



UNITED NATIONS
DEVELOPMENT PROGRAMME



VIETNAM ACADEMY
OF SOCIAL SCIENCES



EMBASSY OF
SWEDEN HANOI

PROCEEDINGS

FROM

THE SECOND HIGH LEVEL ROUNDTABLE MEETING

ON 20 YEAR REVIEW OF *DOI MOI*

HANOI: 30th June - 1st July 2005

These proceedings were drafted by VASS and UNDP Vietnam





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ACRONYMS AND ABBREVIATIONS

ABE	Alternative Basic Education
ACFTA	ASEAN-China Free Trade Area
AFTA	ASEAN Free Trade Agreement
APT	ASEAN Plus Three Summit
ARF	ASEAN Regional Forum
ASEAN	Association of Southeast Asian Nations
BMI	Body Mass Index
CDMA	Code Division Multiple Access
CPSU	Communist Party of the Soviet Union
CPV	Communist Party of Vietnam
DfID	Department for International Development
ETRI	Electronics and Telecommunications Research Institute
EU	European Union
FDI	Foreign Direct Investment
GCI	Gini Coefficient Index
GDP	Gross Domestic Product
GEMS	Global Economic Multilaterals
GM	General Motors
GMS	Greater Mekong Sub-region
GNI	Gross National Income
ICBM	Inter-Continental Ballistic Missile
IDB	Industrial Development Bureau
IMF	International Monetary Fund
ITRI	Industrial Technology Research Institute
MDG	Millennium Development Goal



MIC	Ministry of Information and Communication
MIT	Massachusetts Institute of Technology
MNC	Multinational Corporations
MRC	Mekong River Commission
NGO	Non-Governmental Organisation
NPO	Non-Profit Organisations
NTP	National Target Programme
ODA	Overseas Development Assistance
OECD	Organisation for Economic Cooperation and Development
PBO	Public Benefit Organisations
PLA	People's Liberation Army
PPP	Purchasing Power Parity
PRSP	Poverty Reduction Strategy Paper
SIDA	Swedish International Development Agency
SOE	State-Owned Enterprise
TFC	Taxes, Fees and Contributions
TRIMS	Trade-Related Investments Resources
UN	United Nations
UNDP	United Nations Development Program
US	United States
VASS	Vietnam Academy of Social Sciences
VBSP	Vietnam Bank for Social Policies
VHLSS	Vietnam Household Living Standard Survey
VLSS	Vietnam Living Standard Survey
WTO	World Trade Organisation



INTRODUCTION

In preparation for the Tenth National Party Congress in early 2006, the Communist Party and Government of Vietnam 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 Vietnam" project is a joint initiative by the United Nations Development Program (UNDP), the Embassy of Sweden in Hanoi, and the Vietnam 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 Second High Level Roundtable Meeting was held in Hanoi on 30 June - 1 July 2005 gathering 237 participants (200 from Vietnamese institutions and 37 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 Vietnam's development strategy were present at the meeting.

Among the list of 237 participants, the roundtable meeting benefited from the presence of Mr. Jordan Ryan, Resident Representative of UNDP in Hanoi; Ms. Anna Lindstedt, Ambassador of Sweden to Vietnam, Prof. Robert H. Wade, London School of Economics; Prof. Do Hoai Nam, Member of the Central Committee of the Party and President of the Vietnam Academy of Social Sciences.



The Second 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 Vietnam and, second, to propose new areas for further and new research on different aspects of *doi moi* relevant for policy decision makers.



PROCEEDINGS

OPENING CEREMONY AND KEYNOTE ADDRESS

Co-Chairs:	Prof. Do Hoai Nam , Chairman, Vietnam Academy of Social Sciences
	Mr. Jordan Ryan , Resident Representative, UNDP Vietnam
	Ms. Anna Lindstedt , Ambassador of Sweden to Vietnam
Keynote Address:	Prof. Robert H. Wade , London School of Economics

OPENING REMARKS BY PROF. DO HOAI NAM

Your Excellency Mr. Jordan Ryan, UNDP Resident Representative in Ha Noi,
Your Excellency Ms. Anna Lindstedt, Ambassador of Sweden to Vietnam,
Ladies and Gentlemen,

On behalf of the Vietnam Academy of Social Sciences, I would like to extend my warmest greetings and sincere thanks to all of you for attending this Second High Level Roundtable Meeting on the 20 Year Review of *doi Moi* in Vietnam. I believe that this meeting is a good forum for international and Vietnamese scholars to discuss the *doi moi* reform process in Vietnam, draw lessons learned and provide necessary recommendations for promoting a stronger, more comprehensive and more balanced reform process in the 2006 - 2010 period with a vision to 2020.

Looking back on the past 20 years of *doi moi*, Vietnam has drawn for itself some lessons learned as follows:

- Approaches to *doi moi* and related policies must be independent. The *doi moi* process in Vietnam did not follow any foreign models. Vietnam was very interested in seeking and learning from international experiences to find its own solutions to its development problems.

