those of many countries in the region; social vices have not been curbed, and organised crime, corruption and drug addiction are on the rise.
- *State administration*: Administrative reform is far from meeting the requirements of the socio-economic reform; the bureaucracy has not improved sufficiently, and waste and corruption continue.

H.E. Nguyen Tan Dung said that **some lessons learned in the first 20 years of *doi moi* need to be absorbed:**

- **Persevere in the goal of national independence and socialism;**
- **Be comprehensive;**
- ***Doi moi* must be based on political and social stability;**
- **Serve the interests of the people, rely on the people and be responsive to new ideas;**
- ***Doi moi* must be based on domestic resources and, at the same time, make the best of outside resources;**
- **Uphold the leading role and capacity of the Communist Party of Viet Nam; and,**
- **Bring into full play the strength of the whole united nation.**

H.E. Nguyen Tan Dung expressed Viet Nam's continued commitment to the *doi moi* process. He said that he highly appreciated the initiative



of VASS and UNDP in organising the workshop and hoped it would bring valuable ideas, comments and recommendations.

KEYNOTE ADDRESS BY PROFESSOR PETER NOLAN, UNIVERSITY OF CAMBRIDGE

Professor Nolan began presenting his paper titled 'China at the Crossroads' by comparing the process of reform in China with that in the former Soviet Union. **The collapse of the Soviet Communist Party, the Soviet economy and the rise in poverty and inequality in the former Soviet Union had an immense impact on the way in which China has approached its reform efforts.**

Over the last two decades China's economic and political reforms have attracted the attention of the whole world. China's growth rates in GDP and exports have been remarkable. Poverty rates have been reduced and China has become the favoured home for many multi-national companies. However, history tells us not to get carried away and to look beneath the surface of events. **China's leaders recognise that China faces immense challenges as it enters the twenty-first century and are working extremely hard to meet those challenges and produce a sustainable and socially just development path in China.**

Looking beneath the surface of the statistics of growth and development we can see the deep challenges that are cause for reflection in China and amongst the international community:

- *Growing inequality.* In China about 800 million farmers and around 150 million migrants to the cities live on an average of one dollar or less a day. Another 40-50 million workers are unemployed due to reforms of SOEs. To some degree the situation corresponds to the 'Lewis model' of development in which a country's surplus labour is absorbed into fast growing sectors of the economy. However, **China's ongoing integration with the world economy and its ability to absorb huge amounts of foreign investment is producing clusters of modern businesses and residential areas isolated and protected from the surrounding mass of poor**



people. It is likely that for decades to come the bulk of China's citizens will be the rural poor. The resulting levels of inequality will present a huge problem for the Chinese leadership.

- *Competitiveness of Chinese businesses.* When China began to open itself to international business there was a difference of opinion as to what the consequences would be. One view, loosely described as the economic 'mainstream', believed that Chinese firms would learn to compete in the international free market and would soon catch up with global business leaders. Others argued that the history of economics and business tells a different story. The nature of competition is to produce a concentration of business power. The 1990s witnessed the breakdown of barriers to international capital and a process of merger and acquisition amongst the world largest firms at an unprecedented rate. The beginning of the twenty-first century is witnessing the flowering of an innate tendency toward concentration in the international capitalist system. Big business has become stronger through better branding, greater research and development, procurement at increasingly cheaper prices and the recruitment of more able people. What could almost be described as a 'law' of concentration in international business has seen a handful of 'systems integrators' - companies that organise other companies, contain global brands and leading technologies - come to dominate the high value-added sectors of the global economy. Such a development in itself presents serious challenges to firms in developing countries. However, in consolidating their positions the systems integrators have put pressure on their suppliers who, in response, are also consolidating at high speed. This has implications for development policy. **After two decades of cautious system reform China possesses few companies that can compete equally with global business leaders as systems integrators or as supply chain leaders.** In comparison by the 1970s, after 20 years of development, Japan had around one hundred globally known companies. The challenge for developing countries is they are joining a system that has never had such concentrated business power. This presents a far bigger challenge than anybody imagined 10 or 15 years ago.



- *The environment.* **China's environmental situation reflects the intense pressure of a huge and growing population upon China's already fragile natural environment and the impact of high-speed industrial growth.** Air and water quality is deteriorating at a rapid rate and serious soil erosion affects around 38 percent of the entire country. Desertification is increasing at the rate of around 2,500 square kilometers per year, equivalent to the area of a medium-sized country. In the past four decades, almost one-half of China's forests have been destroyed, so that China now has one of the sparsest forest covers in the world. There is 'rampant water pollution' and a serious and worsening shortage of fresh water. China's emission of organic water pollutants is as large as that of the USA, India, Russia and Japan combined.
- *Reinvigorating the state.* **As the market economy has developed the capability of the Chinese state to extract taxation has declined.** Central government revenue has declined to only 7-8 percent of GDP compared with 15-20 percent in other large developing countries, presenting problems for the provision of health care and education. Creating human capital is difficult in a society where 70-80 percent of expenditure on health and education now comes from personal contributions. There are also challenges within the Communist Party itself. Jiang Zemin, on the 80th anniversary of the founding of the Party, talked explicitly about the **rising tide of corruption both within the country and within the Party.**
- *Foreign control of the financial sector.* The financial system is at the centre of any country's political economy. **In China the interrelationship between the Communist Party and the financial system is far from resolved and waiting in the wings are multi-national financial institutions that are keen and able to increase their presence in the Chinese business system.** In the 1990s the Mexican leadership allowed the liberalisation of the manufacturing and services sectors but were insistent that the financial system would not become dominated by multi-national banks. Today 80-90 percent of Mexican deposits are with multi-



national banks. The same is true in Eastern Europe. The combination of internal weakness, the core position of the Party, the central role of financial institutions combined with the intense desire of large financial corporations to enter and penetrate the Chinese market is a potent danger for China's leaders.

Such wide-ranging challenges threaten China's entire social, economic and political system. **After two decades of successful reform China finds itself at a crossroads and must decide which path it takes.**

Professor Nolan argued that there exist at least four possible directions:

- *China proceeds with modernisation and deals with issues of social justice in the future.* According to this view, which is generally held by the newly emerging wealthy class, **China must go through a period of harsh primitive capitalist accumulation, characterised by growing inequality and continuing high levels of poverty.** A strong state will be necessary to maintain political stability during the transition. Social justice is for the future.
- *The Communist Party divests its monopoly on power, beginning a democratic process.* Proponents of this view believe that China should follow the US model of development. However, China has experienced damaging periods of instability following the end of dynasties at several points in its history. The human cost was extensive and could well be again. The debate revolves around the question of freedom. The interpretation of the word 'freedom' has been the object of intense debate in the USA since the 18th century. At the heart of this struggle is the battle over the role of the state, and its function in the achievement of 'negative' and 'positive' freedoms. 'Negative freedom' refers to the right of individuals to be protected from outside restraint. This view has been used to argue for decentralised political power, limited government and a free market economy. In response many thinkers have pointed to the corresponding extreme levels of inequality and poverty and argue that the state should instead serve as an instrument for the achievement of 'positive freedoms' to enable its citizens to be fulfilled human beings. Both approaches have enjoyed ascendancy at various



points in American history. Professor Nolan argued that the current administration is propagating 'negative freedoms' and that **China must decide whether it maintains a powerful role for the state to ensure positive freedoms for all citizens, or embraces 'free market fundamentalism'**, whose current intellectual and political ascendancy may turn out to be a relatively brief intermission in the long sweep of US history.

- *China returns to the Maoist development path.* China can learn from the heritage of Chairman Mao. It is unlikely that China will return to the Maoist path in the near future. However, **Maoist thought continues to influence many important intellectuals and, for Mao, positive freedoms were paramount.** It was the state's role to provide the possibility for people to fulfil themselves. Although the Great Leap Forward was a disastrous failure the underlying moral message is still attractive to many people in China.
- *China can "use the past to serve the future", turning to its own history for inspiration.* Many commentators point to the absence of a capitalist system in China's history, suggesting that a domineering state prevented its development. In fact China had a capitalist system that drove enormous economic progress over a period of 2000 years. By 1800 the province of Hainan, for instance, was at least as developed as comparable parts of Europe. People could trade and produce for the market, in the process releasing their technical and innovative capacity. Manufacturing, agriculture and trade are just a few of the areas that witnessed technological progress. **Historically, China's capitalism operated under the umbrella of an extremely strong state apparatus, established on a powerful ideology based loosely on Confucianism.** The professional bureaucracy was based on competitive examination and imbued with a deep ethical value system. It was also a system in which merchants and capitalists were allowed to flourish but were not allowed to control politics. Those who sought to enter the political arena had to study Confucianism and pass exams. Money was effectively kept in its place. State intervention built a vast free market with an effective legal system. The state paid



careful attention to monetary stability and intervened where markets failed, most visibly in water control, building large-scale irrigation systems. At the heart of the system was a deep conception of morality. For 2000 years the Chinese economy has been characterised by a vibrant market and state action built on strong ethical foundations.

Asia now has the opportunity to build a sustainable, prosperous and socially just society. Global civilisation requires the reestablishment of an ethic of caring for the mass of the people, for sharing and for social justice. While part of Chinese history, such an ethic has also been articulated by some of the most powerful thinkers in the West. Adam Smith, for example, provides a principal source of inspiration for free market economists across the world. In fact, **Smith had grave doubts about the ability of the free market to meet human needs. He believed that the market was a two-edged sword, with unique dynamic qualities, but also with deep in-built contradictions. The division of labour can have devastating effects on personality and well being, particularly of the poor.** Adam Smith believed that most people are equally endowed with ability and talent, yet are shaped by their work. He considered that people's capability for self-realisation was largely dependent on their social environment, especially their work environment, not on inherited differences. It is the duty of the state to mitigate the effects of the division of labour and enable people, especially 'the labouring poor', to fulfil themselves.

Smith also believed that the fundamental principle of a good society is benevolence. Unless a society is 'just', there is a grave danger that it will disintegrate into chaos: 'Justice, on the contrary, is the main pillar that upholds the whole edifice. If it is removed, the great, the immense fabric of human society, that fabric which to raise and support seems in this world, if I may say so, to have been the peculiar and darling love of Nature, must in a moment crumble into atoms'. If a society is not based on social justice then it will not survive.

China is now wrestling with globalised materialistic individualism and all the contradictions that produces and is trying to look at its own history and the relevant strands of global history to try to



produce a sustainable and socially just society. It is a choice of no choice. Without it the possibility for system survival is low. If China is successful it will contribute with other East Asian people to a fundamentally different world in the twenty-first century.

PLENARY PERSPECTIVES

Professor Le Dang Doanh, Advisor to the Minister, Ministry of Planning and Investment (MPI)

Professor Doanh thanked Professor Nolan on behalf of the participants and opened the floor for questions.

Mr. Robert Glofcheski, Chief Regional Economist, UNDP

Mr. Glofcheski said that financial risk, especially linked with international financial integration, is always a major risk for many developing countries. Thus, he asked if China was doing anything special to avoid such risk and if Professor Nolan could provide a positive view of the financial situation in China.

Professor Vo Dai Luoc, Member of the Prime Minister's Research Commission

Professor Luoc asked how Professor Nolan would counter those presenting a positive picture of China as a future world power that surpassed the US in certain areas.

Professor Le Dang Doanh, Advisor to the Minister, MPI

Professor Doanh said corruption is a serious problem in China, yet he also believed the Chinese state can play a great role in "using the past to serve the present". He asked how the Chinese state could fulfil this important mission and provide services to its people.

Professor Peter Nolan

Professor Nolan likened China's reform strategy to 'groping for stones to cross the river'. This continual experimentation is the most



important characteristic of reform in China, and is completely different to the process in the former Soviet Union and Eastern Europe. In response to the first question Professor Nolan said that such an approach particularly applies to China's financial system. For a long time international advisors and institutions pressed China to convert the renminbi to a freely floating currency; a view that is now less prominent in light of the Asian crisis. China is now in the fortunate position of being able to study the collapse of both the Soviet Union and the Asian crisis itself, an event that has deeply affected China's leaders' thinking regarding the sequence and pace of reform of China's relationship with the international financial system. China was actually more closely affected by the Asian crisis than many realised because of Chinese firms in Hong Kong, with serious potential consequences for China's financial system. So for the foreseeable future China will continue to move gradually and experimentally toward greater convertibility of the renminbi as it recognises the potential dangers of destabilising flows of capital.

Professor Nolan then turned to banking reform. He said banks have many functions, not purely to serve the interests of rent seeking and corruption. China faces difficulties with unemployment in the state owned sector. By lending to SOEs banks serve to sustain many firms whose demise would have severe repercussions for many.

Regarding the global financial system, Professor Nolan said that nobody can be really sure what will happen. However, many who think the system will not last point to the instability of many financial structures. Such instabilities reinforce the cautious approach of Chinese policy makers, who are also aware of the way global giant banks have been able to dominate the financial systems of other countries. Such experiences have encouraged the Chinese government to try to bolster the competitiveness of the Chinese financial system.

Professor Nolan argued that **there is an intense need for a strong and effective state to lead the development process.** In terms of expenditure, there are obvious priorities in education and health. However, both suffer large market failures. China has now recognised that the process of privatisation has gone too far and is now enhancing



state provision of both education and health. The state also has a role to play in the agricultural sector, another area subject to a high degree of market failure.

He then commented on the state's strong role in agricultural development and its ability to nurture competitive firms. Even in the West in the early nineteenth century, powerful firms only emerged behind powerful state protection. The same is true of Japan, South Korea and Europe. In the airline industry, for example, Airbus rose to rival Boeing only with state support. **Now China is looking for ways to enable its firms to compete as systems integrators or as firms that will grow and compete in the world market.**



PANEL I: PROACTIVE INTERNATIONAL ECONOMIC INTEGRATION

Time: 10:45 - 12:30

Chair: Professor Le Dang Doanh, Advisor to the Minister, MPI

Keynote Presenter: Mr. John Kurtz, Southeast Asia Director of A.T. Kearney

Panellists: Professor Tran Xuan Gia,
Head of Prime Minister Research Commission

Mr. Jonathan Pincus,
Country Economist, UNDP Viet Nam

Introductory words by Professor Le Dang Doanh

Professor Doanh opened the first panel of the roundtable introducing the keynote presenter and the panellist.

KEYNOTE PRESENTATION BY MR. JOHN KURTZ

The presentation of Mr. John Kurtz on Viet Nam's competitiveness focused on three topics:

- Viet Nam's progress in the course of the *doi moi* reforms and the coming risks of integration;
- Inputs and enablers of a country's competitiveness; and,
- Viet Nam's industrial competitiveness: How to compete and in what industries can Viet Nam compete?

Mr. Kurtz's presentation began by highlighting the remarkable progress that Viet Nam has achieved in terms of strong and sustainable economic growth. **Impressive export growth has been largely due to Viet Nam's program of trade liberalisation, suggesting greater integration with the global economy.** Trade liberalisation has given Viet Nam new markets for products and access to cheaper raw materials. Other benefits include:



- The expansion of Viet Nam's export markets for major commodities and products, with widespread optimism about WTO accession;
- Integration into global production and distribution networks;
- The opportunity to position the country as a base for a cost effective light manufacturing center in Southeast Asia;
- Access to advanced production technology;
- Improved price competitiveness of Vietnamese exports;
- Improved access to sophisticated managerial knowledge and best practices; and,
- Access to affordable consumer imports contributing to a better standard of living.

However, Mr. Kurtz warned that **if the effects of trade liberalisation are not fully anticipated, further liberalisation could damage vulnerable areas.** Potential risks include:

- Weaker domestic industries which don't enjoy economies of scale or factor cost advantages will be unable to compete with the influx of global products, especially commodities, where there is little differentiation between domestic and imported products;
- There is the danger Viet Nam will be caught in a low cost trap, able to compete only in those industries where labour cost outweighs scale. The cost of investment and the time required for learning would never outweigh the advantages of the global companies, whose products will be imported cheaply and directly to Viet Nam after liberalisation. The degree to which the risk outweighs the advantages for openness depends on how Viet Nam prepares itself for WTO and AFTA;
- The influx of cheaper imports from China and other neighboring countries could swing trade imbalances;
- The possible loss of FDI as production bases for industries like textile and garments may relocate to other countries to take



advantage of cheaper labour costs and closer proximity to raw materials; and,

- The possible loss of competitiveness of local service industries to foreign firms with larger economies of scale and advanced management.

Mr. Kurtz echoed Professor Peter Nolan's example of Mexico. **In the 1990s, Mexico was thought to be a success story; trade liberalisation was a path to growth and prosperity for its people.** However, foreign investment did not have the intended effect on the economy. Most manufacturing inputs were imported, ensuring Mexican industries remained sub-scale. **By 2000, FDI net inflows had increased impressively but GDP growth actually fell. Mexico became a low cost assembler, a political target for US labour unions, and had moved backward rather than forward.**

For Viet Nam to be truly competitive, Mr. Kurtz argued that it must improve faster than regional neighbours such as Thailand, China, Singapore, Malaysia, Indonesia and the Philippines. Viet Nam must move quickly to an open market, lower barriers that hinder business operations, create an environment with low levels of corruption, and compete heavily for FDI.

Addressing the second topic on inputs and enablers of a country's competitiveness, Mr. Kurtz argued that **if a national economy wants to obtain rapid gains in competitiveness, it must put in place several building blocks such as:**

- **A supportive environment**, both in terms of macroeconomics and political stability;
- **Better access to capital;**
- **FDI policy must** not only attract required funds, but also **drive technology transfer, and training and management expertise;**
- Development of **physical infrastructure** to reduce logistical costs and lower transaction costs; and,
- **Innovation and development of specific human capital.**



Mr. Kurtz emphasised that Viet Nam must do a few key things correctly at the same time and in unison. In terms of government priorities, several things must happen at the same time, and must be coordinated among ministries.

Viet Nam has been successful in attracting foreign investment to develop the country's private sector, but the overall value of FDI inflows has not yet returned to levels prior to the Asian crisis. **Viet Nam has received a lot of ODA and remittances, but there has been a slow inflow of FDI.** A.T. Kearney's FDI Confidence Index shows a decline in Viet Nam's ranking from 21 in 2003 to 30 in 2004. Taken separately, Viet Nam has made progress. However, other countries have developed faster, which is why Viet Nam has fallen behind. Mr. Kurtz repeated, "It's not about running fast; it's about running faster than others."

Viet Nam has improved significantly in the provision of basic infrastructure although there remains significant work to be made on core infrastructure costs, growth and access. Comparing Viet Nam to other countries we can see that Viet Nam's challenges include its relative ability to attract FDI and relative competitiveness in logistics. Shipping costs are much higher than in other countries and electricity and rental costs are middle ranking. Mr. Kurtz said the availability and cost of telecommunications - key drivers of competitiveness in other industries - is a serious concern. The service sector, for instance, depends on it. Although many countries argue that telecommunications is a vital strategic industry that should be protected from foreign investment, it is in fact the sector most in need of FDI.

Viet Nam's literacy rate (94%) and educational spending are high. However, **Viet Nam's per capita spending on education is among the lowest in the region.** In 2003 Viet Nam's per capita spending on education (USD 31.6) was way below Malaysia (243.7), Thailand (117) and Singapore (778). Tertiary education is also extremely important, yet Viet Nam is currently only focusing on primary education. Tertiary education is aligned with growth as languages and technical skills are industry priorities. Moreover, the general quality of



education and training in Viet Nam is very poor. **While innovation is not a core concern today, Viet Nam will have to build a foundation for the future.**

Mr. Kurtz used the coffee sector in Viet Nam as an example. Coffee has been a successful product and has made fantastic strides in its share of global export, but the growth of coffee industries is negative. **From a policy perspective, the key issue is to identify growth sectors, both industries and parts of industries.** For example, in electronics, should Viet Nam compete in product design, manufacturing, distribution and regional logistics, or prototyping? With further integration into the global economy, Viet Nam will be able to enter different parts of the production chain. Therefore, **policymakers should decide which part of the value chain Viet Nam should compete in. All successful countries have moved up the value chain, from low cost labour to higher skill inputs.**

Citing the example of Mexico, Mr. Kurtz remarked:

- Liberalisation can be disappointing if the necessary enablers are not in place;
- The industrial strategy and exchange rate policy must be supportive of the liberalisation process;
- There must be an appropriate balance between a country's exports and imports at the capacity growth rate (as determined by labour force and productivity growth);
- Investments in intangibles such as R&D and education result in more sustainable development than investments in fixed capital; and
- Establish strong development strategies and ensure strong linkages between foreign direct investment and domestic industries

Mr. Kurtz's conclusion focused on three areas:

- **Decide which industries to grow or sustain.** Some industries are export earners, and others which are not export earners such



as telecom, finance and banking, are necessary to ensure domestic and international competitiveness.

- It is time for Viet Nam to move from a factor driven economy to an investment driven economy. A high priority is to aggressively attract the right kind of FDI that helps increase the quality of labour. It is also important to understand to whom Viet Nam should market. **Viet Nam is an attractive destination for FDI but needs to identify which industries receive investment.**
- **How effective are Viet Nam's enablers?** Mr. Kurtz quoted multi-national corporations, who said that Viet Nam's "high transaction costs, expensive ICT, and underdeveloped commercial law are challenges" to the country's competitiveness.

PANELLISTS' PERSPECTIVES

Professor Tran Xuan Gia

Professor Cia thanked VASS and UNDP for organising the roundtable and inviting him to present his view on Viet Nam's integration into the world economy.

In his view, Viet Nam started the integration process quite early, when Viet Nam was a member of the Council for Mutual Economic Assistance (COMECON) although the nature and scope of that integration differed from today. In 1991, Viet Nam confirmed its policy of "active regional and international economic integration".

Professor Cia argued that Viet Nam embarked upon international economic integration in a very difficult situation as its economy was very weak and income per capita was among the lowest in the region. Thus, Viet Nam had to both establish market mechanisms and further the process of international integration. Over the last 20 years, Viet Nam has made significant progress in international economic integration, namely:



- Bilateral and multilateral international relations have been expanded (with the International Monetary Fund (IMF), World Bank (WB), Asian Development Bank (ADB), ASEAN, ASEM, APEC, European Union (EU), WTO, etc.);
- Important liberal policies to attract FDI and ODA resulting in large inflows of FDI and ODA; and,
- Appropriate export-promotion laws and policies which have increased export volumes in 2004 to about thirteen times that of 1991.

However, Professor Gia pointed to some limitations in external economic relations, such as:

- High value-added goods account for a moderate proportion of exports;
- Viet Nam's export volume is small compared to that of most countries in the region;
- FDI growth is low and indirect foreign investment is small;
- Although it has improved, the investment environment is still less attractive compared to many neighbouring countries; and,
- ODA disbursement is low.

Professor Gia believed **it is possible to draw some lessons from the process of economic integration:**

- Given the context of imminent crisis and economic blockage, **Viet Nam's comprehensive reforms were absolutely correct;**
- **Viet Nam is slow to understand the positive and negative sides of international economic integration;**
- **Some government agencies and SOEs want to prolong protectionist measures, as they are not prepared for the challenges of integration;** and,
- If reforms, such as the Company Law and export permits for private companies, had been carried out earlier, the economy would have grown at a faster rate.



Professor Gia then tackled the very important question of what Viet Nam should do in the next stage. He said that the overall objective is achieving a breakthrough in international integration and external economic relations, both in perception and in practice. Professor Gia argued that:

- It is imperative to be pro-active and more comprehensive during the process of regional and international integration;
- In the process of joining the WTO, Viet Nam should make all necessary preparations to sign bilateral trade agreements with as many countries as possible;
- Radical reforms should be carried out in the field of institution building for the market economy;
- Viet Nam should create favourable conditions for investors, both domestic and foreign; and finally,
- Viet Nam should promote exports in order to double export volume in five years.

Professor Gia concluded that improving international competitiveness would help Viet Nam achieve successful economic integration and accelerate development.

Mr. Jonathan Pincus

Mr. Pincus asked what kind of research should be undertaken in the coming year to assist the 20 year review of *doi moi* to make an assessment of past reforms and help policy-making for future reforms.

Mr. Pincus analysed the link between growth and exports. He said that **in light of many Latin American countries' integration experience, Viet Nam should be clear what the causes of integration without growth are.** Returning to the example of Mexico he said Mexico attracted a great level of FDI, doubling exports but in the end experiencing slower GDP growth. Mr. Pincus advised that Viet Nam should avoid the concept of "export fundamentalism," which argues that higher productivity growth is directly caused by export growth. Export growth is related to economic growth, but it is not the single



most important factor. **So when thinking about competitiveness Viet Nam should avoid equating exports with competitiveness because of the danger of being caught in the low cost trap.**

Mr. Pincus then said **East Asian economies are distinguished from Latin American economies not by levels of export growth but by the rate of investment, which is linked to domestic savings.** A key determinant of East Asian success was the reinvestment of corporate savings. Both East Asian and Latin American countries enjoyed high levels of exports but Latin American countries did not achieve the growth that the East Asian countries enjoyed.

Mr. Pincus raised **a number of issues for the research agenda in Viet Nam:**

- How can Viet Nam increase **corporate and household savings?**;
- How can Viet Nam **control speculative investments** in the land market and the **role of corruption in inducing wasteful investments?**;
- Although small and medium enterprises (SMEs) are important in generating employment and poverty reduction, it is imperative to have **vigorous industries** that can achieve economies of scale, acquiring new technology so Viet Nam can compete in new international markets; and,
- Given its short-term commitments, **how much policy space** does Viet Nam have to **encourage investment, nurture domestic industries and attract the right kind of investment that leads to technological upgrading?**

Mr. Pincus concluded by giving a more detailed list of issues to be raised:

- How much do we know about the rate of corporate savings and profit retention in Viet Nam? What is the link between corporate savings and investment in Viet Nam? Can Viet Nam sustain a rate of accumulation equal to the trajectory of successful East Asian countries? Are these savings linked to productivity enhancement?;



- What is the extent of non-productive investment, particularly speculation in land in Viet Nam? To what extent is it a drag on production? This suggests that the actual rate of investment is not a good indication of Viet Nam's current rate of capital accumulation in productive industries;
- The issue of import intensiveness of export production by domestic and join-venture enterprises in order to understand the linkages between domestic and join-venture firms and industries so that we can attract the right kind of FDI; and,
- To consider policy scope for Viet Nam given international commitments to nurture domestic industries, to encourage the right kind of FDI, avoid the wrong kind of FDI, and understand how all of that is related to Viet Nam's dynamic competitive advantages in the long-term.

Professor Le Dang Doanh

Professor Doanh said he highly appreciated Mr. Pincus' presentation, which demonstrated his deep understanding of Viet Nam. Professor Doanh said raising domestic savings, particularly savings by Vietnamese firms, to increase productivity rather than investing in land speculation was a particularly powerful idea.

Professor Doanh also valued the contribution of Mr. Kurtz, particularly the idea that Viet Nam should continually compare itself to its competitors in the region so as not to lag behind. Education was a subject of intense debate in Viet Nam. Although Viet Nam's primary education may be good, high school and university education lags behind. Vietnamese students' English skills need to be given more attention.

Professor Doanh then drew the participants' attention to another issue about Viet Nam's economy. He said **Viet Nam had two economies**. The official economy, which was governed by official financial regulations, and which paid tax and another economy comprising some 2.2 million households and 6 million farming households, which is under threat from large multinational companies. **The question is how to help this "unofficial" economy to organise itself and join the stream of**



integration. Professor Doanh asked Mr. Pincus to include this issue into the research programme that Mr. Pincus recommended earlier.

Professor Doanh said that many of Viet Nam's 160 thousand enterprises are dynamic, energetic and pro-active. They practice thrift, cut costs and aggressively seek new markets. Yet, many other firms rely heavily on the state and protection to maintain their monopoly. The fight against monopoly power and the struggle to reform state-owned companies is of utmost importance. A comprehensive approach to help all sectors, including small-scale enterprises, to embark upon integration is required.

Finally Professor Doanh said that Viet Nam's strength lies in its human resources. The Vietnamese people are intelligent, committed and hard-working. **To enable them to fully realise their capabilities, it is necessary to continue reforming the education and health care system.**

PLENARY PERSPECTIVES

Dr. Martin Gainsborough, University of Bristol

Dr. Gainsborough said that when it comes to picking industries there is a view that there is nothing much the state can do, as firms will only know whether they are able to compete once they enter into the market. However, **the state actually has a role to provide information to firms to enable them to move ahead in particular industries.** Viet Nam should focus on determining what sort of research the state should do and how should it pass the information to companies, as many companies might be suspicious of information coming from officials.

Dr. Luu Bich Ho, Member of PMRC

Dr. Ho asked if Viet Nam could enhance its competitiveness by 2010 and what were the critical constraints Viet Nam faced in achieving this goal?



Professor Pham Xuan Nam, Former Vice-Director VASS

Professor Nam said opinions differ as to the state's role in social and human development. Some argue that the market mechanism should be applied to education and healthcare. Others argue that the state must retain such roles. Alternatively, the solution is somewhere in between. Professor Nam asked what the current thinking was.

Professor Luong Van Hy, University of Toronto

Professor Hy asked how Vietnamese firms could cope with the challenge presented by the new agglomeration.

Mr. Kurtz

Mr. Kurtz responded to the first question by sharing the view that firms are all responsible for their investment, however, relevant government ministries can play a major role. By working closely with academic circles and the donor community, **the government can identify primary industries and which firms and industries could become suppliers rather than producers, which industries are threatened by global giants, which are the industries where Vietnamese firms can compete and so on.** He said that **ministries could make significant contribution if they developed effective plans and talented experts and officials could work independently and free from political interference.**

Professor Nolan, University of Cambridge

Professor Nolan said China has demonstrated the danger of predominantly market-based provision of education and health, key aspects of a cohesive and socially just society. The challenge is finding the optimal balance between state and market. **Specific decisions should be made by each country depending on its practical reality, as it is not simply the provision of education at issue but the content of education and the moral foundation of society.** In Europe there are two models. In the UK there exists a thriving private sector, while in France state education dominates. Each society should make its own decision over which system to adopt.



Turning to industrial policy Professor Nolan said that given the evolution of the world system it is not easy to move up the value chain. All of the major sectors are dominated by global giants. In terms of determining which firms and industries the market already gives a solution as to which firms can move ahead and compete. This can be clearly shown in the case of private companies. Global leaders in industries have their own policies. Big companies such as Boeing, Airbus, Ford, and Toyota meet with potential suppliers to decide which to contract with.

Another option is joint-ventures. People think that joint-ventures would help local firms to catch up. But it is an illusion. **World giants come to China to set up joint-ventures with a number of plants. No individual plant can compete but world giants pool the plants together into a world system.** So in China there are many joint-ventures with world giants, but none of the plants can catch up and compete with the giants.

Another aspect is monopoly. World giants talk about setting up level playing fields, but they are setting up very unlevel playing fields in developing countries. **What is very important is merger policy. By allowing mergers and acquisitions, big companies can emerge.** France has been very successful in this policy and it now has various successful giants, Airbus for example. China has only recently recognised this and let successful companies merge together. This is the case in the oil and chemical industries, which are now becoming a real challenge to some world giants in these fields.



PANEL II: STATE, GOVERNMENT AND POLITICAL SYSTEM

Time: 14:00 - 15:30

Chair: Dr. Nguyen Si Dung, National Assembly

Keynote Presenter: Professor Melanie Beresford, Macquarie University

Panellists: Dr. Martin Gainsborough, University of Bristol

Dr. Thang Van Phuc, Vice-Minister MOHA

Introductory words by Dr. Nguyen Si Dung

Dr. Nguyen Si Dung opened the afternoon session introducing Professor Melanie Beresford, the keynote presenter of the second panel on State, Government and Political System.

KEYNOTE PRESENTATION BY PROFESSOR MELANIE BERESFORD

Professor Melanie Beresford stressed that there existed a knowledge gap on *doi moi*, government, the state and political system. There is little Vietnamese data or international literature available. Professor Beresford, therefore, focused on two main points: the way the state and political life are influenced and have been influenced by the changing economic structure and comparisons with other East Asian countries.

Professor Beresford looked at the role of the state in the East Asian development experience. Robert Wade's concept of 'alliance capitalism' was a useful way to describe the way in which East Asian countries combined the power of the state with industrial development. Wade identified three important features:

- Firms were characterised by a high debt-equity ratio, and were not reliant on stock markets for capital;
- There were very close relations between the business sector and the government; and,



- There is a difference between ‘alliance capitalism’ and what has been popularly termed ‘cronyism’. ‘Alliance capitalism’ is driven by an economic rationale but ‘crony capitalism’ is driven by political rationales.

Governments can only exist in the long term if they are broadly perceived as legitimate by the population. Where governments suffer low levels of legitimacy it is easy to see how politics and economics go together, as every economic decision creates political conflicts and vice versa. **In cases such as Viet Nam where governments enjoy high levels of legitimacy it is not so easy to see the relationship between politics and economics.**

‘Alliance capitalism’ can become ‘cronyism’ when state actors are unable or unwilling to keep the business community at arms length. Key lessons can be drawn from South Korea where the state was able to maintain separation from the business sector and discipline firms.

Professor Beresford reiterated Professor Peter Nolan’s point that investment is the key to economic growth. Investment decisions are not short-term decisions and they create long-term structural change. **In ‘alliance capitalism’, investment decisions are influenced directly by politics so the decisions of the private sector are not dominant during the early stages of industrialisation.**

Professor Beresford turned to the evolution of the concept of ‘socialism’ in Viet Nam. Of the three key characteristics of socialism - central planning, public ownership, and the principle of labour-based distribution - Viet Nam retains only public ownership of the means of production. Therefore, **the policy rationale for maintaining SOEs in Viet Nam has been the state’s ability to influence long-term structural change.** However, the state’s capacity to plan in Viet Nam is actually very weak and was originally reliant on Soviet aid.

Professor Beresford then proposed several important research questions:

- How can the state adopt East Asian styled industrial and development policies?;



- How can the state support SOEs in ways that are beneficial to the society without degenerating into the cronyism?; and,
- How can we achieve an equitable and civilised society in the context of the emerging market economy in Viet Nam?

Regarding the role of SOEs in the development of Viet Nam Professor Beresford likened SOEs to deformed babies born in the socialist system. Since the 1970s, the focus has not been on supporting existing SOEs but on building new enterprises, leading to huge over-investment. The common explanations for the inefficiency of SOEs, such as a lack of technical and managerial competence, failed to appreciate that the fundamental problems derived from the economic system itself.

In the 1990s, the Vietnamese government continued to support SOEs, providing them with subsidies. Unfortunately, many became increasingly dependent on credit simply to maintain their enterprises, rather than upgrading to become more competitive in the global market. However, FDI inflows in the form of joint ventures have helped the SOE sector upgrade itself technologically and financially. Professor Beresford observed that **the decisions of foreign investors rather than the SOEs themselves led to the changes in the Vietnamese economy in the 1990s.**

Professor Beresford then discussed social networking - the so-called "Guanxi" - in East Asian economies, where markets are characterised by embedded social networks. Such networks clearly operate in Viet Nam. **Western economists have underestimated the role of social networks in Western society as well as their successful operation in East Asia economies.** Networks are comprised of government officials, directors of large firms, directors of sub-contracting firms, and social relationships. **The distinction between the state and the private sector is in fact extremely blurred suggesting that a state-private dichotomy is not a useful way to understand the business sector in Viet Nam.**

Professor Beresford then argued that exclusion from networks is a cause of poverty and inequality in Viet Nam today. **Identifying those excluded from networks rather than categorising people as ethnic minorities or as other vulnerable groups is a useful way of**



understanding why people struggle to escape poverty. Possibly the most important reason for wide acceptance of *doi moi* is increased individual autonomy and people's enhanced capacity to assume control of their lives.

However, Professor Beresford believed that Vietnamese women have taken a step backward under *doi moi*. **Once an inspiration to women around the world, Vietnamese women have been forced to retreat into the household because of obstacles to their participation in the country's professional and public life.**

PANELLISTS' PERSPECTIVES

Dr. Nguyen Si Dung

Dr. Nguyen Si Dung observed that after 20 years of *doi moi*, Viet Nam is beginning a new period of development requiring more markets as well as more democracy. More markets will require a clear understanding of the role of the state and of the market. However, the government should impose the system of principles on the market to ensure its efficient operation.

Dr. Dung suggested that the state may not be the most efficient provider of public services, however, it could provide regulations and principles of delivery. The state should also ensure the provision of transparent information, such as accounting practises and accounting. If the government intervenes directly there is the risk of 'crony capitalism'.

Dr. Dung saw grass-root democracy as a model to balance the diversified interests of society. Viet Nam is also developing its civil society so that everyone can voice and propagate their interests. More representation of the poor and farmers in the National Assembly is required so that decisions reflect the needs of the poor. To ensure equality, the state needs to invest in education and health care to provide every individual the opportunity to develop their capacity. Inequality in capacity building will lead to inequality in access to services.



Dr. Martin Gainsborough

Dr. Martin Gainsborough argued that the interrelation between the economic and the political should be seen as a dynamic relationship. The state seeks to influence development, but at the same time the state and the society are altered by that experience, in turn demanding further response by the state to the foreseen and unforeseen consequences of development.

Dr. Gainsborough's comments focused on the quest for a development model and the issue of inclusion and exclusion in Viet Nam. The quest for a development model involves the state, business and banks working closely together. As Professor Beresford said, it need not be cronyism, however, there is always the possibility of crony capitalism developing. Dr. Gainsborough said that as we are designing a research agenda we couldn't afford to ignore the Communist Party of Viet Nam or the National Assembly.

Dr. Gainsborough then turned to the East Asian model and its relevance to Viet Nam. He said there was a need for greater coherence, a stronger National Assembly and People's Councils. The world has changed since the successes of Taiwan and Korea in the 1950s and 1960s, or Malaysia and Thailand in the 1970s and 1980s. There are new constraints and processes such as globalisation and the transnationalisation of capital that demand different approaches. However, there is probably more room for manoeuvre than is commonly thought. Any future research agenda should look at the details of new constraints as well as new sources of opportunity.

Dr. Gainsborough then raised two very important issues for Viet Nam: first, managing the social change that will come with economic development; and, second, institutions. **The state has to identify the changing aspirations of the population as it becomes wealthier, and respond in a timely and appropriate manner.** The examples of Singapore and Thailand may provide lessons for Viet Nam. South Korea's transition was accompanied by high labour unrest. Could something similar happen in Viet Nam and how could it be prevented? Other countries may provide the answers. Another example is the issue



of participation. It is necessary to determine what constitutes the kind of participation that contributes to social cohesion.

Turning to the question of institutions, Dr. Gainsborough said that there is still much research to be done. In his own work he had looked at the State Treasury in Viet Nam: set up in 1990, it was vertically integrated, operated at the local level and was a clear attempt to create order and robustness. He asked whether it was the beginning of a new breed of technocratic, efficient institutions. It may well be so, but **there is also a need to create a stronger public service ethic**. Salary reform is not necessarily the answer. **Issues of leadership, example, education, the use of the stick as well as carrot are as important. In the end it is about implementing a deeply held belief in the duty to serve.** The research agenda should look at places where the public sector works well, and the way institutions work together.

Dr. Gainsborough finished with three questions: where do we think Viet Nam will be in 20 years time? Where would we like Viet Nam to be in 20 years time? And, what do we need to ensure we will get there?

Dr. Thang Van Phuc

Dr. Phuc said that re-defining the development model was now a critical challenge for the whole region as well as each nation, and it was impossible for Viet Nam to exactly imitate others.

Dr. Van Phuc observed that political support for economic subsidies for SOEs still prevailed in the Vietnamese economy. It was impossible to completely abandon a centrally planned system when subsidies were still in place and an equal playing field had not been established for every actor and individual in the society.

Dr. Phuc agreed that Viet Nam's public administration reform was slower than economic reform. This may be because economic forces create the momentum for administrative and political reforms. He recommended that the project could consider the issue of socialisation and the delegation of public services and the scope and scale of government intervention in the market.



PANEL III: CULTURE, SOCIETY AND HUMAN DEVELOPMENT

<i>Time:</i>	15:45 - 17:15
<i>Chair:</i>	Professor Do Hoai Nam, Chairman, VASS
<i>Keynote Presenter:</i>	Professor Luong Van Hy, University of Toronto
<i>Panellists:</i>	Dr. Pham Minh Hac, Institute of Human Studies Mr. Michael Digregorio, Ford Foundation

Introductory words by Professor Do Hoai Nam

Professor Do Hoai Nam presented the last keynote presenter of the day Professor Luong Van Hy, a Vietnamese professor at University of Toronto.

KEYNOTE PRESENTATION BY PROFESSOR LUONG VAN HY

Professor Hy observed that for the majority of the Vietnamese population living standards have improved during the *doi moi* period. *Doi moi* has also increased opportunities for people to participate in society. However, several challenges have also emerged such as increasing health and education costs, emerging risks following integration with global markets and serious environmental problems.

Professor Hy pointed out that an important issue in Viet Nam is the extent to which certain sectors of Vietnamese society have been exposed to significantly different degrees of risk in an increasingly globalised economy as well as the extent to which they had different risk-coping strategies and opportunities for economic mobility and human development. The future research agenda should pay more attention to local socio-cultural dynamics, particularly those underlying migration and poverty.

There is a common assumption that urban poverty is much less a phenomenon than rural poverty. However, Professor Hy suggested that urban poverty has been vastly underestimated. Using data from his Ford Foundation-funded project in collaboration with the Social Sciences Institute in Ho Chi Minh City, he pointed to the emergence of



a new phenomenon in Viet Nam that has not been fully captured by the Living Standards Survey data. There is a need for better living standards research in Viet Nam, especially in the urban context.

Professor Hy made the following observations regarding migration and poverty in the Mekong River Delta and the Red River Delta:

- Migrants in the Mekong Delta tend to stay long-term in the new community, while migrants from the Red River Delta and Northern provinces are more likely to be seasonal migrants.
- Higher degrees of mutual assistance within the central and northern communities suggested higher degrees of social capital in central and northern communities than southern communities.
- A lower proportion of migrants returned to the southern province of Long An than the northern province of Bac Ninh, which shows the local socio-cultural dynamics.

Professor Hy then hypothesised that the urban poverty rate in the south maybe higher because people tend to stay in the city , even in times of economic downturn. **So different local socio-cultural dynamics may affect urban poverty, and a better understanding of such dynamics would allow Viet Nam to deal with the issue in a much more effective way.**

Turning to the ethnic dimension of poverty, Professor Hy observed that the poverty rate had declined more slowly among ethnic minorities than Chinese and Kinh. The Viet Nam Development Report in 2004 suggested that the poor in ethnic minorities could make up to 40 percent of the poor in Viet Nam by 2010. It is important to understand the underlying reasons for this phenomenon, as it is not simply the difference in actual financial and human capital among ethnic groups.

Professor Hy then discussed the significance of 'social capital'. Social relations are extremely important for Vietnamese people from all walks of life, particularly with regard to economic mobility and human development. **The hypothesis that the role of social capital explains the differences among ethnic groups and along regional dimensions needs to be studied more systematically.**



Professor Hy stressed **the need to better understand the relationship between law and society at large and not simply the law and the state.** It is very useful to know the new trends in poverty and human development in Viet Nam and why there is an increasing gap among different regions and groups in Viet Nam.

PANELLISTS' PERSPECTIVES

Dr. Pham Minh Hac

Dr. Hac agreed with Professor Hy's observations on the differences among regions, gender and ethnic groups.

Dr. Hac then said that the progress in human development is an outstanding achievement of *doi moi*. Human development is the goal and motivation for socio-economic development. Human capital is the prerequisite for the success of a market economy, integration and open door policies.

The idea of human development being the determining factor of all development has been incorporated in Viet Nam. Following UNDP's guidelines, Viet Nam has worked hard to improve its Human Development Index. Viet Nam's HDI has increased from 0.610 in 1990 to 0.691 in 2002.

Mr. Michael Digregorio

Dr. Digregorio focused his comments on issues of social relations and entitlements. Economic relations consist of exchanges of land, labour, and capital. Capital more frequently refers to all forms of financial assets. Land, in addition to being properties, also means physical assets, buildings, and equipment. Labour has come to imply endowments, including health, education, traditional knowledge and craft. Social capital refers to social relations within economic systems. In other words, it provides the *fourth* point of analysis, whereas traditional or classical economics only focuses on the issues of land, labour and capital. Social relations are an important factor even in a socialist economy. Dr. Digregorio used Amartya Sen's term 'entitlement' to



describe social capital, as he considered entitlements the active part of social relations. Entitlements will increasingly become the basis of new forms of poverty as well as new forms of wealth.

Dr. Digregorio then discussed several of Professor Hy's observations. First, many of what Professor Hy called 'increased opportunities to participate in society' are, in fact, opportunities to build social relations and to increase entitlements. For example, the increase in expenses and participation in funerals and weddings, which provide opportunities for people to enhance relationships. **People in the Red River Delta and North Central Viet Nam have been more successful in maintaining social networks than those in the South.** This has to do with culture and settlement patterns. In the south, villages are dispersed along rivers and canals. **There is mutual assistance in northern Vietnamese villages for poor farmers, and widows, as well as social protection at the local level.** Foreign donors and non-governmental organisations (NGOs) have worked hard to support the tradition of local assistance using microfinance or low interest loans for the poor. However, more work needs to be done. Increasingly, **as urban people are exposed to market risk and rising levels of debt they are looking more to contacts in hospitals or banks to help them cope with rising health and education costs.**

Turning to poverty and ethnicity, Dr. Digregorio said that entitlements add to the difficulties in addressing poverty among ethnic minorities. Poverty reduction for ethnic minorities has taken the form of loans or admission to universities. When this happens, Kinh families living in ethnic regions complain that ethnic minorities receive more benefits than they do, although Kinh people are often better off. Entitlement issues are important but often overlooked. Mentioning two studies, Dr. Digregorio suggested that entitlements are equally important to the classical analysis of differences in physical assets, where endowments such as education and capital and are often overlooked.

Dr. Digregorio concluded by referring to Professor Beresford's comments. He observed that gender relations also provide a context for entitlements and there are entitlement issues in rural-to-urban migration. Rural-to-urban migrants face difficulties they are not faced by people who remain settled, such as social protection and public services. These issues have to be dealt with in the future research agenda.



CLOSING REMARKS

CLOSING REMARKS BY PROFESSOR DO HOAI NAM

Professor Nam said that the speakers have referred to the achievements of 20 years of *doi moi* and the progress made in culture and social and human development in Viet Nam. Suggestions have also touched on the weaknesses and constraints that Viet Nam has to consider in the coming decade. These suggestions will help to specify the content of the project's research agenda, and then recommendations can be made for policy-making in the new stage of development in Viet Nam.

Professor Nam observed that the First High Level Roundtable meeting of the "Assistance to the 20 Year Review of *Doi Moi* in Viet Nam" project had been a success both in terms of straightforward discussion and academic spirit. Keynote presenters, panellists and the plenary have suggested new ideas and good policy advice to the Government of Viet Nam. On behalf of VASS, Professor Nam expressed his sincere thanks to the speakers, international scholars, representatives from international organisations in Hanoi, and Vietnamese scholars who had actively participated in the meeting.

Professor Nam also informed the plenary that **the Communist Party and the Government of Viet Nam are directing the preparation of the next Five Year Socio-Economic Development Plan (2006-2010), with the aim of breaking away from the status of low-income developing country.** To this end, it is necessary for Viet Nam to make a breakthrough in its development thinking.

Professor Nam said that, **in the next five years, Viet Nam should focus on:**

- **Developing market institutions** suitable with its socialist orientation;
- Paying more attention to the **quality of growth**;
- Paying more attention to **social and cultural issues**;



- Improve the efficiency and effectiveness of the **government apparatus**;
- Being more proactive in **international economic integration**; and,
- Creating a development process that is more **environmentally friendly**.

Professor Nam also said that, during his brief talk with Mr. Jordan Ryan, First Deputy Prime Minister Nguyen Tan Dung said that Viet Nam expected to receive more help from UNDP in preparing the next Five Year Plan. Professor Nam strongly believed that, with the cooperation of UNDP, Vietnamese research organisations, policy-making institutions and the administration; the Deputy Prime Minister Nguyen Tan Dung's expectation would come true.

With that in mind, on behalf of the Vietnamese Academy of Social Sciences and Vietnamese scholars, Professor Nam once again expressed his sincere thanks to UNDP for its support and help in the process of knowledge transfer and research capacity building for Vietnamese social scientists and researchers.

Professor Nam wished all participants and their family good health, happiness and prosperity in the New Year.

CLOSING REMARKS BY MR. JORDAN RYAN

Mr. Ryan thanked Professor Nam and his VASS colleagues for their hard work, support and guidance. It had been an excellent beginning to the Review.

Mr. Ryan stressed that UNDP was delighted to reply positively to the First Deputy Prime Minister's request for continued help, both in terms of the next Five Year Plan and, more importantly, Viet Nam's efforts to meet the Millennium Development Goals and the Millennium Declaration.

Mr. Ryan thanked all of the panellists for their active involvement and discussion papers, which set the tone for the research agenda. Mr. Ryan joined Professor Nam in wishing the participants a very good New Year.



ANNEXES

CONFERENCE AGENDA

TWENTY YEAR REVIEW OF DOI MOI FIRST HIGH LEVEL ROUNDTABLE MEETING

Melia Hotel, 8 am 12 January 2005

- 8:00-8:30 Registration
- 8:30-8:45 **Welcome Comments**
 Professor Do Hoai Nam, Chairman, VASS
 Mr. Jordan Ryan, UNDP Resident Representative
- 8:45-9:30 **Opening Address:** Twenty Years of Doi Moi
 H.E. Deputy Prime Minister Nguyen Tan Dung
- 9:30-10:30 **Keynote Address:** China's Open Door Reform
 Professor Peter Nolan, University of Cambridge
- 10:30-10:45 Coffee and tea break
- 10:45-12:30 **Panel 1:** Proactive International Economic Integration
 Chairperson: Professor Le Dang Doanh, MPI
 Brief presentation: A.T. Kearney Discussants:
 Prof. Tran Xuan Gia, Head of PMRC
 Professor Le Dang Doanh, MPI
 Mr. Jonathan Pincus, UNDP
- 12:30 - 14:00 Lunch
- 14:00 - 15:30 **Panel 2:** State, Government and Political System
 Chairperson: Dr. Nguyen Si Dung, National Assembly



	Brief presentation: Professor Melanie Beresford, Macquarie University Discussants: Dr. Nguyen Si Dung, National Assembly Dr. Martin Gainsborough, University of Bristol Dr. Thang Van Phuc, Vice-Minister, MOHA
15:30 - 15:45	Coffee and tea break
15:45 - 17:15	Panel 3: Culture, Society and Human Development Chairperson: Professor Do Hoai Nam, VASS Brief presentation: Professor Hy Van Luong, University of Toronto Discussants: Dr. Pham Minh Hac, Human Study Institute Mr. Michael Digregorio, Ford Foundation
17:15 - 17:30	Closing Remarks, Professor Do Hoai Nam

LIST OF PARTICIPANTS

FIRST ROUNDTABLE MEETING ON 20 YEAR DOI MOI REVIEW

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H.E. Mr. Nguyen Tan Dung, Deputy Prime Minister,
Socialist Republic of Viet Nam

Prof. Peter Nolan, Keynote Presenter, University of Cambridge

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Prof. Le Dang Doanh, Advisor to the Minister, Ministry of Planning
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Prof. Do Hoai Nam, President, Viet Nam Academy of Social Sciences

Prof. Melanie Beresford, Macquarie University

Dr. Martin Gainsborough, University of Bristol



Dr. Michael Digregorio, Ford Foundation
 Dr. Nguyen Si Dung, Vice Chairman, Office of National Assembly
 Dr. Thang Van Phuc, Vice Minister, Ministry of Home Affairs
 Prof. Luong Van Hy, University of Toronto
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SPEECHES, PAPERS AND PRESENTATIONS

KEYNOTE PAPER BY PROFESSOR PETER NOLAN

CHINA AT THE CROSSROADS

Peter Nolan

Judge Institute of Management, University of Cambridge

Since the late 1970s, China has enjoyed one of the most remarkable periods of economic growth ever seen. However, the country faces deep economic, political and social challenges. These include the vast extent of poverty and rapidly growing inequality; the challenge for Chinese businesses from the global business revolution; a deeply degraded natural environment; declining capabilities of the state; a comprehensive challenge in international relations; widespread corruption; and extreme dangers in engaging closely with the global financial system. The Chinese leadership is trying to deal simultaneously with the challenges of globalisation, transition and development. No country has ever faced such a set of challenges. There are no textbooks to guide China along this path. The responsibilities for the leadership are massive, because the price of failure is so huge. The possibility of social and political disintegration is real. Every effort of policy has to be directed towards avoiding this potentially catastrophic outcome. In their search for a way forward, China's leaders are looking to the lessons from the country's own past, as well as to those from other countries, in order to find a way to build a socially just, stable, cohesive and prosperous society. This effort is of vital importance, not only for China, but also for the whole world.



1. The challenges to China's economic and political stability. Poverty and inequality.

Behind almost every aspect of China's development process in the early 21st century lies the harsh reality of the 'Lewis model' of economic development with unlimited supplies of labour (Lewis, 1954). China has a huge population of almost 1.3 billion, increasing by around 15-16 million people each year (SSB, ZTN, 2002). Almost 70 per cent of the Chinese population still lives in the countryside. There are as many as 150 million 'surplus' farm workers. Rural incomes stagnated from the mid-1990s to the early 2000s, and may even have declined. Rural income distribution has become much more unequal: the Gini coefficient of rural income distribution rose from 0.21 in 1978 to 0.40 in 1998. There was a massive decline in absolute poverty in the early years of China's rural reforms post-Mao (Nolan, 1988). However, Chinese official data show that there are approximately 580 million rural dwellers (73 per cent of rural households) with less than US\$ 360 per year (SSB, ZTN, 2002: 343).¹

The great extent of rural underemployment provides intense incentives for rural-urban migration, and intense downward pressure on non-farm wages in unskilled and low-skilled occupations. There are as many as 150 million rural migrants working in the urban areas. They are predominantly unskilled labour, earning US\$ 1-2 per day. Alongside the poor rural migrants, as many as 40-50 million workers have lost their jobs due to reform in state-owned enterprises.