- *Doi moi* must be a comprehensive and balanced reform process, adopting a road map and a way of implementation that are relevant to Vietnam and its people. The *doi moi* process in Vietnam started first with the renovation of thinking. But such renovation of thinking stemmed from the renovation of economic thinking. To date, Vietnam has carried out its *doi moi* reform process in all fields, including economic, political, cultural and social reforms as well as renovation of human development, external relations, national defence and security, the State and the Party.
- The *doi moi* process must be based on socio-political stability, and its gains must serve the goal of human development in Vietnam.
- The *doi moi* process must fully tap all domestic resources while mobilising all external resources through developing the country's market economy and promoting its proactive and strong international economic integration process.
- Vietnam's economy is a market economy. However, we must make greater efforts to simultaneously address three issues: ensuring smooth operation of the market economy in Vietnam; building a social protection system; and developing a monitoring mechanism to ensure transparency and equality of economic actors.
- In the next five years, Vietnam will deepen its integration into the world's economic and political environments in compliance with the principles of respecting national independence, sovereignty and territorial integrity, not interfering in each other's internal affairs as well as enjoying equality and mutual benefits. Vietnam will be actively engaged in activities to promote peace, stability and development cooperation.
- During the *doi moi* process, efforts must be made to firmly maintain the leadership of the Vietnam Communist Party, intensify the building of a rule of law state as well as to promote people's rights and the roles of social organisations.

Ladies and Gentlemen,

Our country's aim is to get itself removed from the list of poor countries by 2010 at the latest. In the next five years, Vietnam will develop its economy in a faster, more effective and more sustainable manner, better address social and cultural issues, link economic growth to further poverty reduction and human development, promote its proactive and strong international integration process on all three (global, regional and bilateral) levels, mobilise all available resources in order to shorten the period of industrialisation and modernisation so that



Vietnam can basically become a modern industrialised country by 2020.

We would highly appreciate it if foreign scholars, Ambassadors and international organisations in Vietnam could provide their objective assessments of the 20 years of *doi moi* in Vietnam, analyse successes and especially failures and recommend what Vietnam needs to do in order to maintain and build on the achievements of *doi moi* in support of human development in Vietnam.

I would like to sincerely thank UNDP and SIDA for providing financial support to the "Assistance to the 20 Year Review of *doi moi* in Vietnam" Project.

I would like to thank the international and Vietnamese guests for their participation in this meeting.

May our meeting be a great success.

Thank you.

INTRODUCTORY REMARKS BY MR. JORDAN RYAN

Your Excellency Ambassador Lindstedt, Prof. Do Hoai Nam, esteemed scholars, colleagues and development partners:

On behalf of UNDP, I would like to thank the Vietnam Academy of Social Sciences for inviting us and the Government of Sweden to take an active role in the "20 Year Review of *doi moi* in Vietnam" project. The *doi moi* Review is a unique opportunity to set our normal day to day pursuits to one side and to reflect more deeply on the social, economic and political changes that have taken place in Vietnam over the past two decades. It is indeed an honour for me, and for my UNDP and Swedish colleagues, to join such a distinguished group of scholars and policymakers in these discussions.

The Assistance to the *doi moi* Review project is itself evidence of how much Vietnam has changed in recent years. When we speak of *doi moi*, most commentators focus on Vietnam's increasingly close trade and investment links with the rest of the world. However, of equal, and perhaps even greater long term importance are the expanded opportunities for Vietnamese scholars and policymakers to exchange information and views with prominent thinkers and leaders on the international scene. We hope that this event, like the first High Level Roundtable Meeting held in January of this year, will provide a forum for frank and open discussion of social, economic and political change in Vietnam and the country's transition not only from central planning to the market but also from acute poverty towards greater prosperity, democracy and freedom for all.



The First High Level Roundtable raised crucial issues relating to Vietnam's achievements during the *doi moi* period and new challenges for the next decade and beyond. The purpose of this meeting is to probe more deeply into a smaller set of topics. Prof. Robert Wade of the London School of Economics will consider the role of the state in economic management in our rapidly integrating global economy. Drawing lessons from successful industrializers in the East Asian region and beyond, he will show that simple answers to this question are generally wrong, and that the oft-cited dichotomy between 'state' and 'market' is misleading. Prof. Mark Sidel will lead a discussion of the regulation and legal position of social organizations in contemporary Vietnam. Growing social and economic inequality is the topic of our third panel, which will be introduced by Dr. Scott Fritzen, who is leading a DFID team working on this theme. Tomorrow morning Prof. Carlyle Thayer will kick off our concluding panel on Vietnam's position in the dynamic East Asian region.

All four panels address the question of the relationship between state and society in Vietnam under *doi moi* and in comparative perspective. The changing nature of state-society relations lie at heart of the *doi moi* process, and will no doubt figure prominently in upcoming deliberations within the Communist Party, the Government of Vietnam and more broadly on the reinvigoration of renovation. As our speakers will make clear, the relationships between government, society and the market must be understood in dynamic terms. For it is not just the state that is changing. As Government reforms and changes the ways in which it carries out its business, so too are markets and societies changing. Economic growth and integration, new technologies that spread information and ideas at the speed of light and cheaper transportation create new possibilities for human self-realization, and also new challenges. Finding the right balance between regulation and incentives, order and freedom and social cohesion and individualism will not be easy.