Alongside these disadvantaged social groups, a new urban 'middle class' is fast emerging. Large amounts of FDI by multinational firms is producing clusters of modern businesses and residential areas, isolated and protected from the surrounding mass of poor people. Chinese privatisation has been characterised by widespread insider dealing and corruption, most notably in the ubiquitous triangular relationship between the local Communist Party, the banks and the allocation of

1. The World Bank estimates that in 1995 there were 716 million people (58 per cent of the population) who had less than US\$ 2 per day, and around 280 million who lived on less than US\$ 1 per day (World Bank, 2001: 236).



publicly owned land for 'development'. The official Gini coefficient of the urban distribution of income rose from 0.25 in 1992 to 0.34 in 2001 (SSB, ZTN, 1993 and 2002). However, these data exclude most rural migrants and foreign employees, and underestimate the highest incomes segments among the native Chinese urban population. If all these factors are considered, then China's urban income distribution is among the most unequal in the world. The early years of the 21st century witnessed a level of strikes and protests that has not been seen in China since the 1920s.

1.1. The global business revolution

Since the 1980s, China has implemented industrial policies intended to nurture a group of globally competitive large firms. In fundamental senses these industrial policies have failed. China is becoming the workshop *for* the world, rather than the 'workshop of the world'. Over sixty per cent of its industrial exports are from foreign invested enterprises. A substantial fraction of the remainder of the country's exports consists of industrial products that are either OEM manufactures, or low value-added, low technology, non-branded goods for global giant firms (e.g garments, footwear, furniture, toys). While the world's giant firms are rapidly building their research and development bases in China, employing relatively cheap, highly-skilled Chinese researchers, indigenous Chinese firms spend negligible amounts on research and development. There is not a single Chinese firm in the world's top 700 firms by research and development expenditure (DTI, 2003). China does not have a single one of the world's top 100 brands. Its leading firms are almost unknown outside the country. Among the fourteen Chinese firms in the *Fortune 500*, none has become a truly globally competitive company that could compete without government protection.² All of these firms are state-owned and subject to systematic state interference in their operation.

On the internal front, China's industrial policy encountered numerous problems. These included policy inconsistency; misguided pursuit of

2. Baosteel is a possible exception.



enterprise autonomy' rather than the multi-plant large firm; an impoverished mass of consumers within the protected domestic market; institutional barriers to cross-regional mergers and acquisitions; pursuit of greater firm size through diversified operations, leading to an 'illusion of scale'; persistent intervention in enterprise decisions by Party and Government officials; and huge 'legacy costs' deriving from the large numbers employed in the former SOEs.

On the international front, China's large firms face severe challenges. China's attempt to build large globally competitive firms has coincided with a revolutionary epoch in world business history, with a unique intensity of merger and acquisition. An unprecedented degree industrial concentration has been established. A veritable 'law' has come into play. Within the high value-added, high technology, and/or strongly branded market segments, a handful of giant firms, the 'systems integrators', occupy upwards of one-half of the global market (Nolan, 2001a and 2001b). The process of concentration ripples across the value chain. Leading firms in each sector select the most capable suppliers, in a form of 'industrial planning', adopting 'aligned partners' who can work with them across the world. A 'cascade effect' produces intense pressures upon first tier suppliers, forcing them to develop leading global positions, achieved through expanded research and development, and investment in global production networks. The result is a fast-developing process of concentration at a global level in numerous industries that supply the systems integrators.

The full flowering of capitalism's tendency towards industrial concentration presents a comprehensive challenge for large firms in developing countries. At the dawn of the twenty first century, intense industrial concentration among both systems integrators and their supply chain, brought about through pressure from the 'cascade effect', presents a comprehensive challenge for both Chinese firms and policy-makers. Not only do they face immense difficulties in catching up with the leading systems integrators, the visible part of the 'iceberg', but they also face immense difficulties in catching up with the powerful firms that now dominate almost every segment of the supply chain, the invisible part of the 'iceberg' that lies hidden from view.



In September 2004, almost three years after China joined the WTO, Li Rongrong, Head of the State-owned Assets and Administration Commission (SASAC) acknowledged: *'There is still a huge gap between China's large enterprises and the world's leading multinational companies, whether one looks at the comparison in terms of their number, scale or efficiency, or from the angle of strength of profits and innovative capability, or internationalization'* (People's Daily website). Successful late-comer industrialising countries, from the USA in the late nineteenth century to South Korea in the late twentieth century, each produced a group of globally competitive firms. China is the first successful latecomer not to have done so. It has become the sixth largest economy (the second largest in PPP terms) (World Bank, 2004) without having a group of internationally competitive large firms. This is highly significant in the history of economic development.

1.2. The environment

China's environmental reflects the intense pressure of a huge and growing population upon China's already fragile natural environment, with the impact hugely reinforced by high-speed industrial growth. Recent Chinese provincial-level studies of 'Green National Product' estimate that 'real output growth' falls to negligible levels when destruction of the natural environment is taken into account. The area affected by serious soil erosion has increased to include around 38 per cent of the entire country (UNDP, 2000: 70). The area of desert is increasing at the rate of around 2,500 square kilometres per year, equivalent to the area of a medium-sized country. In the past four decades, almost one-half of China's forests have been destroyed, so that China now has one of the sparsest forest covers in the world. There is 'rampant water pollution', and a serious and worsening shortage of fresh water. China's emission of organic water pollutants is as large as that of the USA, India, Russia and Japan combined (World Bank, 2004: Table 3.6).

China explosive industrial growth has led to high-speed expansion of energy-intensive industries. By the mid-1990s, China had overtaken the USA as the world's biggest coal producer, accounting for almost thirty



per cent of global output. Coal provides a low-cost way to meet a large fraction of China's booming energy demands. China is the world's second largest producer of carbon dioxide, standing at 50 per cent of the level of the USA, but its per capita emissions are still a mere 11 per cent of those of the USA (World Bank, 2004: Table 3.8). If China follows the US path, allowing complete dominance for the automobile, then the prospects for the world are terrifying. If China's were to sustain its current growth path and at some point catch up with today's USA level of per capita income, and were to use similar technologies, China's emission of carbon dioxide would be one-fifth greater than those of the entire world today.

1.3. The capability and role of the state

The professional capability of the Chinese state has greatly increased since the early 1980s. However, it needs comprehensive reinvigoration that goes far beyond improved technical competence. It needs substantially to expand its scope in order to undertake activities that the market is unable to provide and to re-establish its ethical foundations. Reinvigorating a state apparatus that has atrophied may present greater challenges than constructing from scratch a strong, effective apparatus to serve development needs.

Government. China is a vast, poor country with urgent development needs, which can only be met by state action. The Chinese state attempted to increase its fiscal strength after the mid-1990s, with a series of important reforms. However, central government revenue still accounts for only around seven per cent of GDP (World Bank, 2004: Table 4.11). The share of central government revenue in GDP is not only below that of other large developing countries, but also below even that of Russia.³ The state's reduced fiscal strength has forced it to look for drastically increased contributions from fees paid by people when they use health and education services. By the end of the 1990s, budgetary allocations covered just 46 per cent of actual

3. In 2001, the share of central government revenue in GDP stood at 7.2 per cent in China, 13.0 per cent in India, 14.8 per cent in Mexico, 15.6 per cent in Pakistan, 21.2 per cent in Indonesia, and 26.8 per cent in the Russian Federation (World Bank, 2004: Table 4.11).



expenditures on education (World Bank, 2002: 85). A wide variety of other sources of funding have been mobilised to finance education, including surcharges, fees collected from students, revenues from school-run enterprises, work study programmes, donations and gifts. Between the late 1980s and mid-1990s, there was 'a substantial deterioration in the educational status of the poor' (World Bank, 2002: 42).

Over the past five decades, China has built an impressive rural health system, and overall health achievements are impressive, with a life expectancy of 70 and an infant mortality rate of 31 per 1000 live births. At the peak of the rural people's communes before 1976, around 85 per cent of villages had a co-operative medical system, albeit often rudimentary. When the agricultural collectives were disbanded in the early 1980s, the financial basis for risk-sharing was largely eliminated. Over 90 per cent of the rural population were without any coverage from risk-pooling welfare schemes (World Bank, 2002: 116). In 1999, the government budget funded just eleven per cent of total health expenditure, while 59 per cent came from out-of-pocket payments (World Bank, 2002: 43). These changes have resulted in a system that provides highly unequal access to health services. China ranks 61st out of 191 countries in overall quality of health, but 188th in terms of fairness in financial contribution (World Bank, 2002: iv).

Party. Communist Party leadership is the foundation of China's modernisation. The Party is deeply intertwined with every aspect of socio-economic life. In the late 1980s and early 1990s, Deng Xiaoping warned repeatedly of the dangers of China collapsing into chaos. In his 2001 speech to celebrate the 80th anniversary of the founding of the Chinese Communist Party, Jiang Zemin stated: '[The Party] must address the two major historic subjects of enhancing the Party's ability of exercising state power and art of leadership, and resisting corruption and warding off risks... [W]e must be strict in Party discipline. We should have a deeper understanding of the loss of political power by some Communist Parties in the world that had long been ruling parties and learn a lesson from them' .



In recent years, the level at which Party members were tried and sentenced for corruption (including even execution in some cases) has risen to include many in high positions. These include a former deputy governor and former mayor of Shijiazhuang, Hebei's largest city; the mayor of one of China's largest cities, Shenyang; a former vice-minister of public security; a former chief of military intelligence; and a deputy chairman of the National People's Congress. Official reports to the National People's Congress in early 2003 declared that in the previous five years, the war against graft had been substantially stepped up, with a total of almost 13,000 prosecutions of government officials (SCMP, 11 March 2003). The reason that so many cases of corruption have come to light is that China's leadership is aware of the threat that it poses, and is trying to do something about it.

1.4. International relations

In 1999, the USA's military budget stood at US\$ 253 billion, compared with just US\$ 135 billion for NATO Europe (IISS, 1999: 37). In the wake of September 11, the USA announced that the military budget would rise to US\$ 379 billion by 2006, while there are no plans to increase real military expenditure by NATO Europe countries (FT 18 February 2002). Europe trails far behind the world's military superpower.

The USA fears that China's rise will transform fundamentally the balance of world economic and military power. President Bush warned China: 'In pursuing advanced military capabilities that can threaten its neighbors in the Asia Pacific region, China is following an outdated path that, in the end, will hamper its own pursuit of greatness. It is time to reaffirm the essential role of American military strength. We must build and maintain our defences beyond challenge... Our forces will be strong enough to dissuade potential adversaries from pursuing a military build-up in hopes of surpassing, or equalling, the power of the US' (quoted in FT 21 September 2002). Following September 11, the consensus among the inner core of Bush administration shifted to the view that 'in the long-term the US would only find security in a world in which US values were widely held



and spread' (FT 6 March 2003). There is a powerful set of US interests that believes serious conflict with China is unavoidable. Henry Kissinger cautioned that the US foreign policy hawks see China 'as a morally flawed inevitable adversary'.

However, the final shape of the USA's view of how best to 'engage' with China is unclear. In the 1980s, the prime goal of American foreign policy was the overthrow of the 'evil empire' in the Soviet Union. This goal was pursued through acceleration of the arms race and numerous channels of influence upon Soviet policy-makers. US policies played a significant role in the collapse of Soviet communism and the disintegration of the USSR. 'Regime change' resulted in state disintegration, with disastrous consequences for the economy and for the welfare of most Russians. The Soviet economy had only negligible linkages to the US economy. The USSR accounted for a tiny fraction of American exports and there was no investment in Russia by US multinationals. Soviet exports to the USA were trivial in scale. The collapse of the Soviet economy had a negligible impact on the US economy other than the short-term fall in military expenditure.

The Chinese and US economies have become deeply inter-twined. US consumers benefit from the explosive growth of low-priced Chinese exports. US companies and shareholders benefit from China's absorption of booming American investments and from access to the low-cost manufacturing supply-chain in China. US primary product producers (including food, oil and mining companies) benefit from exports to China, both directly from the USA and, increasingly, from production bases in other countries. The US government benefits from Chinese government purchase of its debt, which, ultimately, helps to underpin the growth of US personal consumption. 'System disintegration' in China, such as the US helped bring about in the USSR, Afghanistan and Iraq, would be a disaster for China, but would also have severe economic consequences for the USA. One can only guess at the military consequences. From this perspective it is in the interests of US business and the mass of US citizens, not to speak of the rest of the world, to support the efforts of China's Communist Party leadership to sustain the country's 'peaceful rise'.



1.5. Financial institutions

The Asian Financial Crisis provided a shocking insight into the fragility of the country's financial institutions. China appeared to escape any effects of the crisis, due to the fact that the *renminbi* was not fully convertible. In fact, the crisis had a deep impact through the medium of Hong Kong and the massive debts accumulated there by Mainland 'trust and investment' and 'red chip' companies. The most visible of these were GITIC (Guangdong Trust and Investment Company) and GDE (Guangdong Enterprises) which included five floated 'red chip' companies. During the Asian Financial Crisis, GITIC went into bankruptcy while GDE was insolvent and comprehensively restructured. Prior to the crisis, they each had been regarded as model institutions by international lenders. GITIC's bankruptcy and GDE's restructuring allowed the outside world to look closely inside large Chinese companies for the first time. The investigations revealed comprehensive failure in corporate governance, including disastrous lending practices: a large fraction of their loans were made to firms and institutions that were unable or unwilling to repay their debts. A substantial part of their 'investments' were highly speculative, including heavy participation in the property boom in Guangdong Province and Hong Kong. Investigations into Guangnan, one of GDE's 'red chip' companies, concluded that it was basically a 'criminal company': 35 people from Guangnan were either arrested or had warrants for their arrest issued in Hong Kong. Guangnan was a Hong Kong-listed company, a 'red chip', Hong Kong's environment of high quality rules on corporate governance; over forty per cent of its shares were owned by public investors; its accounts were audited by a famous international accountancy firm; it had two independent directors, both prominent Hong Kong businessmen.

In the late 1990s, especially after the Asian Financial Crisis, the central government began a massive attempt to 'clean up' the country's financial institutions. The cases of GITIC and GDE demonstrate how long and complex will be the process of changing China's financial institutions into well-governed, modern financial institutions. The clean up revealed shocking evidence about the state of corporate governance in China's main banks. In early 2002, it was revealed that the five bank officials at



the BOC branch in Kaiping city (Guangdong) had stolen the equivalent of nearly US\$ 500 million'. The problems penetrated to the apex of the country's banking system, Zhu Xiaohua, Li Fuxiang and Wang Xuebing were members of Premier Zhu Rongji's team of four 'can-do-commanders'. From 1993 to 1996, Zhu Xiaohua was deputy governor of the People's Bank of China and then head of China's foreign exchange reserves. In 1996 he was appointed head of China Everbright Bank. In 1999, he was arrested, and subsequently sentenced to fifteen years imprisonment. Li Fuxiang was formerly the head of the Bank of China's foreign exchange dealings in New York, and subsequently was placed in charge of the national foreign exchange reserves. In May 2000 he committed suicide. Wang Xuebing, formerly head of the China Construction Bank and then of the Bank of China, was arrested in 2002 and subsequently sentenced to twelve years imprisonment.

Under the terms of the WTO Agreement, China's financial firms will face escalating international competition. Since the 1980s the world's leading financial firms have been through a period of unprecedented merger and acquisition. The period saw the emergence of super-large financial services firms, such as Citigroup, JP Morgan Chase, and HSBC. They have rapidly acquired dominant positions in Latin America and Eastern Europe. When Citigroup acquired Banamex, Mexico's 'national champion' in financial services, the *Financial Times* commented: 'The acquisition of Bannamex underscored the rapacious appetite of Citigroup for assets in the developing world'. Citigroup itself said: 'China is top of our radar screen'. If China's indigenous large financial firms cannot achieve their own self-reform, then the global giants are likely to assume an increasing role in the commanding heights of China's financial sector. Citigroup argues that the big four banks in China should be 'torn apart into small units in order to avoid a financial crisis', which would make it far easier for the global giants to 'rout the enemy one by one'.

1.6. Conclusion

China faces wide-ranging challenges that threaten the entire social, economic and political system. Due to the number and intensity of the challenges that China faces, there is a high possibility that at



some point a 'fire' will break out. It is highly likely that it will be connected with the financial system. During the Asian Financial Crisis, China came close to a major financial crisis. The country survived only by adopting bold and effective policies. If China were to face a financial crisis of the dimensions that have regularly attacked developing countries since the 1980s, it would be difficult to maintain overall system stability. The relationship of political instability with financial crisis is long-standing: 'Since the commencement of the eighteenth century there has been no serious revolution in Europe which has not been preceded by a commercial and financial crisis' (Marx, 1853: 9).

China's political economy has reached a crossroads. Which direction will it take?

2. 'Primitive Capitalist Accumulation'?

Many people believe that China has no choice but to follow the harsh logic of 'primitive' capitalist accumulation, as outlined in Marx's *Capital*, Vol 1 (Marx, 1887). They argue that China will become a 'normal' capitalist economy. Indeed, it is already well-advanced on this path, with the state-owned sector already occupying under one-half of national output. They consider argue that the brutal nature of the accumulation process during the 'Lewis' phase of industrialisation, with its foundation in 'economic development with unlimited supplies of labour' at a constant real, subsistence wage, demands an authoritarian political structure, with political power confined to the minority ruling class.

In Britain during the take-off into capitalist industrialisation after the mid-eighteenth century, it took around one hundred years before the rural reserve army of labour was absorbed into the modern sector. This provided strong downward pressure on urban wage rates, with no significant trend improvement in unskilled workers' real wages between 1750 and the 1820s at the earliest. There was a prolonged phase of capital accumulation during which there was a widening of income disparities and no diminution of absolute poverty. Capitalist



accumulation was accompanied by harsh measures of social control to maintain political order. In the late eighteenth and early nineteenth century the predominant political philosophy in Britain considered that the wide divergence of interests between socio-economic groups made it impossible to obtain a democratically worked-out compromise consistent with economic growth (Hirschman, 1977). China's emerging 'global middle class' today is nervous about the consequences of extending political rights to the country's sea of poor people.

Advocates of the 'primitive capitalist accumulation' approach in China draw comfort from the wider lessons of the history of early capitalist industrialisation. Democratic institutions were introduced in almost all cases only after the harsh phase of early capitalist accumulation had been accomplished (Therborn 1977: 33-4). The examples of Japan in the Meiji Period (1868-1912), as well as Taiwan and Korea in recent times are invoked to provide support for the necessity of China passing through a prolonged phase of 'primitive capitalist accumulation' during the prolonged 'Lewis Phase' of development. In each case there was an initial phase of harsh political rule, with rapid absorption of rural surplus labour into the urban workforce at a constant real wage. Once the supply of rural surplus labour dried up, real wages for unskilled urban workers started to grow. It was at this point that demands for political democratisation began to develop.⁴

It will be several decades before China's rural surplus labour supply is exhausted, assuming that the rest of the world has sufficient demand, and sufficient employment flexibility, to absorb the manufactured exports needed to absorb this vast sea of China's rural workers. If the main rationale for political authoritarianism were the existence of a 'Lewis-type' process of capital accumulation, then China would face the prospect of a long period under such a structure. It is questionable whether this structure would be stable over such a long period, given the prospects for growing inequality in the midst of accelerated integration of China into the global economy. In the event that such a structure did survive, it would constitute a prolonged and oppressive form of late industrialization.

4. See Nolan, 1995; and Chang, 2002, for summaries of the evidence on this point.



2.1 'Democracy and the free market'?

Many people believe that the fundamental condition for continued successful Chinese development is a drastic downgrade the state. A major reason that they advocated China joining the WTO was to help achieve this purpose. Many influential international scholars and policy makers believe that the Chinese Communist Party should give up its monopoly control of political power. In China at the end of the 1980s a consensus among international opinion developed which believed that the overthrow of the Chinese Communist Party would lead to a great improvement in welfare for the Chinese people. No idea was more pervasive in the early years of 'transition' in the former USSR and Eastern Europe than that which argued that the state should be destroyed before it could be reconstructed. In recent years US government advisors on China policy have promoted the desirability of 'regime change' in China.

The blunt reality is that the overthrow of the Chinese Communist Party would plunge the country into social and political chaos. China has experienced long periods of system disintegration. The 'dynastic cycle' was so devastating when it entered a downward path at the end of each dynasty, that the theme of avoidance of 'great turmoil' was the focus of Chinese political thought from the earliest times right through to the present day. At the core of the Chinese reform programme after the death of Chairman Mao was a belief in the need to prevent China's political economy from disintegrating and the country descending into 'big turbulence', which would 'deprive the Chinese people of all hope'. It is possible that the entire Chinese system of political economy could disintegrate, notwithstanding US\$ 500 billion-worth of FDI.

The USSR was a highly sophisticated country, with great human and technological resources. It had huge potential for high-speed advance in economic performance and living standards if appropriate policies had been adopted (Nolan, 1995). In fact, it has been 'de-developed' in a way never witnessed before in peacetime. China is still a poor country. Comparable 'de-development' for China would cause immense suffering. It was unimaginable to most people that there could be system meltdown either in the USSR, in Yugoslavia, once a sophisticated European state,



in Argentina, the IMF's favourite pupil in Latin America, or in Indonesia, the exemplar of the 'East Asian Model'. Yet such a comprehensive system meltdown occurred, with disastrous consequences for the people of those countries. The central task of Chinese political economy is to learn from those experiences and avoid such an outcome.

A widespread view among those who wish for 'regime change' in China is the belief that China can 'follow the American path'. American foreign policy is based on the premise that the whole world, including China should, and will, follow this 'natural' path of development. Intense external pressure is exerted already through innumerable channels upon Chinese internal ideology to promote this view of the desirable future political economic structure for China. Such views will become ever more influential as the US-dominated global mass media is allowed to penetrate the Mainland in accordance with the WTO Agreement. President Bush's national security strategy document of September 2002 is entitled 'How the US will lead "freedom's triumph"'. It states: 'Freedom is the non-negotiable demand of human dignity; the birthright of every person - in every civilisation... Today, humanity holds in its hands the opportunity to further freedom's triumph over all [its] foes. The US welcomes our responsibility to lead in this great mission'. It commits the USA to 'defend liberty and justice because these principles are right and true for all people everywhere'. It commits the USA to 'stand firmly for the non-negotiable demands of human dignity: the rule of law; limits on the absolute power of the state; free speech; freedom of worship; equal justice; respect for women; religious and ethnic tolerance; and respect for private property'.

In fact, the interpretation of the word 'freedom' has been the object of intense debate in the USA (Foner, 1998). At the heart of this struggle is the battle over the role of the state. Was the US state to serve purely as the guardian of individual liberties or 'negative freedom', or was the state to serve as the instrument for the achievement of 'positive freedom' of all citizens to enable them to be fulfilled human beings?

Struggles over the interpretation of 'freedom' have existed in America since the eighteenth century.



By the late nineteenth century the idea that 'freedom' essentially meant freedom of contract became the bedrock of 'liberal' thinking. The true realm of freedom meant 'the liberty to buy and sell, and mend and make, where and how we please, without interference from the state' (Foner, 1998: 120). The period saw the rise of Social Darwinism, which strongly opposed any form of state interference with the 'natural' workings of society. Labour laws were seen as a form of slavery, which interfered with the individual's rights to dispose freely of their property.

In the 1890s, alongside intensifying class struggle, powerful critiques of free market fundamentalism emerged, opposing the idea that meaningful 'freedom' could exist in circumstances of extreme inequality, such as that in the USA. The American Economics Association was established in 1885 with the express purpose of combating Social Darwinism and 'laissez-faire orthodoxy'. Its founder AEA, Richard T. Ely, wrote: 'We regard the state as an educational and ethical agency whose positive assistance is one of the indispensable conditions of human progress (quoted in Foner, 1998: 130).⁵ Many younger economists believed that the private property had become a 'means of depriving others of their freedom', and that 'poverty posed a far graver danger to the republic than an activist state' (Foner, 1998: 130). During the Progressive Era leading up to the First World War, T.H. Green, the British philosopher made a profound impact with his lecture in the USA in which he argued that freedom was a 'positive concept'.⁶ The Great Depression had a major impact on the struggle over the interpretation of 'freedom'. In 1933, Franklin D. Roosevelt proclaimed: "For too many Americans, life is no longer free; liberty no longer real; men can no longer follow the pursuit of happiness" (quoted in Foner, 1998: 196). Under his guidance, the Democratic Party led the country towards large-scale state intervention to reconstruct the economy and provide comprehensive social security. These ideas remained as the mainstream of US political thought long into the post-war world.

5. It is an extreme irony that one hundred years later, the AEA should have become the vehicle for conveying the most stultifying form of orthodoxy, which eliminated from the subject of 'economics' anything other than formal mathematical modelling, largely based on free market models, leaving the subject far removed from the open-minded analysis of the real world from which AEA originally derived its inspiration.

6. Green's ideas on 'positive freedom' far precede similar notions propounded by such late twentieth century philosophers as Isaiah Berlin (Berlin, 1969) or A.K. Sen (eg Dreze and Sen, 1989).



In the 1950s, a group of conservative thinkers set out to 'reclaim the idea of freedom'. For them, freedom meant de-centralised political power, limited government, and a free market economy. The immediate intellectual origins of the movement can be traced back to the publication of Hayek's book *The Road to Serfdom* (Hayek, 1944), which became a clarion call for conservatives to reclaim the word 'freedom' from the socialists. The dominant view in the USA came to equate 'freedom' with individual choice in the market place with minimal interference from the state. The idea gained force that the US should lead the world towards a universal free market. The collapse of the USSR deeply reinforced Americans' confidence in the free market.

The idea that the free market is a moral concept stands at the centre of political discourse in the USA at the start of the 21st century. President Bush's Security Strategy declaration of September 2002 states: 'The concept of "free trade" arose as a moral principle even before it became a pillar of economics. If you can make something that others value, you should be able to sell it to them. If others make something that you value you should be able to buy it. This is real freedom, the freedom for a person-or nation- to make a living' (Bush, 21 September 2002). In the wake of September 11, the US government is even more firmly convinced of its historic function to spread the moral principle of the free market across the whole world: 'The great struggles of the 20th century between liberty and totalitarianism ended with a decisive victory for the forces of freedom - and a single sustainable model for national success: freedom, democracy and free enterprise. Today, the US enjoys a position of unparalleled military strength, and great economic and political influence... We seek to create a balance of power that favours human freedom... The US will use this opportunity to spread the benefits of freedom across the globe... We will make freedom and the development of democratic institutions key themes in our bilateral relations' (Bush, 21 September 2002).

Which American tradition should China turn to: that which argues for a powerful role for the state to ensure positive freedoms for all citizens, or 'free market fundamentalism', whose current intellectual and political ascendancy may turn out to be a relatively brief intermission in the long sweep of US history?



2.2 *'Backwards to Maoism'?*

Chairman Mao led the Chinese Communist Party in an attempt drastically to attack social inequality. This amounted to nothing less than an attempt to transform people's work motivation, to overcome the classic 'principal-agent' problem, by liberating human productive energies from the link with material reward. 'Serve the people' was the foundation of Maoist ideology. Chairman Mao hoped to build a non-capitalist, humane society, which provided the opportunity for the whole population to fulfil their human potential. It was a philosophy that was powerfully driven by the intention to restrict drastically the population's 'negative' freedoms to act in accordance with their individual wishes free of external restriction, while providing the maximum equality of opportunity for citizens to achieve their 'positive freedoms': 'In a socialist society, it is necessary to acknowledge the differences in the rewards for labour, but the differences ought not to be too great. We must actively create the conditions for communist society's stage, "from each according to their abilities, to each according to their needs", and should constantly strive to lessen the three great differences and increasingly extirpate the influence of bourgeois right' (Comrades, 1974: 597).

From the mid-1950s, through to the mid-1970s, China's GNP growth rate was faster than that of most developing countries. In normal times, the mass of the people enjoyed a high degree of livelihood security. Life expectancy at birth rose from 36 years pre-1949 to 71 years in 1981 (Nolan, 1995: 49). These achievements were applauded by numerous Western scholars as evidence that redistributive policies could enable low income countries to achieve high levels of 'basic needs' long before average per capita incomes had risen to high levels.⁷

However, China paid a high price for the attempt to suppress market forces completely, to cut the country off from the global economy and society, to drastically constrain the dimensions of inequality, to eliminate material incentives, and to radically limit cultural freedom, and for wild, nation-wide mass movements: 'The decade of the Cultural

7. See, especially, the numerous writings of A.K.Sen on this topic.



Revolution brought catastrophe upon us and caused profound suffering... Had it not been for “Left” interference, the reversals of 1958, significant progress would certainly have been achieved in our industrial and agricultural production and in science and education, and the people’s standard of living would certainly improved to a fair extent’ (Deng Xiaoping, 1980: 234).

Diversity of thought was crushed. Large numbers of people were imprisoned for their political views. Freedom of cultural expression was dramatically narrowed, causing large-scale damage to people’s welfare. The intense political struggles to limit social differentiation caused immense suffering to innumerable participants. Although growth rates were high, they were achieved in a highly inefficient way, with slow technical progress, a long-run fall in capital productivity, and stagnation in average per capita incomes. Apart from improvements in consumption of a narrow range of consumer durables, per capita consumption of most other items either stagnated or declined. The proportion of the population in absolute poverty remained at around 30 per cent in the mid-1970s, totalling around 270 million people, compared with around 190 million in 1957 (Nolan, 1995: 50). The utopian attempt to leap into a communist society during the Great Leap Forward resulted in a colossal man-made disaster. The collapse in farm output caused the biggest famine of the twentieth century, with as many as 30 million ‘excess deaths’.

The Maoist development path is not one to which many Chinese people would wish to return. China cannot go back. It needs to steer a course between the pursuit of extreme individual ‘negative’ freedom and extreme collective ‘positive’ freedoms.

2.3 ‘Use the past to serve the present’?

In their search for a way forward, China’s leaders can engage with international experience, but, above all can turn to the country’s own past for a source of inspiration. This rich history can provide intellectual nourishment for persisting with the approach of ‘groping for a way forwards’, ‘seeking truth from facts’ devising policies in a pragmatic, experimental, non-ideological fashion to solve concrete problems.



China's long-run economic dynamism

Needham (1954-) demonstrated that China made great technical advances before the West. This led scholars to ask why China failed to experience an 'Industrial Revolution', despite having made much early technical progress. Most scholars used to believe (and some still do) that the 'totalitarian' traditional Chinese state crushed the development of the market (e.g. Balazs, 1964; Huang, 1990; Wittfogel, 1957; Lin Yifu, et al, 1996). A corollary of this perspective is that China should 'learn from the past' by reducing even further the state's economic role in order to sustain China's growth.

Recent research by Chinese economic historians has shown that the traditional Chinese economy was far more dynamic over the long-term than had formerly been thought.⁸ Economic historians are increasingly investigating why the Chinese economy made such sustained progress over more than 1000 years. This necessitates probing deeply into China's traditional political economy, especially the relationship of state and market. Key aspects of China's traditional system of political economy form an inspiration for understanding the possible solutions to the challenges facing China today. They provide a source of confidence to resist the intense pressures to adopt free market economics as the solution to these challenges.

The foundation of Chinese civilisation was, and still is, agriculture. For almost 1000 years up until the mid-twentieth century Chinese rice-based agriculture responded positively to sustained population growth and absorbed productively the huge long-term increase in farm labour force (Perkins, 1968). From the tenth to the thirteenth century, China set out along the path of the 'Second Industrial Revolution' well before Europe (Needham, 1954-). A steady stream of significant technical advances was made thereafter through until the nineteenth century (Xu Dixin and Wu Chengming, 2000). China's technological achievements were stimulated by long-term growth of both domestic and international trade. For long periods, the Chinese state united the vast

8. See especially Li Bozhong, 1986, 1998 and 2000, and Xu Dixin and Wu Chengming, eds., 2000.



territory of China into a single integrated market and international trade operated free of government controls.

The textile industry was much the most important in traditional China. Towards the end of the Ming dynasty (1368-1644), cotton replaced hemp and silk as the principal fabric for daily wear. Cloth spinning and weaving became the largest handicraft industry, of which around one-half was for sale on the market. By the early Qing (1644-1911), in the late seventeenth and early eighteenth century, there were numerous large-scale businesses, including mining, iron manufacture, salt-making, porcelain and shipbuilding (Xu Dixin and Wu Chengming, 2000: 250-298). Imperial China had a high level of urbanisation for a pre-industrial society. In the nineteenth century there were estimated to have been a total of 35,000 'standard' and 'intermediate' market towns (Skinner, 1997b). Above this dense local trading structure were a further 2,300 'central market towns', 932 'cities' and 26 huge 'metropolitan trading systems', which in turn formed eight great economic systems'. China possessed cities of a size and level of sophistication that far exceeded those of contemporary Europe until late in the latter's development.

In 1750, China's share of global manufacturing output stood at around 33 per cent, compared with 25 per cent in India/Pakistan and just 18 per cent in the 'West' (Bairoch, 1982). In 1800, China's per capita GNP was US\$ 228 (at 1960 prices) compared with US\$ 150 - 200 for England and France (Bairoch, 1981). As late as 1798, Malthus declared China was the richest country in the world (Dawson, 1964: 7). In his description of McCartney mission to China in 1793, Sir George Staunton said: 'In respect to its natural and artificial productions, the policy and uniformity of its government, the language, manners, and opinions of the people, the moral maxims, and civil institutions, and the general economy and tranquillity of the state, it is the grandest collective object that can be presented for human contemplation or research' (quoted in Dawson, 1964: 7).

State and market in Chinese development

The bureaucracy. The traditional Chinese state combined a hereditary emperor with a large professional civil service, selected by competitive



examination. In addition, there was a much larger number of members of the local 'gentry' who dealt with many interests of their local communities for which the official government had no time (Michael, 1964: 60). The bureaucracy's ideology was conveyed through the examination system, for which Confucianism was the foundation, forming the key to the system's long-term stability and cohesion. The over-riding values were those of 'the primacy of order and stability, of co-operative human harmony, of accepting one's place in the social hierarchy, of social integration (Feuerwerker, 1976: 15). The sole test of a good ruler is 'whether he succeeds in promoting the welfare of the common people... This is the most basic principle in Confucianism and has remained unchanged throughout the ages' (Lau, 1979: 32 and 37). In order to serve the interests of the mass of the people, the bureaucracy must gain the trust of the masses: 'Only after he has gained the trust of the common people does the gentleman work them hard, for otherwise they would feel ill-used' (Confucius, 1979: 154). It is disastrous if the bureaucracy becomes corrupt and loses its moral foundation: 'Those in authority have lost the Way and the common people have for long been rootless' (Confucius, 1979: 155).

Merchants performed an essential function in expanding the division of labour, facilitated through trade, but were excluded from political power and the ideology underpinning that structure. They were at the bottom of the bureaucracy's official ranking of social strata, behind the scholars, farmers and artisans. There was no official representation of their interests in either the local or the central government. However, this did not mean that trade itself was regarded as undesirable. The successful merchant's wealth 'had always drawn covetous awe if not respect' (Faure, 2001). If merchants wished their families to enter the ruling bureaucratic class, their children needed to go through the laborious and highly competitive examination system, which resulted in their thorough absorption of the ideology of the ruling scholar-bureaucrat elite.

Law. During the long periods in which it functioned relatively effectively, the Chinese state provided a framework of law and order and protection for property rights within which long-term economic development took place. Chinese merchants never developed the



independence from the state that occurred in increasingly autonomous towns in late medieval Europe (Balazs, 1964). However, in periods when the central government functioned well, the cities provided a secure environment in which to conduct business and in which their property rights were protected by the state. The huge quantities of merchandise would not have been traded without security that the corresponding contracts were legally enforceable, or that robbery of the merchants' property was illegal. Research on late Imperial Hankow has shown that before 1850 there were all manner of written commercial agreements, including shipping orders, bills of lading, promissory notes and contracts of sale, all of which were routinely circulated and enforceable in the city (Rowe, 1984). Local officials in late imperial Hankow played a key role in ensuring debt repayment.

The army. The most important function of the imperial state was to provide long periods of relative peace and stability over the vast territory under its rule. For long periods China was distinguished from the rest of the world by the fact that the central authorities were able to establish peaceful conditions over vast territories. Even in the midst of long dynasties, such as the Ming, China had the world's largest army (Huang, 1981: 160). The presence of so many troops also provided a source of security for economic activities during the long periods in which they were under effective control from the civilian authorities. They provided merchants with the confidence to undertake trade that far exceeded that in other parts of the world until modern times. The normally peaceful environment over wide areas provided a powerful incentive to those with capital to undertake long-term investments. It also enabled the entire territory of China to form a single unified free trade area. The degree of state interference in trade was small, in normal times confined mainly to taxation of small number of key items. Estimates for the eighteenth century show that only around seven per cent of national income went into the central government budget, of which the vast bulk, 74 per cent came from the land tax and just 14 per cent came for the domestic and international customs revenue (Nolan, 1993: 17). Therefore, long before any other comparable region of the world, China was able to enjoy for long period the powerful 'Smithian' stimulus of specialisation, the division



of labour, the rapid spread of best practice techniques, and powerful incentives to accumulate capital.

Money. In the traditional Chinese economy exchange was almost always a monetary transaction (King, 1965: 42). During the Yuan dynasty, the Mongol rulers were the first economy in the world to have paper money. Marco Polo was amazed that 'all the people's and populations who are subject to [the Great Khan's] rule are perfectly willing to accept these papers in payment, since wherever they go they pay in the same currency, whether for goods or for pearls or precious stones or gold or silver. With these pieces of paper they can buy anything and pay for anything' (Marco Polo, 1958: 148). For over two thousand years, the Chinese government was aware of the importance of money to a sound economy. One of its ongoing struggles was to ensure that the money supply was not debased and that the quantity of money corresponded to current economic needs. The central government tried persistently to maintain central control over the amount and nature of currency in circulation. Detailed accounts from the early Qing dynasty show the way in which the central government closely monitored the money supply, frequently changing the specified weight and composition of coins in response to changing economic conditions, and attempting to maintain a constant exchange rate between rate between copper cash and silver coinage (King, 1965: 133-143).

Water control. The most important single function of the state in traditional China was water control, both for drainage and irrigation, as well as for transport. Large water control projects were almost exclusively public, organised either directly by the central government, or by lower levels of the bureaucracy. Water control activities carried a grave moral imperative for government officials, with a similar responsibility as national defence: '[B]uilding embankments on the Yellow River is like constructing defenses on the frontier, and to keep watch on the dike is like maintaining vigilance on the frontier' (a high official of the Ming dynasty, quoted in Ch'ao-ting Chi, 1936: 73). The central administration had important functions in inter-district water projects or projects with large expenses. In the Ming and Qing dynasties, maintenance of the embankment of the Yellow River was in



the charge of a special official ranking high in the bureaucratic hierarchy. The Grand Canal was by far the greatest transport infrastructure achievement of the traditional Chinese state. It played a significant part in providing a transport system linking the productive south with the political north, engaging the attention of the best minds of China for more than ten centuries. It demanded countless millions of lives and a large portion of the wealth of the country for its improvement and maintenance.

Local government officials had an important role in water control. For almost any local water works beyond the capacity of the peasants of a single village, the magistrate intervened with the delegation of the duty of mobilizing forced labour, supervising the construction of local works, and regulating the use of water by rival villages. There was a heavy moral burden upon local officials to ensure that the innumerable local water control activities were provided at an adequate level. The ideal magistrate 'is an official close to the people, and flood and drought should be of as much concern to him as pain or sickness of his person' (Ku Shih-lien, an early Qing dynasty scholar and official, quoted in Ch'ao Tingchi, 1936: 72). The ideal magistrate should make extensive visits to the countryside during the slack season: 'He should survey the topography of the region, ask about conditions of drainage, and investigate sluices and locks... All these affect the conditions of the public treasury and the welfare of the people and must be carefully considered by the magistrate' (Ku Shih-lien, quoted in Ch'ao-ting Chi, 1936: 72).

Famine relief. Famine relief in the Chinese empire included famine investigation, providing relief funds, supplying relief grain, controlling prices, strengthening and rebuilding production (Will 1990).⁹ Many of the measures to fight famine demonstrated subtle strategies by the State in providing relief to the poor and the capability of the State in using the market to combat famine problems. Many of the measures adopted anticipate the analysis of famine made by modern writers such as A.K. Sen. The 'detailed and formalised procedures for combating famine' were permitted by 'the sophistication, centralisation, and stability of the (Chinese) bureaucratic system' (Will, 1990: 4).

9. Will (1990) provides a meticulous account of famine relief in late Imperial China.



The local gentry had a prominent part in fighting famine and distributing relief. Collective action at the local level was 'to the advantage of both the bureaucrats and the holders of local power, headed by the great landowners and the gentry, that appropriate measures be taken to prevent the ruin of the economy and social disorder, and this was certainly a powerful factor for cohesion within the global power system' (Will, 1990: 5). Official famine prevention measures had been formulated as early as the Song period. Many of the recommended procedures - surveys of the disaster and its victims, the regular distribution of grain, public soup kitchens, and so forth - had been practised for centuries, albeit on a smaller scale, by the local notables and landlords in co-operation with the bureaucracy (Will, 1990: 74).

Commodity price stabilisation. From early in Chinese history, the Chinese state sought for ways to stabilise basic commodity prices, with deep awareness of the damaging effects of speculation upon ordinary people's livelihood. As early as the Warring States Period (475-221 BC), the government tried to keep fluctuations in the grain price within a certain range (Hu Jichuang, 1984: 17). Marco Polo described the provision of grain in the Yuan Dynasty (1271-1368). When harvests were plentiful and the price of crops was cheap, the Great Khan accumulated vast quantities grain and stored them in huge granaries. When crops failed he drew on these stocks, 'releasing enough for all... throughout all parts of his empire' (Marco Polo, 1974: 157). Will's (1990) meticulous account shows the way in which in eighteenth century China the bureaucracy intervened in the rice market to protect the livelihood of the masses from price fluctuations and speculation. The government established a vast network of 'ever-normal granaries' across the country in order to stabilise grain prices. In addition to maintaining emergency reserves, the purpose of the 'evernormal granaries' was 'to cushion the impact of seasonal price fluctuations by buying up grain immediately after the harvest, when prices were low, and reselling it at a low price during the lean period before the new harvest came in'. The 'ever-normal granaries' spring sales and autumn purchases were supposed to even out prices by compensating for the weakness of the private sector or by competing with it when it tended to take advantage of and speculate on seasonal and/or regional price differentials.



Conclusion. The traditional Chinese state strongly encouraged the market, but did not allow commerce, financial interests and speculation to dominate politics and society. It stepped in where markets failed, not only in respect to immediate growth issues, but also in relation to the wider issues of social stability and cohesion. Behind the edifice of authoritarian Imperial rule was a pervasive morality based on the necessity all strata of society observing their duties in order to sustain social cohesion, to achieve social and political stability and to achieve environmental sustainability. When these functions operated effectively, there was 'great harmony', a prosperous economy and a stable society. When they operated poorly, there was 'great turmoil', economic retrogression and social disorder.

3. Conclusion

If by the 'Third Way', we mean a creative symbiotic inter-relationship between state and market, then we can say that China practised its own 'Third Way' for two thousand years. This was the foundation of its hugely impressive long-run economic and social development. The Chinese 'Third Way' was a complete philosophy that combined concrete ways of both stimulating and controlling the market, with a deeply thought out system of morality for rulers, bureaucrats and ordinary people. When the system worked well, the philosophical foundation was supplemented by non-ideological state actions to try to solve practical problems that the market could not solve. Confucianism produced a deeply developed concept of 'duty' which was the foundation of social prosperity and collective action. The fact that the system went through regular cycles when these principles were poorly observed, rulers and bureaucrats were corrupt and the economy and society foundered, should not blind us to the underlying coherence and lasting benefit from this integrated system.

In recent decades Europe has been groping its own way towards a 'Third Way'. However, Europe is already industrialised, with a dominant middle class. It is militarily strong, and contains a mass of powerful, globally competitive firms. China today is groping for its own Third Way in totally different circumstances. It is painfully weak



militarily compared with the USA. The vast mass of the population are poor farmers or unskilled migrants, and it is still locked into the 'Lewis phase' of 'economic development with unlimited supplies of labour'. The 'global middle class' constitutes a small fraction of the population. The economy is increasingly 'dependent', with the modern sector increasingly dominated by international capital, forming complete productions systems within China, and accounting for over one-half of the country's export earnings. China faces intense pressure to liberalise comprehensively its financial system as the price for participation in the international economy. China's leaders are trying to construct a civilised society in this uniquely challenging setting.

China cannot close itself off from the main trend in international economics and politics. It cannot turn round and go back to the Maoist period. However, system survival necessitates that it uses the market as the servant of the development process, not the master, as if the market possesses an intrinsic moral value, which the current US leadership and proponents of the unfettered free market believe to be the case. In this effort China's leaders can make common cause with powerful streams in international thought that have gone against the current mainstream.¹⁰ They have at certain periods been highly influential both in the West, including even in the USA, and in the Far East outside the Chinese mainland.

Can free market fundamentalism prevent a 'China Financial Crisis'? Can it solve the problem of the rapid rise in social inequality within China? Can it solve the problems of the Chinese farm economy? Can it enable China's large firms to compete on the 'global level playing field'? Can it help China to deal with the massive international relations challenge? Can it solve the Chinese environmental crisis? Can it provide China with an ethical foundation for building a socially cohesive society? Anglo-Saxon free market fundamentalism, which reached its modern apogee in the 1990s, offers no hope for sustainable global development, at the level either of ecology, society, or international relations. China's numerous deep socio-economic challenges each requires creative, non-ideological

10. See, for example, Nolan's (2004) analysis of the relevance of Adam Smith's Theory of Moral Sentiments to China's current situation, and its close relationship to key ethical concepts in the Chinese Confucian tradition.



state intervention with the market, to solve the innumerable practical problems that the market alone cannot solve.

If China is able to marry the 'snake' of the global market economy with the 'hedgehog' of China's ancient history, as well as its recent history, it will offer a way forward for a stable, socially cohesive society within the country. If it fails in this attempt, the Chinese entire system of political economy may collapse. This would be devastating, not only for China, but for the whole global political economy. At the very least, China may be condemned to a long period of harsh social control to contain the surging tensions of the country's high-speed growth. During the Asian Financial Crisis, China had to take a 'choice of no choice' to survive by 'cutting the trees to save the forest' (i.e. making GITIC bankrupt). If it wishes the system to survive today it must also take the 'choice of no choice' to re-establish an ethical foundation for social cohesiveness, confidently using its own past traditions and the best traditions from outside the country.

If China were to 'choose' the path of 'state desertion' and free market fundamentalism, it would lead to uncontrollable tensions and social disintegration. Full liberalisation of international financial firm competition inside China and full liberalisation of international financial flows is the most dangerous area through which this disintegration might occur. A crisis in the financial system would fan the flames amidst the 'combustible material' in all other sectors of society, into which the long tentacles of the financial system extend. The 'choice' to increase and make more effective the role of the state to solve the intensifying socio-economic challenges facing the country can only succeed if the Chinese state today, with the Communist Party at its core, as in periods of greatest prosperity in the past, can radically improve its level of effectiveness, and eliminate rampant corruption. State improvement, not state desertion, is the only rational goal for Chinese system reform. This is the 'choice of no choice' for China's system survival.

By taking the 'choice of no choice', China's own survival can contribute to global survival and sustainable development, by offering a beacon as an alternative to the US-dominated drive towards global free market fundamentalism. This is a cross-roads not only for China, but for the whole world.



APPENDIX

Adam Smith and the contradictions of the free market economy

Introduction

Adam Smith provides a principal source of inspiration for free market economists across the world. In fact, Smith himself had grave doubts about the ability of the free market to meet human needs. He believed that the market was a two-edged sword, with unique dynamic qualities, but also with deep in-built contradictions. Free market economists rarely, if ever, acknowledge his penetrating and realistic analysis of the inherent contradictions of the market economy. In fact, Smith has left a rich legacy of ideas in this sphere which are even more relevant to the pressing issues that face the world today than they were when he wrote his key works.

The *Wealth of Nations*, first published in 1776, is the most influential book in the history of economics, arguably more so even than Marx's *Das Kapital*. It is a huge work of more than one thousand pages. Apart from specialist scholars of Smith, few people read the whole text. Few economics undergraduates read the book. Indeed, many professional economists, while freely making use of the idea of the 'invisible hand', have never read any part of it. It is widely assumed that the *Wealth of Nations* 'proves' that the free market, guided by the 'invisible hand', is the best arrangement for organising economic life. Smith's other great work was the *Theory of Moral Sentiments*, published in 1759, revised by Smith in 1761. Many economists have never heard of this work. Fewer still have read it. Far from being an 'early work', which was superseded by the *Wealth of Nations*, the *Theory of Moral Sentiments* is intellectually inseparable from the former work. While their main topic is different, they share the same fundamental passion about the moral foundations of social life. At the heart of each of these books is an explicit recognition of fundamental contradictions within the market economy. Smith demonstrated that the free market is an immensely powerful force for impelling economic progress, but one that has deep in-built contradictions. He gave little clue as to how these contradictions might be resolved, but felt it was his duty to point them out.



In the *Wealth of Nations*, Smith identified two powerful drivers of economic progress, the division of labour and the accumulation of capital. The foundation of Smith's 'growth model' was the division of labour, discussion of which occupies the first few chapters of the *Wealth of Nations*. Smith's famous enunciation of this principle declared: 'The greatest improvements in the productive powers of labour, and the greatest part of the skill, dexterity and judgement with which it is any where directed, or applied, seems to have been the effects of the division of labour' (Smith, 1776, vol 1: 7). Smith considered that the fundamental driver of the accumulation process was the pursuit of profit: 'It is only for the sake of profit that any man employs a capital in the support of industry' (Smith, 1776, vol 1: 477). The possessors of capital direct their stock of capital towards those industries that yield the greatest profit and are, therefore 'likely to be of the greatest value': '[B]y directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by the invisible hand to promote an end which was no part of his intention' (Smith, 1776, vol 1: 477).

Smith believed that these principles were the key to 'economic development', or the 'wealth of nations': 'Little else is required to carry a state to the highest level of opulence from the lowest level of barbarism, but peace, easy taxes, and a tolerable administration of justice¹¹... The natural effort of every individual to better his own condition, when suffered to exert itself with freedom and security, is so powerful a principle that it is alone, and without any assistance, not only capable of carrying on the society to wealth and prosperity, but of surmounting a hundred impertinent obstructions with which the folly of human laws encumbers it operation...' (Smith, 1776, vol 2: 49-50).

The system appears to be an elegant, harmonious integration of individual self-interest and social interests. However, this is far from the case. Alongside Smith's rigorous analysis of the growth process, was a deep awareness of the internal contradictions of that same process. Both the division of labour and the pursuit of profit each

11. This famous sentence in fact is not contained in the *Wealth of Nations*. It is from Adam Smith's *Essays*, quoted in Edwin Cannan's Introduction to the 1904 'Cannan' edition of the *Wealth of Nations* (Smith, 1776: xi).



contained deep internal contradictions from an ethical standpoint, the one from the perspective of man as a producer, and the other from the perspective of man as a consumer.

Man as producer

While the division of labour promoted productivity growth, the basis for long-term improvements in the 'wealth of nations', it also has deeply negative consequences for the mass of the population. Smith believed that people are born with relatively equal capacities for self-expression and self-realisation. He considered that people's capability for self-realisation were largely dependent on their social environment, especially their work environment, not on inherited differences: 'The differences of natural talents in different men is, in reality, much less than we are aware of; and the very different genius which appears to distinguish men of different professions, when grown up to maturity, is not upon many occasions so much the cause as the effect of the division of labour. The differences between the most dissimilar characters, between a philosopher and a common street porter, for example, seems to arise not so much from nature, as from habit, custom and education (Smith, 1776, vol 1: 19-20).

In course of industrial advance, opportunities arise for greatly enhanced division of labour, which were not present in agriculture: 'The nature of agriculture, indeed, does not permit of so many subdivisions of labour, nor of so complete a separation of one business from another, as manufactures' (Smith, 1776, vol 1: 9). Smith believed that the advantages of the enhanced division of labour included increased worker dexterity and reduced time lost in passing from one task to another, on account of greater occupational specialisation; the greater possibility for applying mechanisation to specialist tasks; and the associated opportunities for technical progress in the production of new types of machines by specialist machine-makers (Smith, vol 1, 1776: 9-14). However, a major advantage of the enhanced division of labour was the possibility it presented for 'saving time' by increasing the labourer's work intensity: 'The habit of sauntering and of indolent and careless application, which is naturally or, rather, necessarily acquired by every country workman who



is obliged to change his work and tools every half hour, and to apply his hand in twenty different ways almost every day of his life; render him almost always slothful and lazy and incapable of any vigorous application even on the most pressing occasions' (Smith, 1776, vol 1: 12).

For Smith, the division of labour was a two-edged sword. It promoted the advance of productivity, but at a high price. He was brutally realistic about its consequences for the mass of workers: 'In the progress of the division of labour, the employment of the far greater part of those who live by labour, that is the great body of the people, comes to be confined to a few very simple operations, frequently to one or two. But the understanding of the greater part of men are necessarily formed by their ordinary employments. The man whose life is spent in performing a few simple operations, of which the effects too are, perhaps, always the same, or very nearly the same, has no occasion to exert his understanding, or to exercise his invention in finding out expedients for removing difficulties which never occur. He naturally loses, therefore, the habit of such exertion, and generally becomes as stupid and ignorant as it is possible for a human creature to become (Smith, 1776, vol 2: 302-3). Smith warned: '[I]n every improved and civilised society, this is the state into which the labouring poor, that is, the great body of the people, must necessarily fall, unless government takes some pains to prevent it (Smith, 1776, vol 2: 303). The only 'solution' that Smith was able to offer to this deep contradiction was the establishment of 'little schools' in each parish or district, 'where children may be taught for a reward so moderate even a common labourer may afford it' (Smith, 1776, vol 2: 306).

Smith considered that great inequality and class conflicts were unavoidable in a society based on private property: 'Wherever there is great property, there is great inequality. For one very rich man, there must be at least five hundred poor, and the affluence of the few supposes the indigence of the many' (Smith, 1776, vol 2: 232). Smith warned that without substantial 'trickle down' of the fruits of economic progress to the mass of the population, a society would be morally unsatisfactory and at risk due to the threat of social instability: 'Servants, labourers, and workmen of different kinds, make up by far the greater part of every great political society. But what improves the circumstances of the greater part can never be regarded as an



inconvenience to the whole. No society can surely be great and flourishing of which the far greater part of the members are poor and miserable. It is but equity besides, that they who feed, clothe, and lodge the whole body of the people, should have such a share of the produce of their own labour as to be themselves tolerably well fed, cloathed and lodged' (Smith, 1776, vol 1: 88).

However, Smith believed that it would be difficult to obtain co-operative solutions to the great differences of socio-economic interests in an economy like that of Britain in the late eighteenth century: 'The affluence of the rich excites the indignation of the many, who are often driven by want, and prompted by envy, to invade his possessions' (Smith, 1776, vol 2: 232). He concluded that it was a critical duty of the state to protect property-owners, upon whom rested the key instruments for economic progress: 'The acquisition of valuable and extensive property, therefore, necessarily requires the establishment of civil government... Civil government presupposes a certain subordination...[which] gives some men some superiority over the greater part of their brethren' (Smith, 1776, vol 2: 232).

Smith considered that the realities of the labour market were basically antagonistic: 'The workers desire to get as much as possible, the masters to give as little as possible. The former are disposed to combine in order to raise and the latter in order to lower the wages of labour' (Smith, 1776, vol 1: 74). In late eighteenth century England, the balance of power in the labour market was tipped decisively towards the masters: 'The masters, being few in number, can combine much more easily; and law, besides, authorises or at least does not prohibit their combinations, while it prohibits those of the workmen. We have no acts of parliament against combining to lower the price of labour; but many against combining to raise it. In all such disputes, masters can hold out much longer... Many workmen could not subsist a week, few could subsist a month, and scarce any a year without employment' (Smith, 1776, vol 1: 7475).

Smith believed that class stratification was a necessary condition of economic progress, facilitating the accumulation of capital and the division of labour. However, he acknowledged that this contained the



high possibility not only of class conflict, but also of 'corruption of moral sentiments', through the construction of social values that justified 'neglect of the poor and mean': '[T]he disposition to admire, and almost to worship, the rich and powerful, and to despise, or at least, to neglect persons of poor and mean condition, though necessary to maintain the distinction of ranks and the order of society, is at the same time, the great and most universal cause of the corruption of our moral sentiments' (Smith 1761: 61).

Man as consumer

We have seen that one of the central forces in Smith's growth model was the accumulation of capital, and that the central motive for the application of capital was to obtain profit derived from the use of capital. He believed that behind this lay an even deeper psychological drive, namely the desire to acquire 'wealth and greatness'. However, Smith considered that this fundamental driving force of economic progress contained its own 'deception', or inbuilt contradiction: 'The pleasures of wealth and greatness,... strike the imagination as something grand and beautiful and noble, of which the attainment is well worth all the toil and anxiety which we are apt to bestow upon it. And it is well that nature imposes upon us in this manner. It is this deception which rouses and keeps in continual motion the industry of mankind' (Smith, 1761, 183). Smith enumerates the dramatic effects of the application of this 'industry', impelled by the 'deception' of the pursuit of 'wealth and greatness': 'It is this which first prompted them to cultivate the ground, to build houses, to found cities and commonwealths, and to invent and improve all the sciences and arts, which ennoble human life; which have entirely changed the whole face of the globe, have turned the rude forests of nature into agreeable and fertile plains, and made the trackless and barren ocean a new fund of subsistence, and the great high road of communication to the different nations of the earth. The earth by these labours of mankind has been obliged to redouble her natural fertility, and to maintain a greater number of inhabitants' (Smith, 1761, 183-4). It is deeply paradoxical that the driving force for economic progress should be considered to be a 'deception'.



Smith believed that the pursuit of 'wealth and greatness' was a 'deception', because, beyond a certain modest level of consumption, additional consumption brought no increase in happiness, and often brought unhappiness: 'In the langour of disease and the weariness of old age, the pleasures of the vain and empty distinctions of greatness disappear... Power and riches then appear to be, what they are, enormous and operose [sic] machines contrived to produce a few trifling conveniences to the body, consisting of springs the most nice and delicate, which must be kept in order with the most anxious attention, and which, in spite of all our care are ready every moment to burst into pieces, and to crush in their ruins their unfortunate possessor' (Smith, 1761: 183-4). Smith compared 'power and riches', to 'immense fabrics' which 'require the labour of life to raise': '[They] threaten every moment to overwhelm the person that dwells in them, and which while they stand, though they may save him from some smaller inconveniences, can protect him from none of the inclemencies of the season. They keep off the summer shower, not the wintry storm, but leave him always as much, sometimes more exposed than before, to anxiety, to fear, and to sorrow; and to diseases, to danger and to death' (Smith, 1761: 184).

Smith was deeply critical of the pursuit of 'frivolous consumption', believing that it brought no increase in happiness: 'How many people ruin themselves by laying out money on trinkets of frivolous utility... All their pockets are stuffed with little conveniences... They walk about loaded with a multitude of baubles... If we consider the real satisfaction which all these things are capable of affording, by itself and separated from the beauty of the arrangement which is fitted to promote it, it will appear in the highest degree contemptible and trifling... [W]ealth and greatness are mere trinkets of frivolous utility, no more adapted for procuring ease of body or tranquility of mind than the tweezer-cases of the lovers of toys (Smith, 1761: 180-181).

Smith believed that the only worthwhile social goal was the pursuit of happiness. In his view, this was to be attained through 'tranquillity', not the pursuit of 'power and riches': 'Happiness is tranquillity and enjoyment. Without tranquillity there can be no enjoyment; and where there is perfect tranquillity there is scarce anything which is not capable of amusing' (Smith 1761: 150). In Smith's view, the attainment of



happiness did not require high levels of consumption: '[I]n the ordinary situations of human life, a well-disposed mind may be equally calm, equally cheerful, and equally contented... [I]n the most glittering and exalted situation that our ideal fancy can hold out to us, the pleasures from which we propose to derive our real happiness, are almost always the same with those which in our actual though humble situation, we have at all times at hand and in our power... [T]he pleasures of vanity and superiority are seldom consistent with perfect tranquillity, the principle and foundation of all real and satisfactory enjoyment' (Smith, 1761: 149-150).

Smith believed that a good society was one in which people attained happiness through fulfilling basic human needs, not in the vain pursuit of unlimited wants. He considered that there was a clear choice: 'Two different roads are presented to us,... the one by the study of wisdom and the practice of virtue, the other, by the acquisition of wealth and greatness;... the one of proud ambition and ostentatious avidity, the other, of humble modesty and equitable justice; the one more gaudy and glittering in the colouring, the other more correct and exquisitely beautiful in its outline' (Smith, 1761: 62).

Smith considered that human psychology required social cohesion as the foundation of a good society in which all citizens could achieve happiness: 'All the members of human society stand in need of each others assistance... Where the necessary assistance is reciprocally afforded from love, from gratitude, from friendship, and esteem, the society flourishes and is happy. All the different members of it are bound together by the agreeable bonds of love and affection, and are, as it were, drawn to one common centre of mutual good offices' (Smith, 1761: 85). The foundation of such cohesion was 'benevolence': '[T]o feel much for others and little for ourselves, to restrain our selfish, and to indulge our benevolent affections, constitutes the perfection of human nature; and can alone among mankind produce that harmony of sentiments and passions in which consists their whole grace and propriety' (Smith, 1761: 25).

Benevolence, not the pursuit of wealth and greatness' allows the construction of a sense of duty which, in its turn, enables the realisation



of social cohesion: 'The regard to those general rules of conduct, is what is properly called a sense of duty, a principle of the greatest consequence in human life, and the only possible principle by which the bulk of mankind are capable of directing their actions... Without this sacred regard to general rules, there is no man whose conduct can be much depended upon... By acting according to the dictates of our moral faculties, we necessarily pursue the most effectual means for promoting the happiness of mankind' (Smith, 1761: 161-3, and 166). Smith believed unless a society was 'just' , there was a grave danger that it would disintegrate into chaos: 'Justice, on the contrary, is the main pillar that upholds the whole edifice. If it is removed, the great, the immense fabric of human society, that fabric which to raise and support seems in this world, if I may say so, to have been the peculiar and darling love of Nature, must in a moment crumble into atoms' (Smith, 1761: 86).

Conclusion

Smith's analysis of the market mechanism was an attempt to lay bare the fundamental laws governing economic development. At the same time that he sought to identify these principles, he devoted scrupulous attention to the underlying contradictions of the market economy. He did believe that the free market was the fundamental driver of economic progress. However, he demonstrated that this driving force contained deep internal contradictions from the point of view of people as both producers and as consumers. In respect to both issues, Smith insisted that the dynamism of the free market economy should be considered alongside its deep ethical shortcomings. He was unable to answer satisfactorily how the latter shortcomings could be resolved, but his intellectual honesty and driving sense of moral purpose, led him to lay bare these contradictions clearly and passionately.

His analysis of the contradictions of the market economy are highly relevant to fundamental issues facing the world today. These include the nature of work for almost one billion people in developing countries employed as 'lumpen labour' in the non-farm sector for US\$1-2 per day; class conflict between capital and labour in developing countries that are still in the early phase of capitalist industrialisation; the



'degradation of work' for a large fraction of the service sector workers in rich countries, who work under intense pressure from 'remorseless monitoring' made possible by modern information technology, in order to increase 'labour intensity'; the erosion of a sense of social cohesion as 'state desertion', in order to provide a 'good investment environment' for global capital, becomes widespread across countries at all levels of development; widespread consumer fetishism promoted by the immense marketing expenditure of global giant firms, and commercialised global mass media; and even the very sustainability of life on the planet as fast-growing parts of developing countries move towards the immense per capita consumption levels of the advanced capitalist countries.

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VIET NAM'S INDUSTRIAL COMPETITIVENESS SUMMARY PRESENTATION

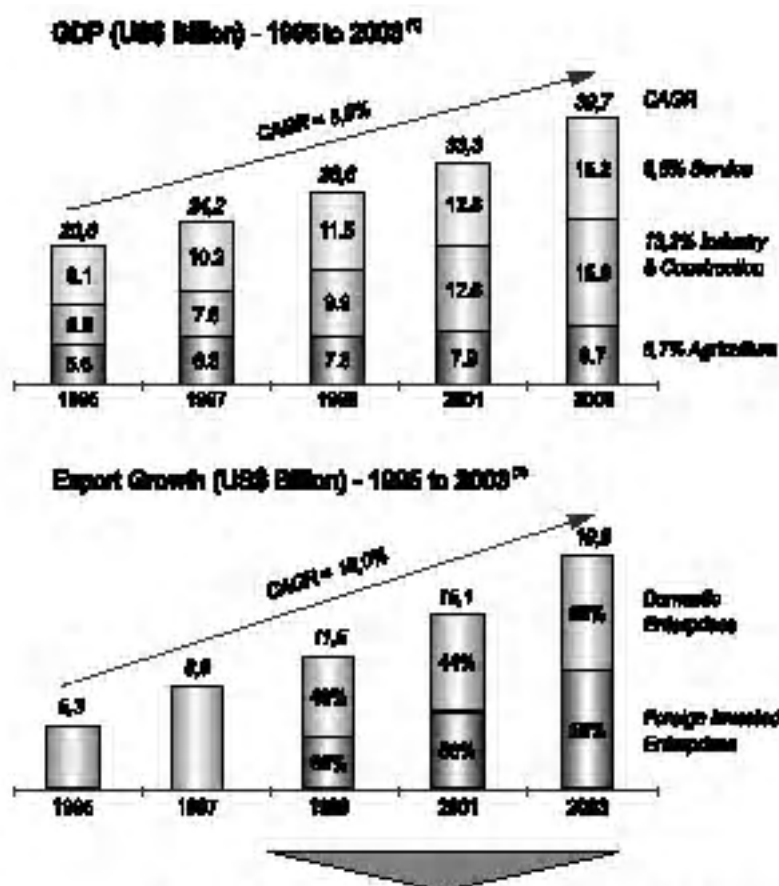
20 YEAR REVIEW OF DOI MOI ROUNDTABLE MEETING

Today's Agenda

- **Clear national progress and the risks of integration**
 - National competitiveness
 - Impact of trade liberalization initiatives
- **Review of inputs and enablers that drive country competitiveness**
 - Global competitiveness
 - Competitiveness drivers
- **Industry competitiveness - the criticality of moving up the value chain**
 - Review of current position in key industries

CLEAR NATIONAL PROGRESS AND THE RISKS OF INTEGRATION

At the national level, the last decade has seen success in two core competitiveness indicators - GDP growth and export performance



VIETNAM'S RECENT ACHIEVEMENTS

- Strong sustained economic growth
 - Among top Asian growth economies
 - GDP / capita rose from US\$287 in 1995 to US\$490 in 2003
 - Strong contribution from the industry and service sectors
- Poverty reduction from 58% in 1992/3 to 32% in 2003
- Gradual economic liberalization
 - Growth in FDI inflows
 - Strong export growth
 - Economic reforms (land & enterprise law etc.) and multi-lateral and bilateral trade agreements
- Continuous economic infrastructure development
 - Improvement and expansion of core infrastructures
 - Development of Industrial estates and parks in major cities
 - Increasing deployment of natural and human resources

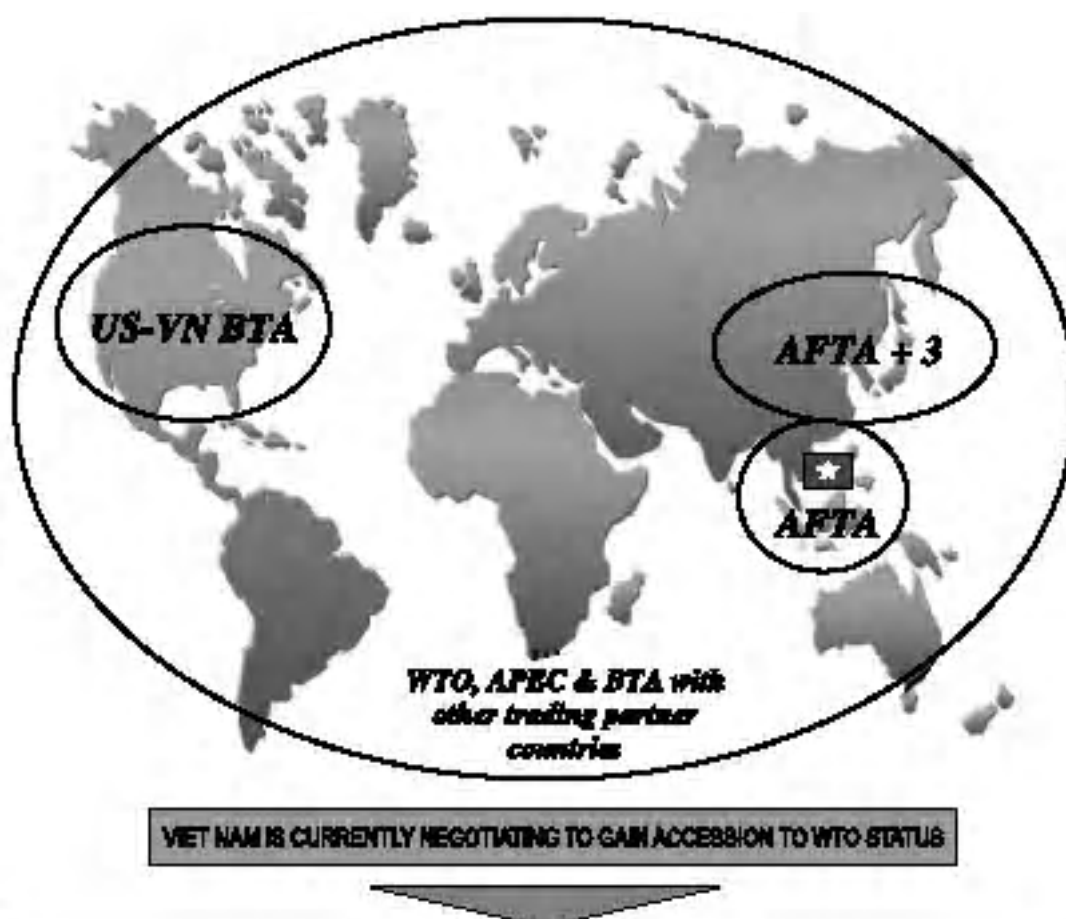
Note: (1) Information on FIE not available for 95 and 97

Source: Strategy for socio-economic development 2010, UNDP, Asia Trade Hub, GSOGDP



A big part of the growth has been due to Viet Nam's various trade liberalization initiatives

Viet Nam's Trade Liberalization And Potential Benefits



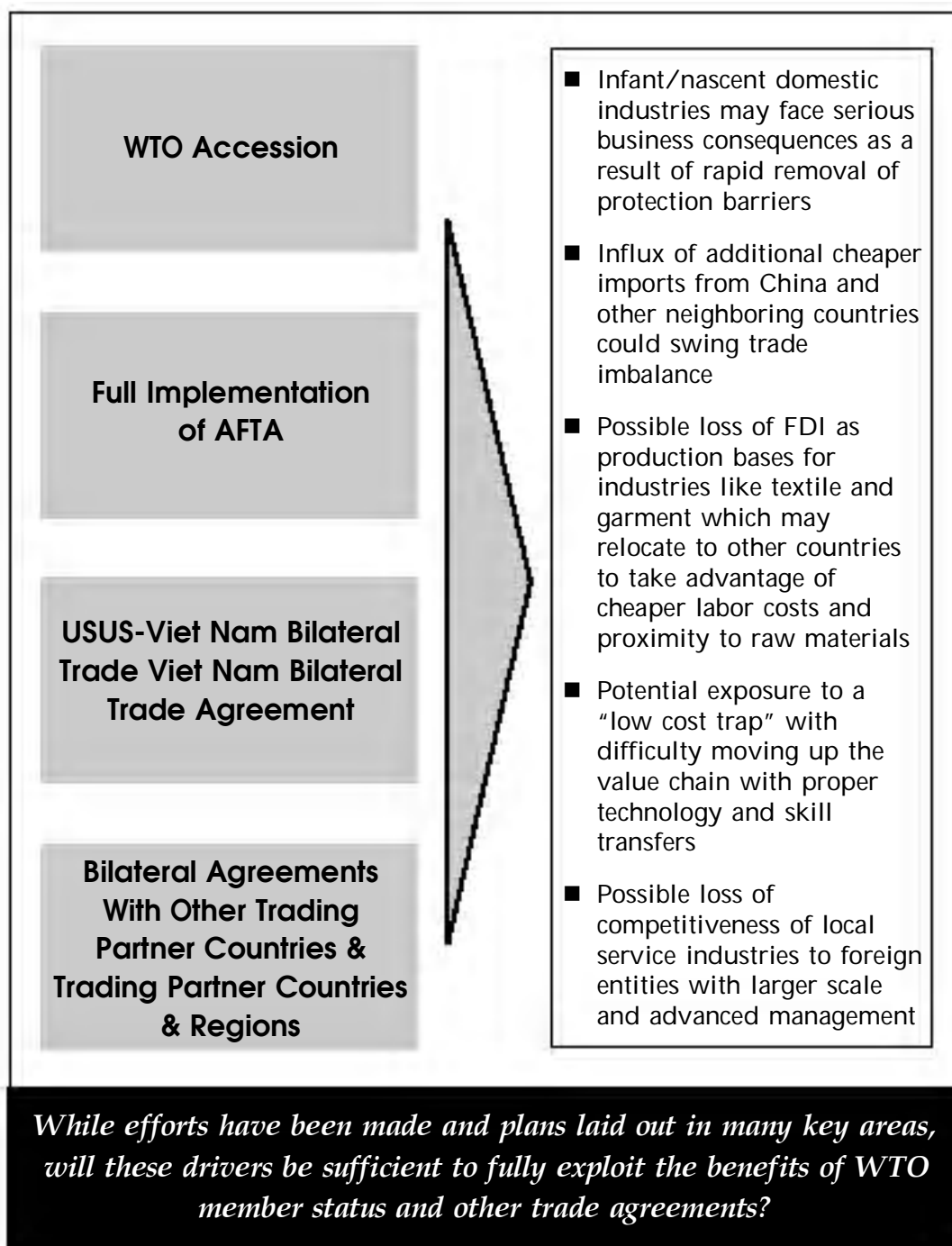
Benefits of Trade Liberalization Initiatives

- Expansion of Viet Nam's export markets for major commodities and products
- Integration into global production and distribution networks; opportunity to position the country as a base for cost effective light manufacturing center in Southeast Asia
- Access to cheaper raw materials and advanced production technology... Improved price competitiveness of Viet Nam's export
- Improved access to sophisticated managerial knowledge and best practices
- Access to affordable consumer imports contributing to better standard of living AFTA

Source: Comprehensive Industry Research-MUTRAP, A.T. Kearney analysis

But further trade liberalization, if its effects are not fully anticipated, could reveal major vulnerabilities

Near Future Strategic Developments And Potential Risks For Viet Nam





Mexico's example shows that trade liberalization does not guarantee growth and competitiveness

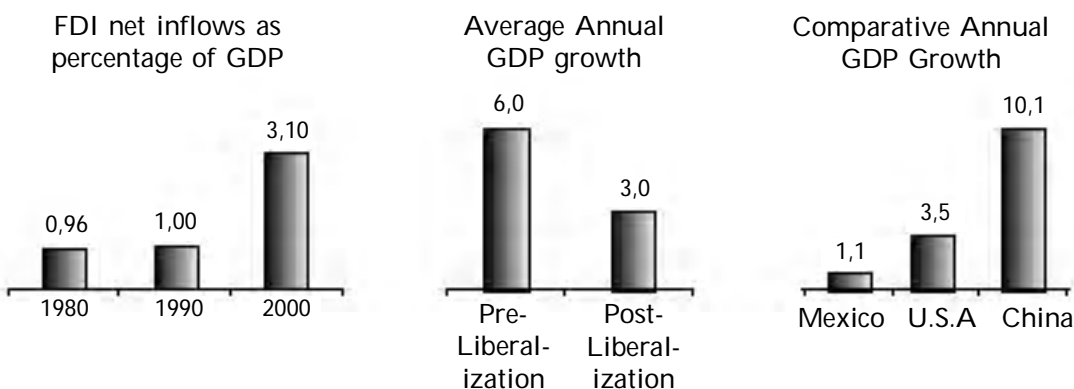
Effects Of Trade Liberalization In Mexico

TRADE LIBERALIZATION IN MEXICO

- Reorientation of Mexico's trade policy from a highly protectionist state focused on domestic market, to that of private sector-led growth and trade openness policy
- Signing of 11 free trade agreements including several Latin American countries, European Free Trade Area, and the North American Free Trade Agreement (NAFTA)
- Reduction of tariff rates, removal of reference prices, elimination of non-tariff barriers and easing of restrictions on foreign investment

IMPACT OF TRADE LIBERALIZATION IN MEXICO

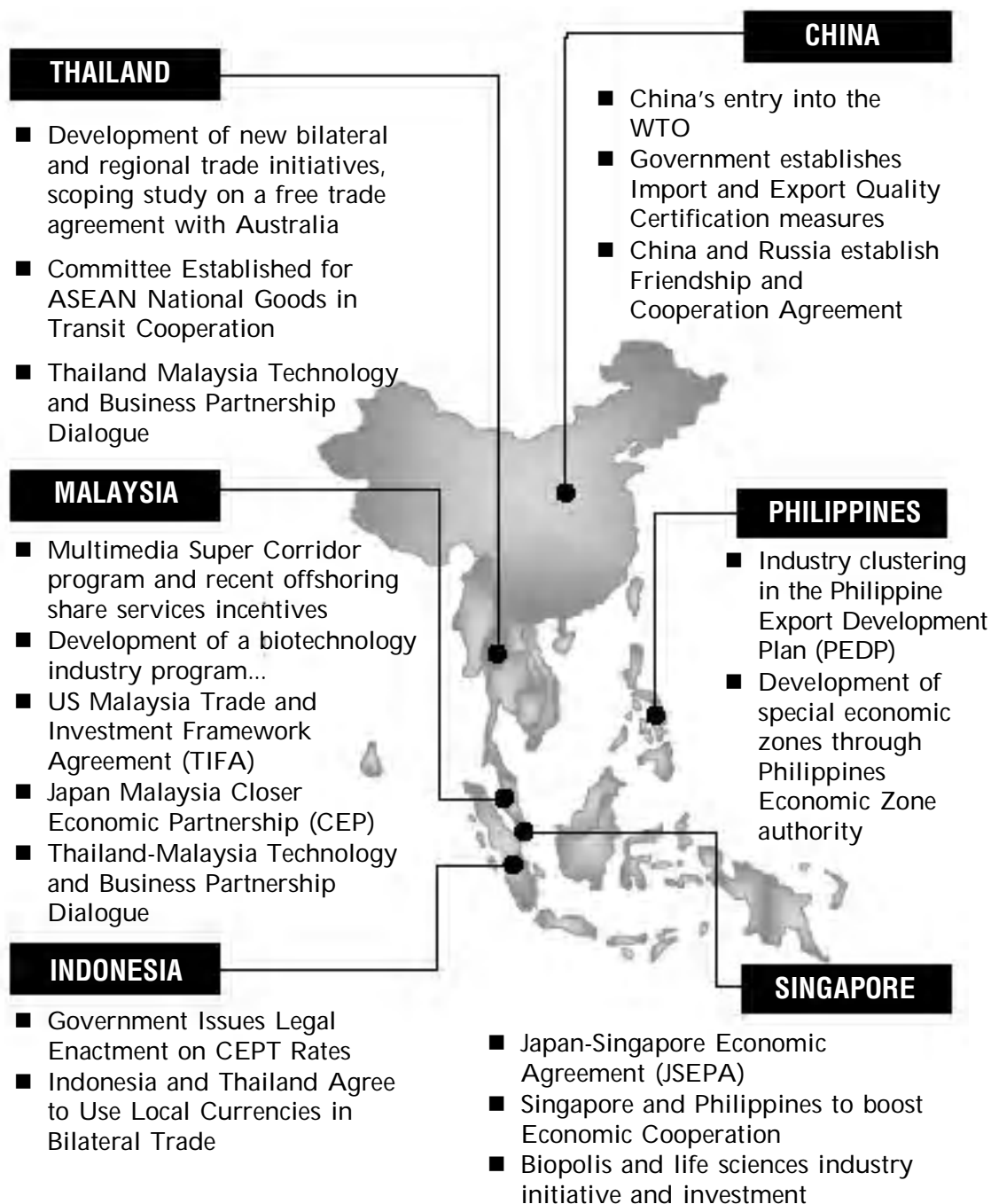
- Control of industrial development has been left largely in the hands of multinationals corporations
- Weak linkages between foreign direct investment and domestic industries
- Majority of foreign direct investment are of high foreign importcontent resulting in no significant growth in exports between pre- and post-liberalization periods



Source: Trade Liberalization in Mexico: Rhetoric and Reality; A. T. Kearney analysis

And being truly competitive will mean improving faster than regional neighbors who are also driving significant gains

Highlights Of Strategic Competitiveness Initiatives In The Region



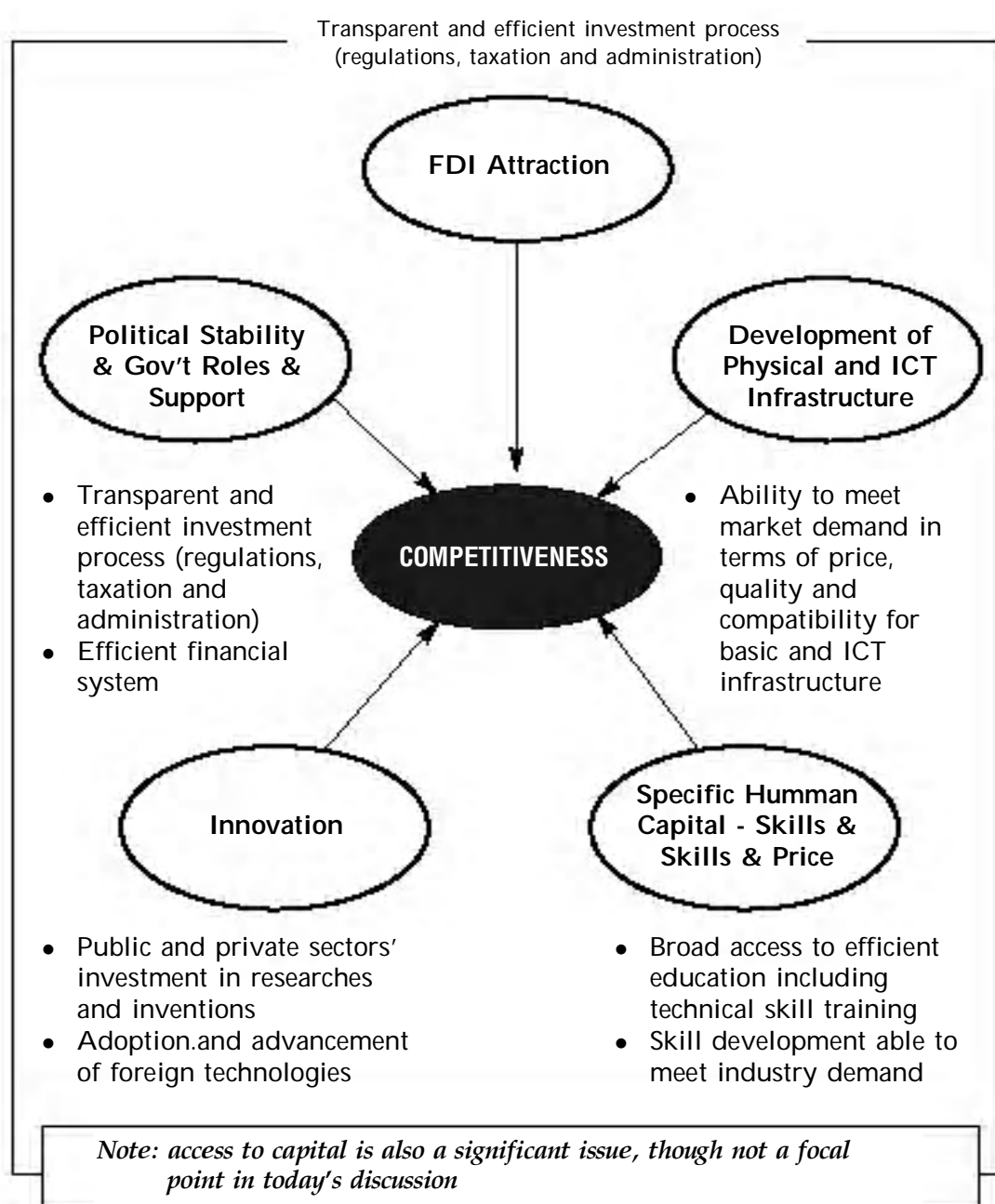
Source: White & Case - Monthly Trade Report, June 2001 & Sept 2003; The Straits Times Interactive; A. T. Kearney analysis



INPUTS AND ENABLERS THAT DRIVE COUNTRY COMPETITIVENESS

At the country level, truly rapid gains do not come unless all the 'building blocks' are in place

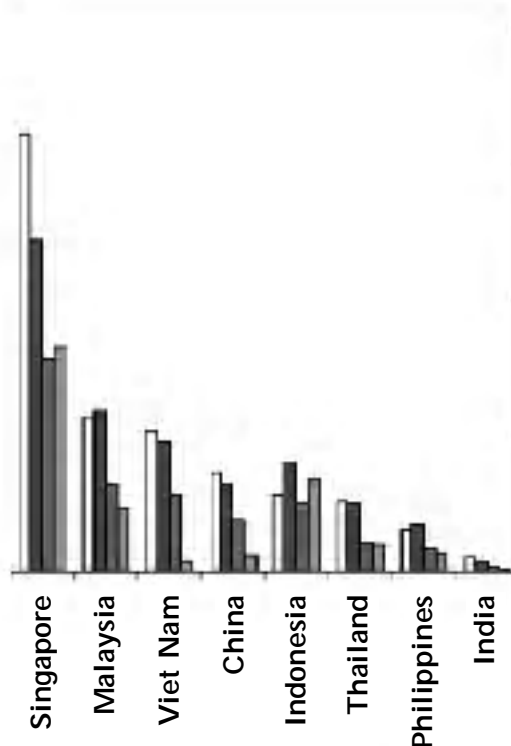
Country Competitiveness-Ingredients For Success in a Global Market



When measured against GDP, Viet Nam has been successful in attracting foreign investment to develop the country's private sector

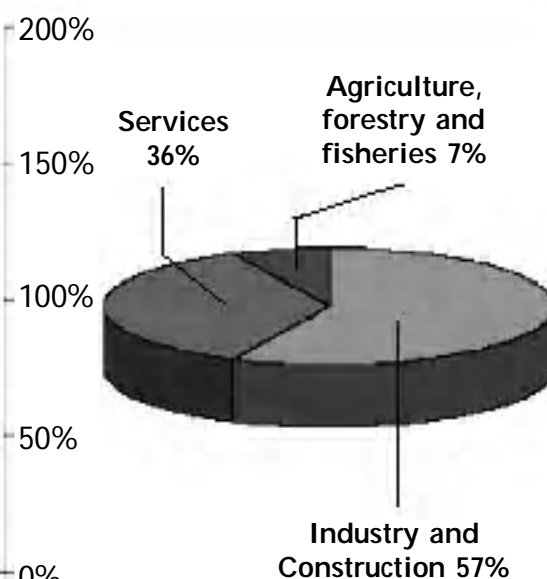
Overview Of Viet Nam's Foreign Direct Investment

FDI inward stock as a percentage of GDP (selected years)



■ 1990 ■ 1995 ■ 2000 □ 2003

Industry allocation of Viet Nam's FDI



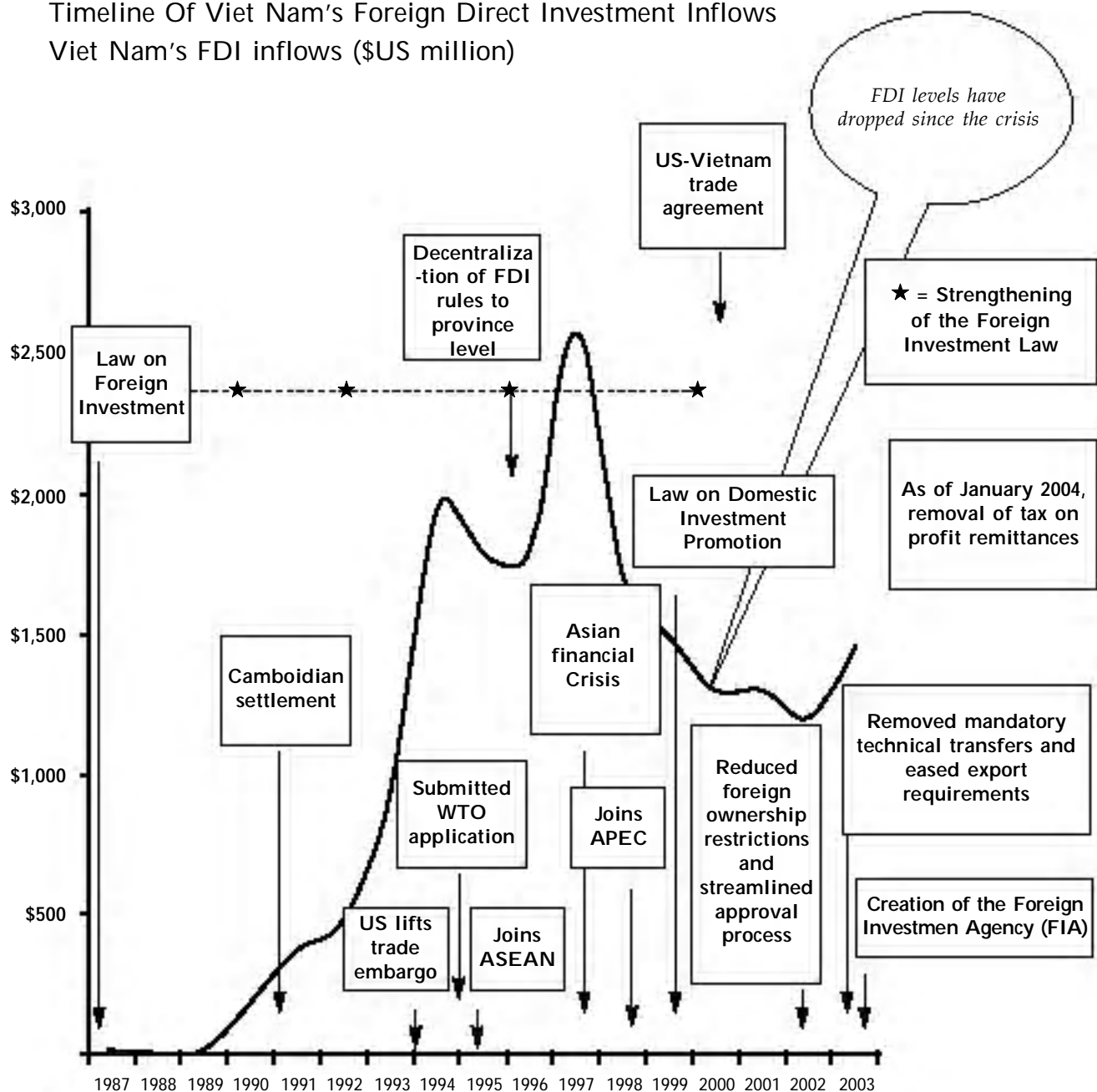
The total \$40.8 billion FDI accumulated since 1987 has fostered economic development across manufacturing, services and agriculture

Source: UNCTAD World Investment Report 2004; Ministry of Planning and Investment; A.T. Kearney analysis



But the overall value of FDI inflows has not yet returned to the pre-crisis levels

Timeline Of Viet Nam's Foreign Direct Investment Inflows
Viet Nam's FDI inflows (\$US million)

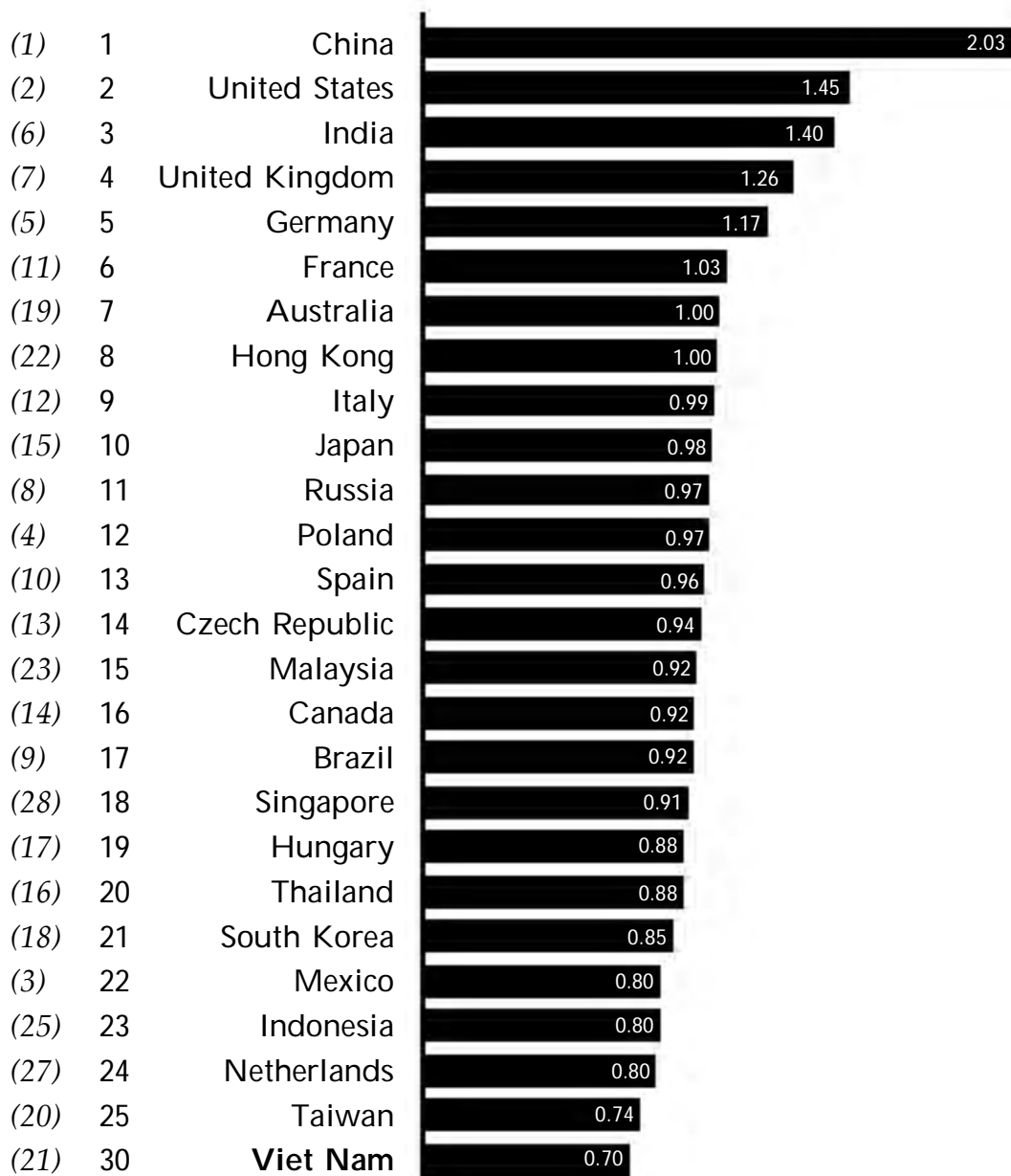


Gradual transition: adoption of civil law, liberalization of economy and establishment of FDI regulatory framework

Source: UNCTAD World Investment Report 2004, EIU; A.T. Kearney analysis

And A. T. Kearney's FDI Confidence Index shows that Viet Nam has declined in its ranking from 21 in 2003 to 30 in 2004

FDI Confidence Index 2004 (2003), Top 25



Note: (1) FDI Confidence index is an annual survey of top executives of Global 1000 companies to assess corporate investor confidence in investment destinations. Source: A. T. Kearney, FDI Confidence Index 2004



Viet Nam's loss of momentum has been primarily due to increased interest in Hong Kong, Malaysia, Indonesia and Singapore

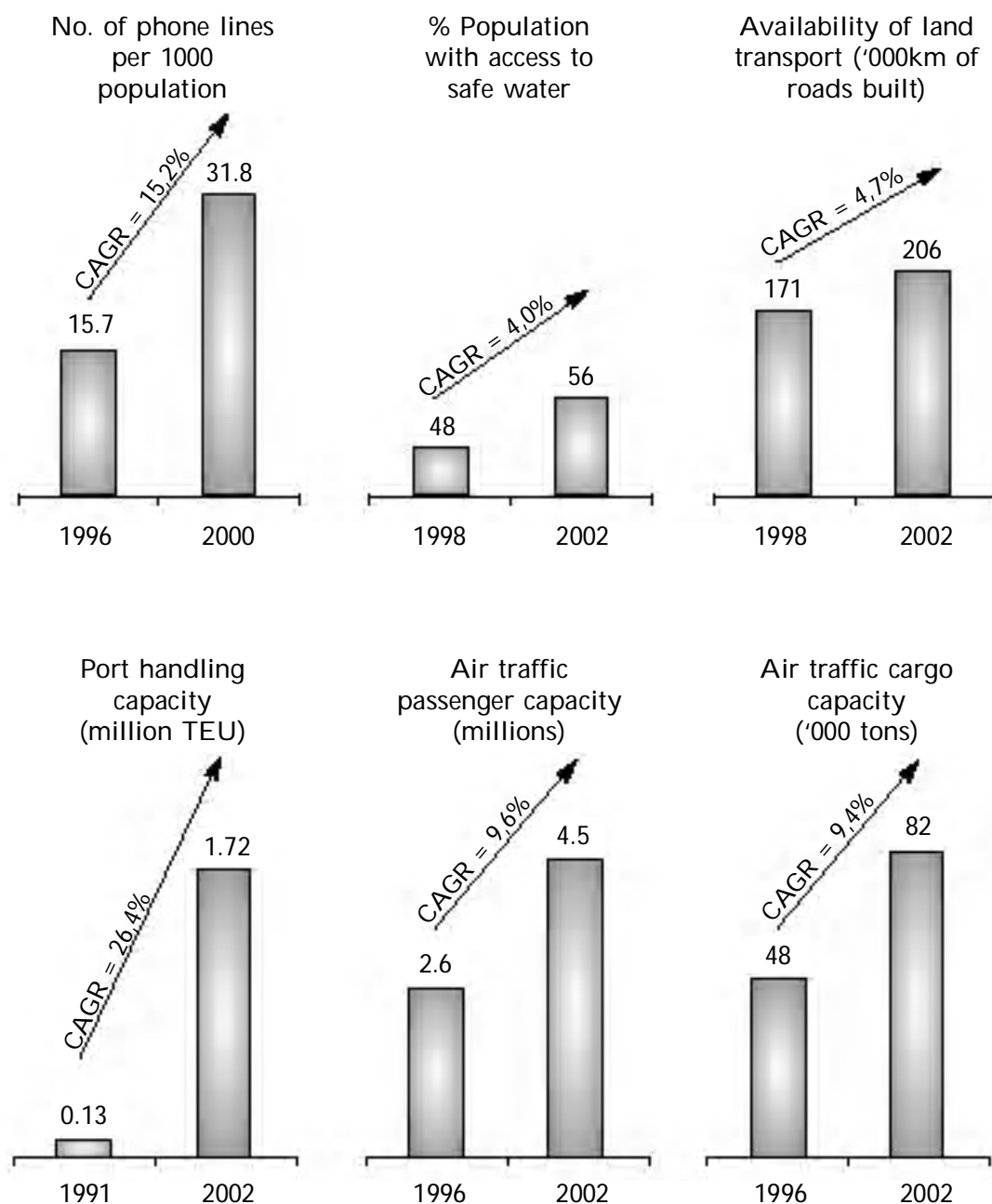
FDI Confidence Index, Top 15 Asian Markets

June 1999	Jan 2000	Feb 2001	Sept 2002	Sept 2003	Sept 2004
1 China	1 China	1 China	1 China	1 China	1 China
2 India	2 Australia	2 India	2 Australia	2 India	2 India
3 Australia	3 India	3 Singapore	3 Japan	3 Japan	3 Australia
4 Thailand	4 Thailand	4 Thailand	4 India	4 Thailand	4 Hong Kong
5 South Korea	5 South Korea	5 Australia	5 Hong Kong	5 South Korea	5 Japan
6 Singapore	6 Japan	6 South Korea	6 Thailand	6 Australia	6 Malaysia
7 Japan	7 Singapore	7 Taiwan	7 South Korea	7 Taiwan	7 Singapore
8 Malaysia	8 Malaysia	8 Japan	8 Singapore	8 Vietnam	8 Thailand
9 Taiwan	9 Taiwan	9 Malaysia	9 Taiwan	9 Hong Kong	9 South Korea
10 Philippines	10 Philippines	10 Hong Kong	10 New Zealand	10 Malaysia	10 Indonesia
11 Hong Kong	11 Hong Kong	11 Indonesia	11 Indonesia	11 Indonesia	11 Taiwan
12 Indonesia	12 Indonesia	12 Vietnam	12 Vietnam	12 Singapore	12 Vietnam
13 New Zealand	13 Vietnam	13 Philippines	13 Philippines	13 Philippines	13 New Zealand
14 Vietnam	14 New Zealand	14 New Zealand	14 Malaysia	14 New Zealand	14 Philippines
15 Pakistan	15 Pakistan	15 Pakistan	15 Pakistan	15 Pakistan	15 Pakistan

Source: A.T. Kearney FDI Confidence Index; A.T. Kearney Analysis

In terms of infrastructural enablers, Viet Nam has improved significantly in the provision of basic needs...

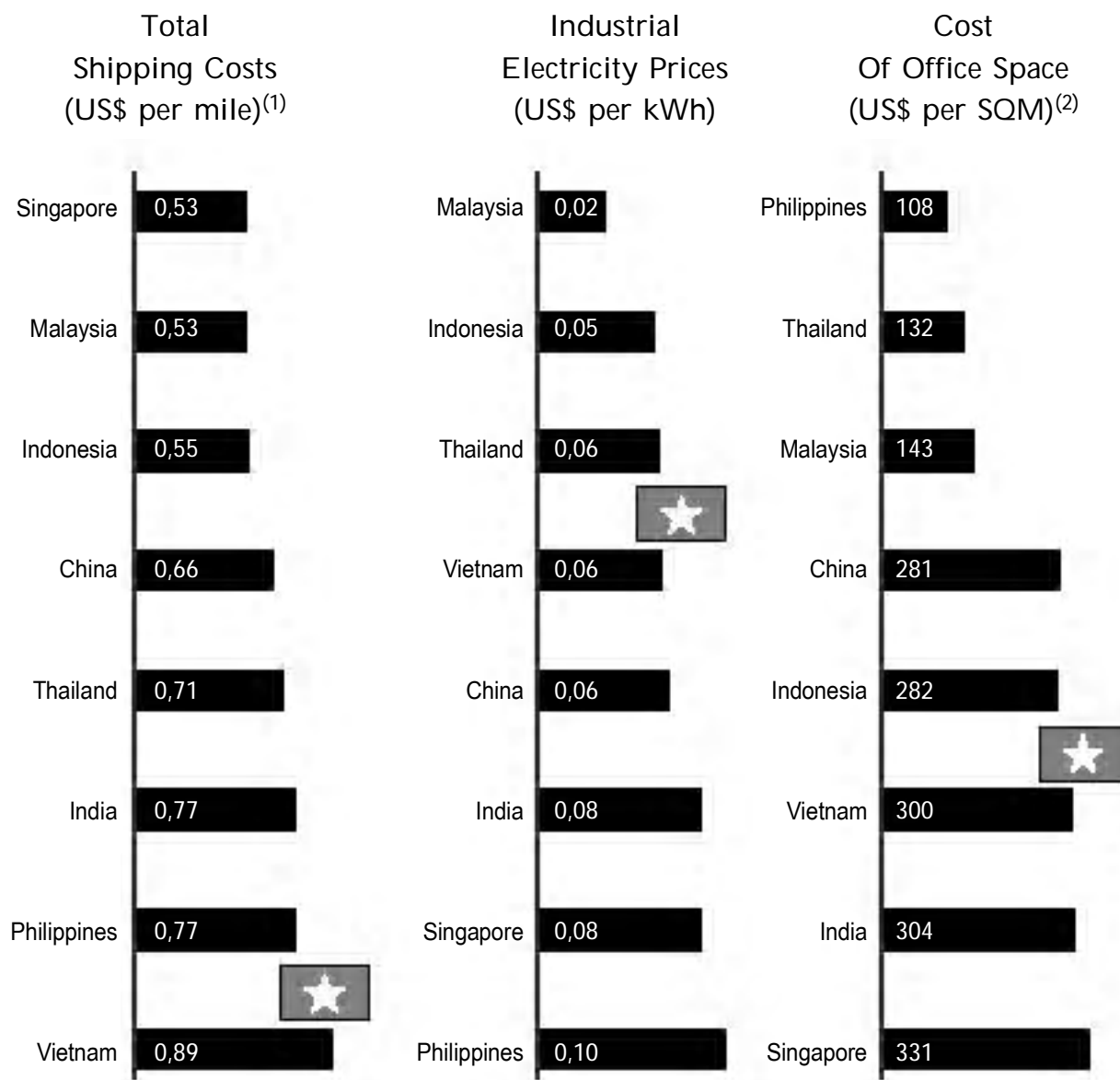
Development Of Basic Infrastructure In Viet Nam



Sources: Asia Development Bank; Vietnam Ministry of Transport; A.T. Kearney analysis

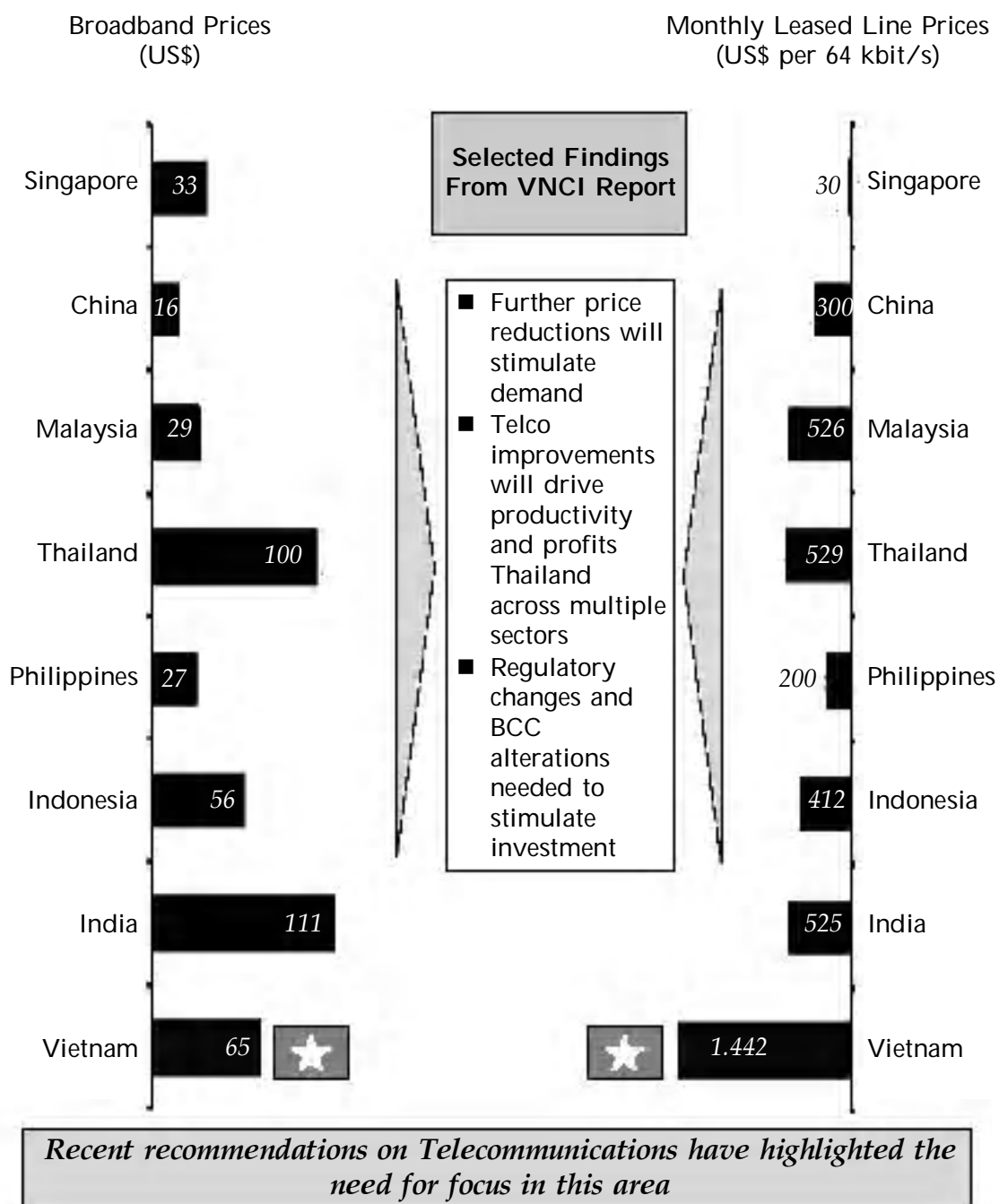


..but significant progress still needs to be made on core infrastructure costs



Note: (1) Based on shipping cost for standard 20ft container; (2) Based on Class A buildings
Sources: Maersk; OECD; Richard Ellis; A.T. Kearney analysis

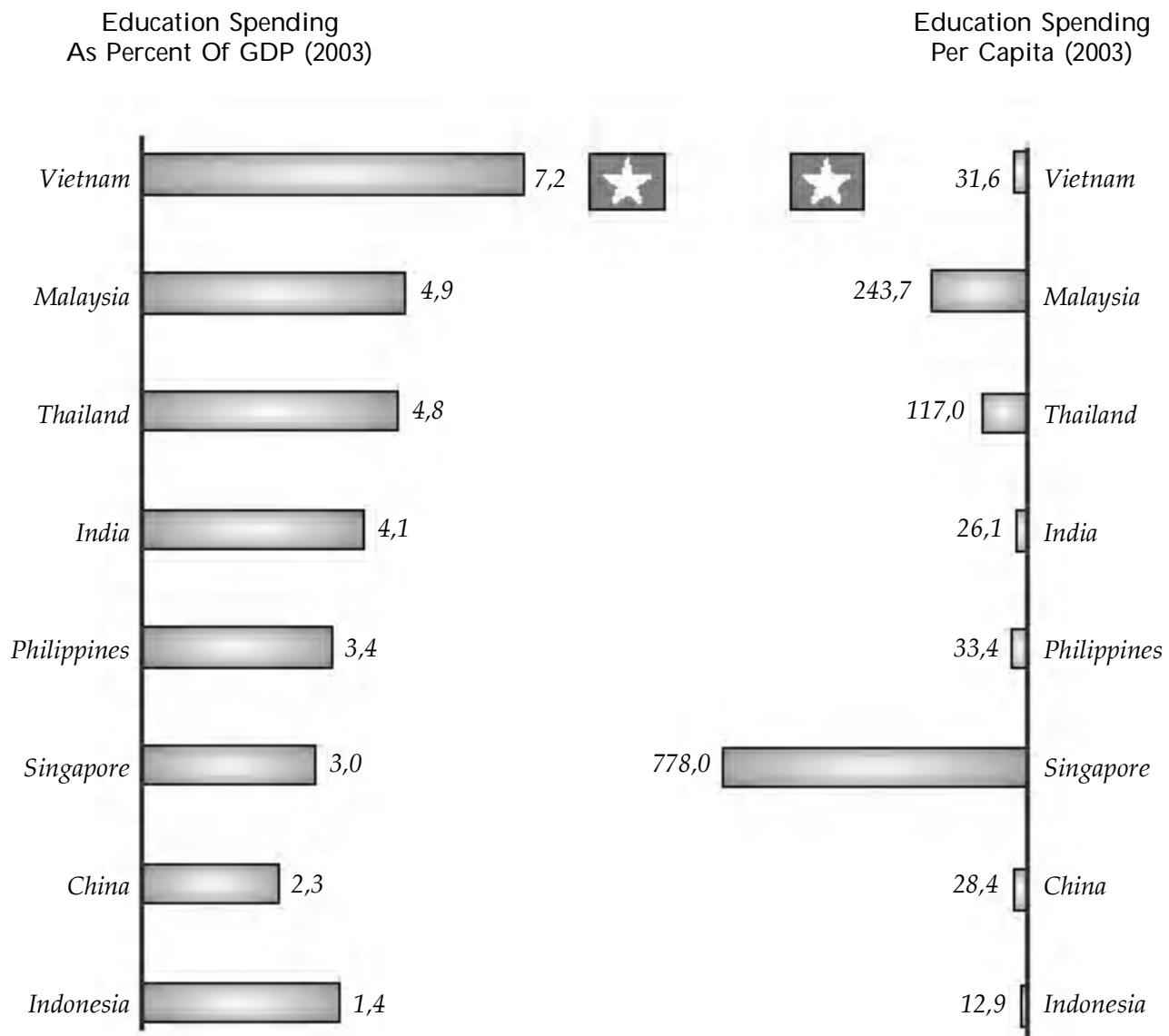
**A further concern is the availability and cost of telecommunications-
an important enabler for industry development**



Source: ITU World Telecommunication Indicators Database; A.T. Kearney analysis; Vietbidand VNCI Competition Review of Telecom Sector in Vietnam, Draft Report, November 2004

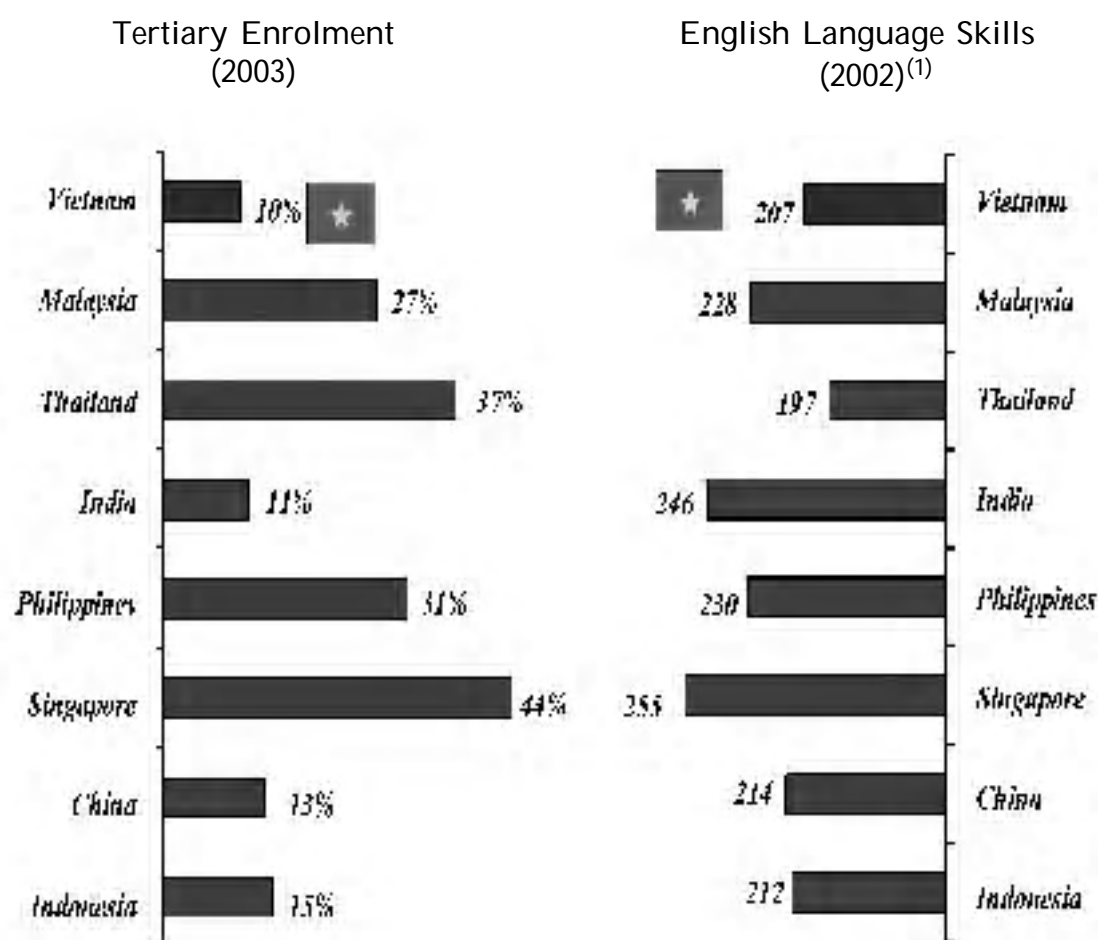


While Viet Nam's (94%) literacy rate and educational spending are high, the more useful measure is education spending per capita



Source: Development Data Group, Deutsche Bank Research, A.T. Kearney analysis

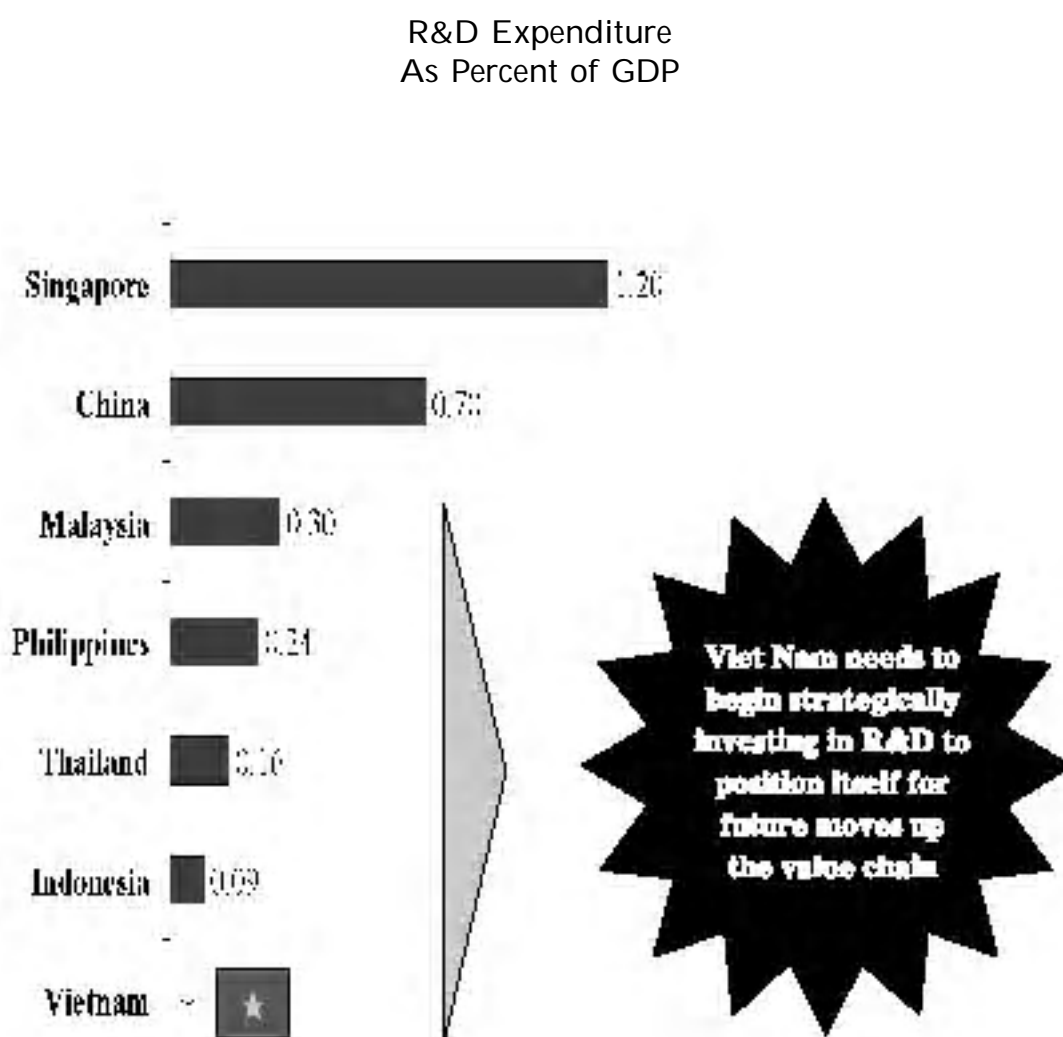
And there are crucial issues regarding tertiary education, quality, and alignment of language and technical skills to industry priorities



Note: (1) As measured by average TOEFL scores for the nation
Source: Asia Development Bank, TOEFL, A.T. Kearney analysis



Similarly, while innovation is not a core concern today, Viet Nam will have to build a foundation for the future

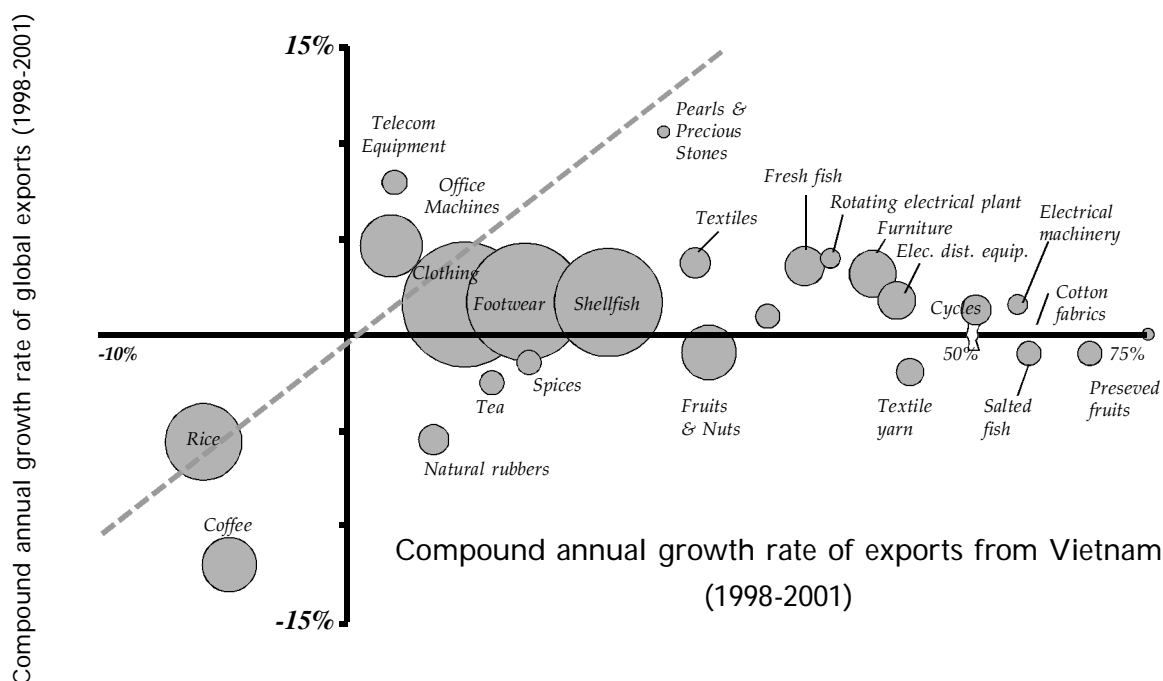


Source: World Economic Forum; A.T. Kearney analysis

INDUSTRY COMPETITIVENESS - THE CRITICALITY OF MOVING UP THE VALUE CHAIN

Viet Nam should concentrate on those industries which have potential for growth both internally and on the global front

Growth And Competitiveness Of Viet Nam's Export Industries



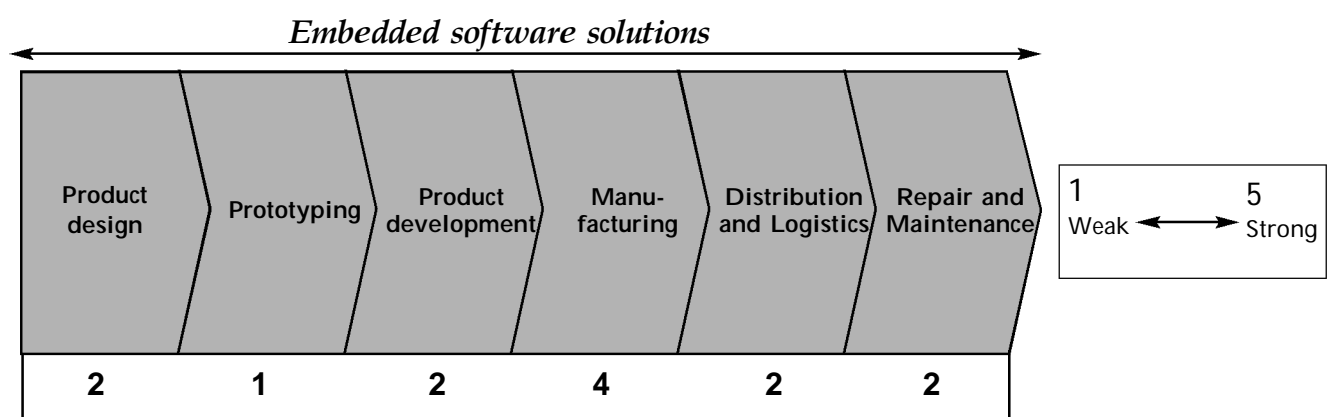
Note: Includes product categories in which exports account for 1.0% of more of total non-oil exports from Vietnam, as measured by SITC

Source: United Nations Statistics Division, COMTRADE database; UNCTAD Handbook of Statistics; A.T. Kearney analysis Growth And Competitiveness Of Viet Nam's Export Industries



And it is crucial to break down the value chain of each industry to determine where and how Viet Nam can best compete

Example Of An Electronics Value Chain



Viet Nam's capabilities (illustrative)



- Where else along the value chain can Viet Nam be a key player?
- Which of these are of higher value added?
- What kind of skills are required? Can these be developed easily?
- What is needed to nurture and grow these segments?



Choosing industries carefully-and determining Viet Nam's position within each industry-is crucial to avoiding the mistakes of others

Key Challenges And Lessons Learned

Key Lessons Learned From The Mexico Experience
<ul style="list-style-type: none"> ■ Liberalization can be disappointing if the necessary enablers are not in place ■ An industrial strategy and exchange rate policy must be supportive of the liberalization process ■ Ensure appropriate balance between a country's export and import at the capacity growth rate (as determined by labor force and productivity growth) ■ Investments in intangibles such as R&D and education result in more sustainable development than investments in fixed capital ■ Establish strong development strategies and ensure strong linkages between foreign direct investment and domestic industries

Moving forward, we recommend increased attention to three major thrusts

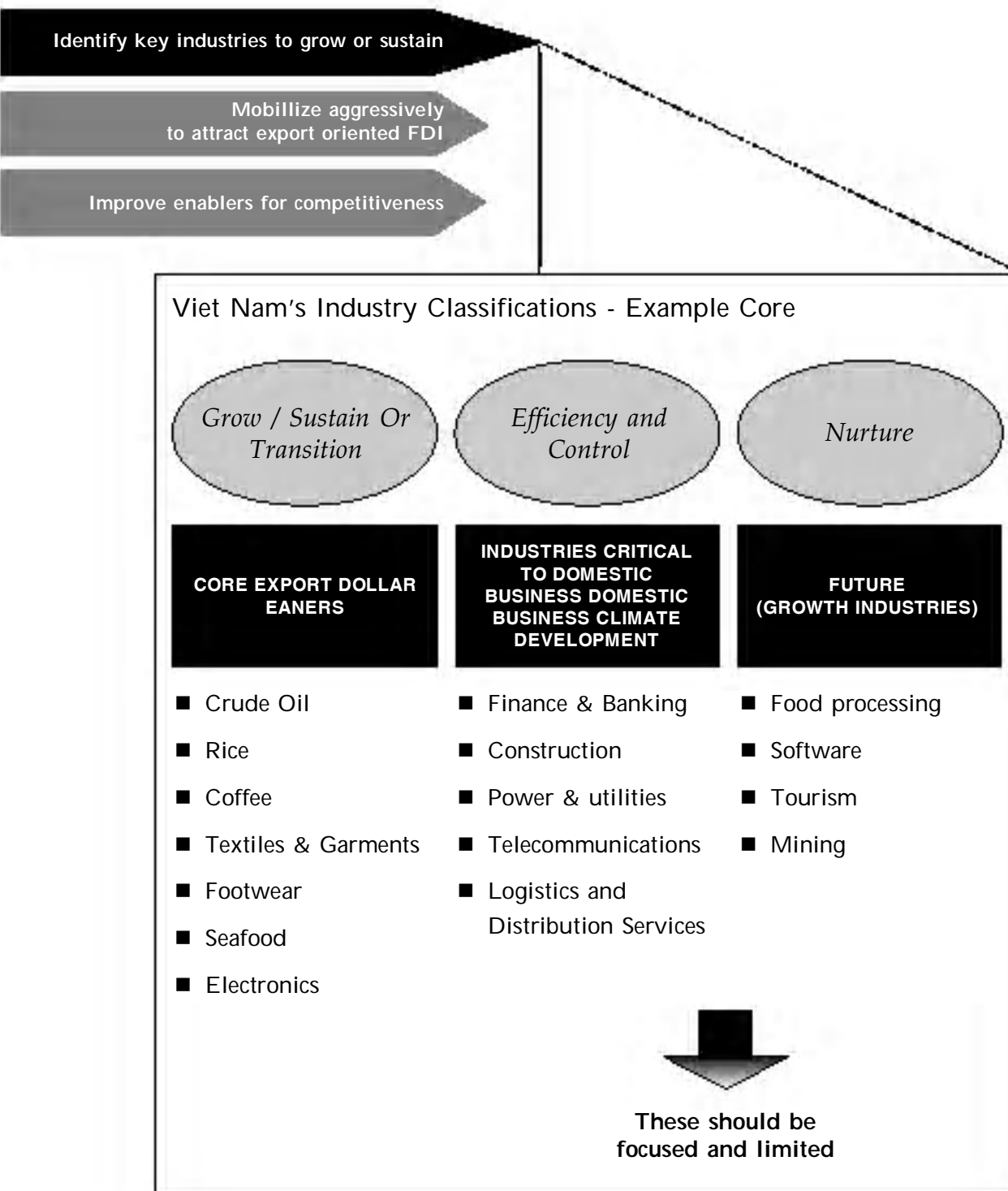
Identify key industries to grow or sustain

Mobilize aggressively to attract efficiency seeking export oriented FDI

Improve enablers for competitiveness



For each of the current and potential major industry sectors important to Viet Nam, an assessment for growth is required identify

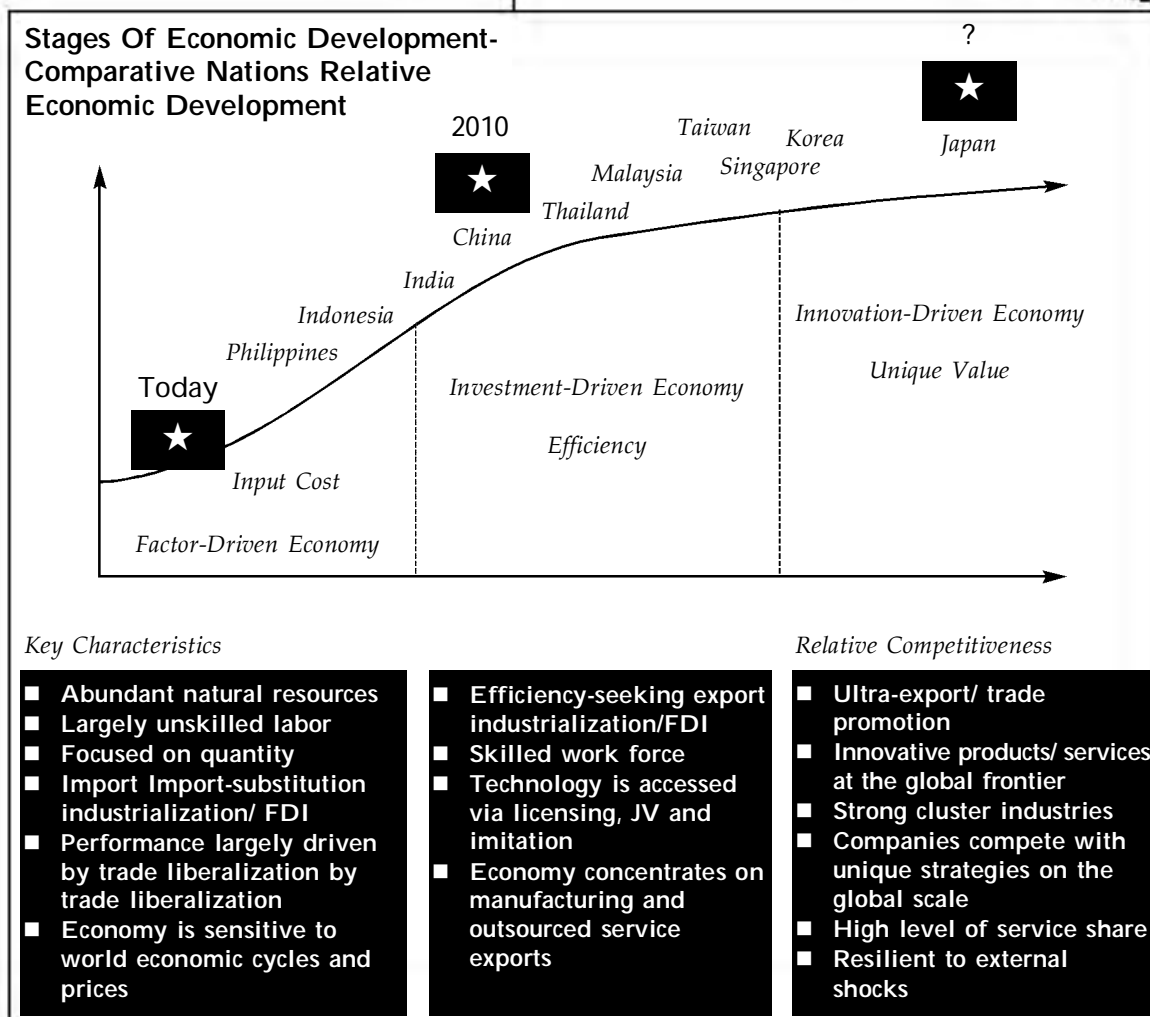


Viet Nam needs to aggressively move towards an investment driven economy to further drive competitiveness and growth

Identify key industries to grow or sustain

Mobilize aggressively to attract efficiency export oriented FDI

Improve enablers for competitiveness





Who are Viet Nam's potential 'customers' and what are they looking for?

Identify key industries to grow or sustain

Mobilize aggressively to attract efficiency seeking export oriented FDI

Improve enablers for competitiveness

FDI Confidence Index 2004

Asian Investor Index	Japanese Investor Index	Australian Investor Index	Singaporean Investor Index
1 China	1 China	1 New Zealand	1 China
2 Hong Kong	2 United States	2 China	2 Vietnam
3 Thailand	3 Germany	3 Hong Kong	3 India
4 India	4 Indonesia	4 United Kingdom	4 Malaysia
5 Malaysia	5 India	5 Malaysia	5 Thailand
6 Vietnam	6 United Kingdom	6 Singapore	6 Hong Kong
7 Indonesia	7 Hong Kong	7 India	7 Australia
8 United States	8 Taiwan	8 South Korea	8 Indonesia
9 Singapore	9 France	9 Indonesia	9 Philippines
10 Australia	10 Singapore	10 Taiwan	10 Central Asia
11 United Kingdom	11 Vietnam	11 Thailand	11 Japan
12 Taiwan	12 Thailand	12 Vietnam	12 Pakistan
13 New Zealand	13 Malaysia	13 United States	13 South Korea
14 South Korea	14 Denmark	14 Ireland	14 Taiwan
15 France	15 Spain	15 Central Asia	15 New Zealand

Viet Nam also ranks highly among food, textile and apparel, communications and transportation industry investors

Current gaps in competitiveness enablers and issues currently faced by investors in the country need to be identified and understood

Identify key industries to grow or sustain

Mobilize aggressively to attract efficiency seeking FDI

Improve enablers for competitiveness

"Vietnam should be a competitor to Eastern China, with a low-cost workforce which is more familiar with the West and better educated than other parts of Asia. Its large population and fast economic growth are attractive. The government has done a good job of providing infrastructure. We are planning on expanding capacity in ASEAN -Vietnam would be the logical choice. However, red tape, corruption, old fashioned restrictions and protection of indigenous industries are holding us back."

Head of Global Strategy for leading European electronics company

"Energy and infrastructure companies see potential in the Vietnam, however they are waiting for the government to create greater market access in these sectors. It's uncertain that current investors will move up the value chain. The population is commercial-minded, hardworking, and well-educated. They believe in a better future. However, government relationships are still the key to doing business and corruptions said to be an issue. Looking ahead, Vietnam could compete with Thailand -likely in the next 5-10 years".

Board Member of large French energy company

"We sell a lot in Vietnam and have done some subcontracting in the market. We expect to do more sourcing in Vietnam in the future. But, we are not likely to make investments in the market in the near future. Our investments are in high-tech and we have significant investments in Asia -in China, Malaysia and Singapore. However, Vietnam does not offer the skill-set we are looking for at this time. The country's high transaction costs, expensive ICT, and underdeveloped commercial law are challenges."

Senior Manager for Int'l Trade and Investment for large American conglomerate

Source: Informality and the Playing Field in Vietnam's Business Sector, IFC



Educational priorities need to be clearly linked to industry priorities and focus

Identify key industries to grow or sustain

Mobilize aggressively to attract efficiency seeking FDI

Improve enablers for competitiveness

- Continued broad investment in basic education is important but a new stream of activity needs to focus on aligning education priorities with industry specific demand = vocation training and private sector involvement
- Further work will be required to address the following key questions at the general level...
 - Are the supply of vocational and management resources sufficient to drive growth domestically and attract investment?
 - Does Viet Nam's educational system emphasize the right attributes e.g. creativity, self learning etc?
 - Which aspects of the curriculum be reviewed to ensure linkages to industry priorities?
 - Through what means can Viet Nam encourage the rapid growth of vocational training?
 - How should language training priorities (notably English and Mandarin) find their way into the standard curriculum?
 - How can Viet Nam raise overall academic excellence in Viet Nam's educational institutions?
- Based on industry priorities, the requirements for these industries needs to be identified and mapped to Viet Nam's work force development and education improvement program (e.g. the Ireland example, cited earlier)



DOI MOI IN REVIEW: STATE, SOCIETY AND POLITICS

*Melanie Beresford,
Macquarie University, Sydney, Australia*

Introduction

- Focus of this paper: ways in which state and political life influence and are influenced by changing economic structure
- The only model for successful Late Industrialization in recent history is East Asia

1. RESTRUCTURING THE BUSINESS SECTOR:

Some conceptual issues

Robert Wade: East Asian 'Alliance capitalism'

- High debt-equity ratios, low importance of stock market
- Features close relations between banks, firms, government
- Different from 'cronyism', which has political goal (regime maintenance).

Blurring the lines a bit

- Problem: Wade separates economic from political
- 'Regime maintenance' includes maintaining legitimacy
- Low legitimacy → difficult to separate politics and economics
- High legitimacy → political nature of alliances less visible.



When is alliance capitalism the same as 'cronyism'?

- when state actors cannot maintain arm's length from business; for example:
- firms are run by family, friends, classmates, etc. of state actors
- regime is widely perceived as illegitimate and relies on key firms / groups for political support
- government unable or unwilling to discipline firms

What are consequences of 'alliance capitalism'?

- Investment decisions (therefore, longterm structural change) influenced directly by politics
- Specifically, this means that private/firm decisions are not dominant during the industrialization process
- Discipline of the market is replaced by political discipline
- Firms must perform or die.

2. VIETNAM: LOOKING EAST?

Vietnamese definition of 'socialism'...

- Was (in the past) defined by central planning; public ownership; distribution according to labour;
- Since Doi Moi this has effectively been reduced to 'public ownership of the major means of production';
- Rationale is ability of the state to influence the long-term structural changes mentioned above;
- Implies support for state-owned enterprises as a central plank of 'socialist market economy';
- 'Civilized and equitable' society.



Situation of SOEs

- SOEs: eating the 'armless and legless babies'?
- True that many SOEs were born lacking essential parts or with parts cobbled together from a range of different sources
- In general, they received little support before 1990 - focus was on creating new enterprises rather than upgrading existing ones.

Situation of SOEs (more)

- After 1990 focus on institutional reform majority of SOEs continued to lack investment support
- Relatively small proportion of SOEs funded by joint-ventures

Investment shares 1991-99 (per cent)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
(1) Share of GDP Gross capital formation	15.0	17.6	24.9	25.5	27.1	27.9	29.2	27.0	29.6	30.5	31.5
State investment	5.9	6.8	12.2	10.8	10.3	13.2	14.8	14.6	11.0	na	na
(2) Share of total investment											
Government investment					24.4	31.2	36.3	33.3	47.0	57.5	58.1
State budget					19.9	20.8	22.6	22.8	30.5	a	a
Credit					4.5	10.4	13.7	10.5	16.6	a	a
SOE investment					13.8	13.9	14.4	20.7	11.8	a	a
Domestic private investment					29.4	26.2	21.9	21.1	29.4	23.8	23.6
Foreign investment					32.3	28.6	28.4	25.0	11.8	18.7	18.3

Political or economic rationale?

- Too many SOEs have survived through increasing indebtedness and 'soft budget constraints'
- Others have changed their line of business in order to survive
- Situation complicated by donor attitude



- → Incentives to SOE directors mixed
- Offsetting this is success of FDI sector (including some key JVs)

Output per worker in industry in 1998

	<i>million dong (1994 prices)</i>
SOEs	82.5
Domestic private*	101.7
Foreign invested	161.2

Guanxi - Vietnamese style

- East Asian economies characterized by markets embedded in social networks.
- Vietnamese networks comprise government officials, large firms, sub-contractors, etc.
- Distinction between state and non-state sectors very blurred
- Follows that state vs private dichotomy not very useful (cannot assume so much enterprise autonomy)
- Also follows that state vs civil society models not useful

Conclusion:

- problem of poverty (and potential for social instability) arises from noninclusion in the networks of capital accumulation
- This can also apply to SOEs that are unable to participate in successful politico-economic networks

3. INCLUSION AND EXCLUSION

Achievements since Doi Moi

- Rapid rate of growth in national income combined with rapid reduction in absolute poverty



- Increased ability of people to make decisions or to be consulted about decisions impinging on their economic and social well-being
- Uneven distribution of these improvements has been widely noted
- Changes in ways in which people become poor and unable to participate in the benefits of growth

The 'Growth Pole' model

- State support for central SOEs and FDI located in two major urban agglomerations
- Fiscal redistribution not very strong.

Beneficiaries of this growth

- Joint ventures provide opportunities for skilled workers and managers
- Protective attitude to SOEs has fulfilled welfare function, cushioned effects of restructuring
- Ability of state officials to benefit financially
- Ability to privatize previously unutilized or underutilized resources
- Limited employment creation in export-oriented industries
- Household sector benefits where it is integrated into global and domestic markets

Limited or non-existent benefits

- Inability to participate in market economy due to poor infrastructure (transport, power, clean water), below average access to information, education, etc
- Poor public investment decisions, lack of budget, poor use of budget and lack of public scrutiny of local decision-making

Unpaid household labour

- Has doi moi been a backward step for women, especially rural women?



- increased obstacles to their involvement in public life -retreat into the household
- increased reliance on domestic labour to support household members (including provision of safety net)
- increased participation in the least productive, low growth economic sectors (agriculture and microenterprise)
- reduced opportunities for high skilled employment

4. CONCLUSION

- SOEs have been awarded a privileged position in Vietnamese economic life under Doi Moi, but not really helped to become successful.
- Successful economic networks have combined political/official with foreign investors, SOEs and **quasi-private sector actors**
- Weak state direction inherited from centrally planned economy - leaves scope for rise of sectional interests in politics

5. CONCLUSION (more)

- Inclusion in successful networks is crucial for participation in rising prosperity
- Exclusion could be addressed by:
- Better fiscal redistribution targeting employment creation and market development for poor communities
- Better implementation of 29-CP - consultation with communities - especially a focus on individuals not households.



SOCIETY, CULTURE, AND HUMAN DEVELOPMENT UNDER *DOI MOI*

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INTRODUCTION

- In the last decade and a half, the Vietnamese state has redefined its role in relation not only to the market but also to culture and society.
- As widely acclaimed, at least for the overwhelming majority of the population in Viet Nam, living standards in particular and human development in general have improved:
 - The poverty rate declined from an estimate of over 70% in the mid-1980s to 58% in 1993 and 29% in 2002
 - Improvements in human development are reflected in
- Societal members' generally greater access to basic education and improvements in child health (the stunting rate declined from 50% in 1993 to 23% in 2002); and
- Increased opportunities for people to participate in society, not only as producers and consumers but also:
 - through greater access to different media (including televisions and internet) and more diverse media contents;
 - the intensification of ritual activities (both rites of passage like weddings, and rites of solidarity like ancestor worship, religious ceremonies, and community festivals);
 - the proliferation of social organizations with little support from the state (patrilineages, same native-place associations, same-age associations, etc.);



- the greater opportunity to participate in the governance process through the grass-roots democracy policy adopted in 1998.
- The *Doi moi* policy of the Vietnamese state, and increased funding for education and health care in the past decade, have contributed significantly to greater human development.
- However, *Doi moi* is not only an era of enhanced capacities for most members of society and increased social participation. In the context of economic growth and globalization, poverty reduction and human development in Viet Nam have also encountered a number of challenges: higher costs of education and health care and societal members' greater share of these costs; greater economic, health, and environmental risks; and the possible emergence of new pockets of poverty. More specifically,
 - VLSS data shows that the Vietnamese population absorbed about half of the education costs and 80% of the health care costs in the 1990s;
 - Greater engagement with the global market also involves risks, such as the wide fluctuation in commodity prices (linked in some cases to trade disputes). For farmers in the Central Highlands and the Mekong delta, this risk is seen most clearly in the wide fluctuation of coffee, rice, pepper prices as well as in the U.S.-imposed tariffs on Vietnamese *basa* fish ("catfish");
 - Health risks have increased with globalization (AIDS, SARS, etc.);
 - Environmental problems with major short-or long-term economic and health implications have also increased:
 - with deforestation and land degradation
 - air, land, and water pollution due to the increasing consumption of fuel and less biodegradable materials (plastics), and to the increasing amount of untreated household and industrial waste water dumped into rivers and canals.
- A vital question which has a bearing upon the sustainability of the rates of poverty reduction and human development in Viet Nam is



the extent to which different sectors of the Vietnamese population have been exposed to significantly differential degrees of risk in an increasingly globalized economy and in the context of the restructuring of the state's role; and the extent to which and why they have different risk-coping strategies, and different opportunities for socio-economic mobility and human development.

- We have a generally excellent *description* of differential risks and opportunities among different groups. But I would like to suggest that our understanding of trends and underlying factors and our ability for more effective intervention for human development will be significantly enhanced by not only focusing on the roles of the market and the state, but also by paying more systematic attention to local sociocultural dynamics.
- Due to the time constraint and the vast domains labeled “society”, “culture” and “human development”, my discussion is inevitably selective, and I will focus on areas that require more attention. While I do not have access to the raw data set from the 2002 Viet Nam Living Standard Survey, other projects in which I have participated over the years provide additional data for the following discussion.

Poverty, Risk-coping Strategies, and Human Development Opportunities

1. Rural/urban dimension: Underestimation of urban poverty and the urbanization of poverty?

- VLSS data indicate that:
- Poverty remains overwhelmingly concentrated in rural areas,
- The urban poverty rate dropped from 25.1% in 1993 to 9.2% in 1998 and 6.6% in 2002, in comparison to the respective rural poverty rates of 66.4%, 45.5%, and 35.6%; and
- The urban poor made up only 8.9% of the poor in 1993, 5.7% in 1998, and 5.8% in 2002.



- However, inter-provincial migrants classified as KT3 and KT4 in the household registration system have been underrepresented in VLSS samples.
- Relying on the tract/block census of households and individuals in two wards and a rapidly urbanizing commune (divided into three wards in 2003) in order not to miss migrants in sampling frames, a 1998-2001 panel study in Ho Chi Minh city reveals an increase in the poverty rate in the largest urban area in Viet Nam due to the sharp rise in poverty among migrants:

	KT1 + KT2	KT3	KT4	Total
1998	4.2%	2.2%	0%	3.8%
(N	3994	402	226	4622)
2001	3.5%	10.7%	5%	4.7%
(N	3916	748	1149	5817)

Note: Poverty rates calculated on the basis of World Bank poverty line for urban Southeast, based on per capita household consumption, with living cost adjustment for 2001.

- While the low standard of living among many individual migrants and migrant households are self-imposed due to their remittances to home villages, it remains an open question why the poverty rate among those new urban residents in HCMC increased sharply in a three-year period (higher rate of unemployment and lower incomes in the context of fewer opportunities to return to native villages in the Mekong delta? And/or more dependents joining them from the countryside, leading to lower per capita expenditures in many cases? Any differences among migrants from different regions of Viet Nam). The limited available data from the projects in which I have been involved suggest significant regional variations among migrants and in the migration flow from different parts of Viet Nam.
- According to my multiple-regression analyses, in 2000, migrants from the two sending sites in the Mekong delta tended not to come from landless households, but from heavily indebted landed households. In contrast, the number of previous migratory trips by household members

played a significant role in accounting for the number of migrants from Bac Ninh households to Ha Noi, and a fairly important role among those from Quang Ngai households to HCMC and the Central Highlands.

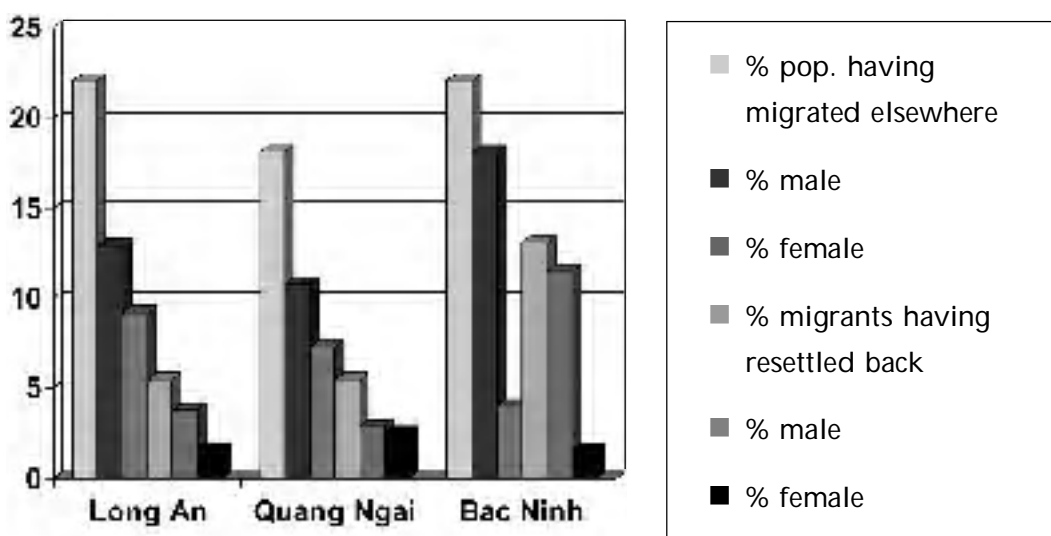
- Intra-community social capital, as reflected in the proportion of interest-free loans, was also lower in the studied Mekong delta communes than in central and northern ones.

Debt in 2000 (in millions of dong)

	interest-free	with interest
Long An I	35.280 (12%)	254.100 (88%)
Long An II	79.415 (17%)	392.620 (83%)
Quang Ngai I	94.146 (38%)	135.200 (62%)
Quang Ngai II	105.870 (57%)	79.200 (43%)
Bac Ninh	114.150 (28%)	291.198 (72%)

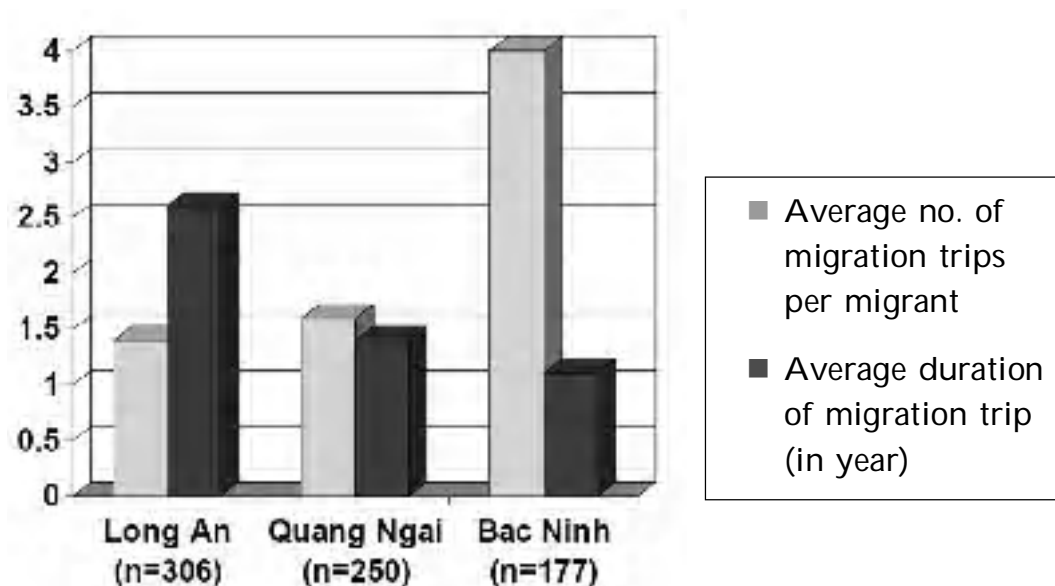
- Migrants from the Mekong delta tended to resettle in their home communities much less often than those from central and northern Viet Nam (see the two following figures).

Out-migration of current household members by gender over the years & % having resettled in home communities by gender.





Divergent patterns of migration



- In terms of human development in urban contexts, the percentage of 7 to 11 year old children in sampled households in HCMC never attending school increased from 2.2% in 1998 to 8.5% in 2001. Most were migrant children. In the long run, to what extent do the widely known barriers to KT3 and KT4 urban residents' access to health care and education restrict their human development and socio-economic mobility opportunities and contribute to the formation of an urban underclass?
- I hypothesize and predict that, in comparison to northern and central urban areas, the southern areas (with more Mekong delta migrants from indebted rural households unlikely to go back to their native villages) will have higher rates of urban poverty. A systematic and comparative study of migration and urban poverty, with close attention to regional variations in the sociocultural dynamics of migration and rural-urban linkages, will allow us to understand the trends and the factors at work in urban poverty, with major implications for human development in urban areas.



2. Gender, regional, and ethnic dimensions of poverty and human development: the role of social capital and sociocultural dynamics

a. A Review of Trends

- Poverty data at the household level indicate that female-headed households have not had a higher poverty rate than male-headed households in the *doi moi* era.
- Under *doi moi*, the gender gap has been considerably narrowed in education, earnings, and political representation.
 - The gender gap no longer exists in net school enrolment at the primary and lower secondary levels. It has been significantly reduced at the upper secondary level.
 - If women's earnings stood at 72% of men's in 1993, this percentage increased to 82% in 1998 and 85% in 2002 (GSO 2000: 188; GSO 2004: 59)
 - In terms of political representation, the percentage of women deputies in the National Assembly increased from 17.7% in the 1987-92 period, to 27.3% in the 2002-07 period. This can be seen in other branches of the government and at different levels. The progress in this area can be attributed to state policy (specifically Decree 37 of the Vietnamese Communist Party in 1994).
- Gender issues still need close monitoring and analyses to ensure equal opportunities for human development, particularly the following areas:
 - Women's share of household chores
 - The gap in earnings and political representation
 - The increasing trafficking of women, especially from the southern part of rural Viet Nam.
- Living standard survey data indicate that between 1993 and 2002, the decline in the poverty rate among ethnic minorities (by 17%) was far below the average drop of 29%; and that among the seven socio-economic regions of Viet Nam, the poverty rate declined the least in the Central Highlands, the South Central coast, and the Mekong delta:



	1993	2002	Change
<i>Region:</i>			
N. Highlands	82%	44%	-38%
Red River delta	63%	22%	-39%
N. Central coast	75%	44%	-41%
S. Central coast	47%	25%	-22%
Central Highlands	70%	52%	-18%
Southeast	37%	11%	-26%
Mekong delta	47%	23%	-24%
<i>Ethnic group</i>			
Vietnamese & Chinese	54%	23%	-31%
Other minorities	86%	69%	-17%
Viet Nam	58%	29%	-29%

Source: Viet Nam Development Report 2004 "Poverty", pp. 9-10

- VLSS data in the 1990s show that the Central Highlands and the Mekong delta lagged far behind other regions not only in poverty reduction but also in some aspects of human development such as education. These two regions, for example, fell further behind other regions in the net enrolment rate at the upper secondary level: in the 1993-1998 period, the net enrolment rates at the upper secondary level increased from 4% to 17% (+13%) in the Mekong delta and 2% to 11% (+9%) in the Central Highlands in comparison to an increase from 7% to 29% (+22%) in the nation as a whole [Nguyen Nguyet Nga 2004: 435]. In the context of the strong affirmative action of the Vietnamese state in order to enhance education access of ethnic minorities, the net school enrolment gap between ethnic Vietnamese-Chinese and other minorities has been reduced only at the primary and lower secondary levels, but the absolute gap at the upper secondary level has widened (an increase from 8% in 1993 to 45% in 2002 among ethnic Vietnamese and Chinese, in comparison to an increase from 2% to 19% in other ethnic groups) (Viet Nam Development Report 2004).



b. How Important are Social Capital and Local Sociocultural Dynamics in Poverty Reduction and Human Development?

- World Bank commissioned analyses have suggested that the slower decline in poverty among ethnic minorities results not simply from the gap in physical and human capital (land, financial resources, and education), but also from the increasing gap in the returns on physical and human capital. In the 1990s, only about half of per capita expenditure differences between ethnic Vietnamese/Chinese households and others were due to the gap in physical and human capital (Van de Walle & Gunewardena 2000; Baulch, Chuyen, Haughton and Haughton 2004). Between ethnic Vietnamese and Chinese, in 1998, Baulch et al. conclude that the per capita expenditure difference is “entirely due to the higher returns to characteristics that Chinese households enjoy.” They hypothesize that it may result from “the strength of business bonds and mutual aid within the Chinese community” or, in other words, from the higher social capital among ethnic Chinese households (Baulch 2004: 297).
- To have a fuller picture of the poverty reduction and human development lag in the Mekong delta in comparison to other lowland areas, I propose that we may need to examine carefully not only the greater vulnerabilities of Mekong delta farmers to global market price fluctuation, but also possible regional differences in social capital formation:
 - As earlier mentioned, the proportion of interest-free loans is lower in studied Mekong delta communes than in Central and Northern villages. This reflects greater mutual assistance or social capital within a northern or central Vietnamese village than in a Mekong delta village.
 - At least in the *doi moi* era, associations without state support have proliferated both in rural northern Viet Nam and among northerners in urban contexts: from same-age, alumni, same military-service associations, among many others, in the northern countryside, to same-village associations in Ha Noi and some other big cities.



- Many migrants from the north and the center in HCMC have formed same-native-place associations for mutual assistance, while these associations are rare among migrants to HCMC from the south.
- Vietnamese of all strata consider social relations (or social capital) an important part of their socioeconomic mobility and human development. Few studies of poverty and human development have systematically examined the role of social capital and its regional variation.

CONCLUSION

- In 2001, with the strong support of UNDP, the Vietnamese Academy of Social Sciences issued a major report on *doi moi* and human development in Viet Nam. In order to achieve greater human development, this report recommended:
 - Accelerating institutional reforms (improving the legal framework, reforming public administration, and promoting a wider participation of the public in social, economic, and political life)
 - Furthering economic restructuring
 - Promoting rural development
 - Reforming education and training, science and technology
 - Expanding and improving public services
- With close attention to provincial and regional variations in human development, the 2001 Human Development report from VASS emphasized the need for special targeting of regions lagging behind others in human development.
- The Vietnamese state has given high priority to all of the five aforementioned areas in the past few years. Needless to say, state efforts have been more successful in some areas than in others. If we take legal reforms, for example, the Enterprise Law has had a more visible positive impact than the 1994 Law on the environment. And while Viet Nam has made further gains in the past few years in poverty reduction and human development, more attention needs to



be paid to the possible emergence of new pockets of urban poverty, the opportunities for human development of rural-to-urban migrants and their children, the increasing gaps among different groups and regions. In order to sustain the gain in poverty reduction and human development, it will be useful know the trends in urban poverty and the causes of the increasing gaps among different regions and groups in the country. I think that a greater sensitivity to the diversity of local sociocultural dynamics will contribute to the success of institutional reforms and of human development in Viet Nam in general.

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