Every country must determine its own answers to these difficult questions. No single model exists that can be applied with equal success in all places. In Prof. Peter Nolan's eloquent phrase delivered at the first High Level Roundtable Meeting, every country must turn it its own history for 'intellectual nourishment' in devising 'pragmatic, experimental and non-ideological solutions to concrete problems'.

Yet the need for local, historically specific solutions does not obviate the need for international standards against which progress can be measured. For members of the United Nations, the Millennium Declaration stands as a powerful statement of the international community's aspirations for a world free of poverty. The Declaration also emphasizes the relationship between freedom from want and what UN Secretary General Kofi Annan has recently referred to as the 'larger freedoms' of human rights, freedom from fear and the freedom to live in dignity.

The Vietnam Academy of Social Sciences is to be congratulated for having the foresight and courage to confront these issues head on, and to involve in the



process top scholars and thinkers not just from Vietnam but from the wider international community. We expect the interaction between Vietnamese intellectuals, with their deep appreciation of the country's own history, culture and traditions, and their counterparts from overseas to generate original, creative thinking on the developing relationship between state, society and market.

We hope that the discussions of the next two days contribute to Vietnam's efforts to build upon the successes of recent years to find a sustainable path of development that is both tailored to Vietnam's specific characteristics and consistent with the Millennium Declaration principles of freedom, equality and solidarity.

Thank you.

INTRODUCTORY REMARKS BY MS. ANNA LINDSTEDT

Mr. Jordan Ryan, Prof. Do Hoai Nam, distinguished professors and scholars, dear colleagues, chào qui vi va các bạn,

First of all, let me thank the Vietnam Academy of Social Sciences for inviting Sweden and UNDP to support and to participate in this project. The *Doi Moi* Review is indeed an excellent opportunity to create a more profound understanding of the dramatic changes that have taken place in Vietnam during the past 20 years, as well as to influence policy choices for the future. This is a priority project for Sweden and I feel honoured to be here today – both to address this illustrious audience and to take part in the discussions. This second High Level Round Table, like the first one held in January, is also an opportunity for scholars and old friends to meet and compare notes on developments in Vietnam.

I am particularly happy that my mentor and colleague, Ambassador Borje Ljunggren, has come from Beijing to attend this forum. Mr. Ljunggren served as the Ambassador of Sweden to Vietnam in the 90s and when I was offered this posting two years ago, I asked Borje's advice about whether to accept or not. "Don't think twice" was the answer and I am grateful for that piece of advice.

As a Swedish diplomat, it is a privilege to serve in Vietnam, not only because of the special atmosphere here and the long-standing relationship between Vietnam and Sweden, dating back to the solidarity demonstrated by the Swedish people for Vietnam during the war, but also because we are proud to be a partner to Vietnam in its reform efforts. Sweden, like UNDP, was an active partner in supporting the initial stages of the *doi moi* economic reforms. But *doi moi* means not only economic reforms, it also consists of social, administrative, legal and



political reforms. Sweden started supporting those areas of reform already in the early 90s and we are proud to be part of this process.

I remember reading about the *doi moi* reforms in the international press in the mid-80s. I have an especially vivid memory of the pictures attached to the articles, pictures of Vietnamese people wearing conical hats, riding their bicycles past rice fields and traditional houses. These pictures are still valid, but another picture, of a more modern Vietnam - with motorbikes, cars and high rise buildings - has emerged. The pace of development has been tremendously fast and the living conditions of the majority of Vietnamese people have indeed undergone changes – mostly for the better – thanks to the renovation process.

Sweden used to be one of only a few development cooperation partners here. Today, there are both bilateral and multilateral donors in abundance. *Doi moi* has created a success story of which so many want to be part. But I do think that Sweden, together with UNDP, retains a somewhat special position.

Poverty figures in Vietnam have indeed come down. But the rapid developments have also created new challenges, like increased pressure on the environment and growing inequalities – both between different ethnic groups and between cities and remote areas. The rising inequalities is one of the topics being taken up here today.

But poverty is not only about material resources, it is also about security, about influence, about rule of law, about power and choice – about the diverse aspects of human rights, as referred to by Jordan Ryan. The different aspects of poverty alleviation are addressed both in Sweden's and in UNDPs development cooperation and policy dialogue with Vietnam.

Policy options for the future lie with the people of Vietnam, but it is my hope that the exchange of views today between Vietnamese and foreign scholars, together with the continuing activities of the project will contribute to facilitating sound policy choices.

Let me conclude by congratulating the Vietnam Academy of Social Sciences, one of the leading policy research think tanks in Vietnam, for initiating the "20 Year Review of Doi Moi in Vietnam" project.

Thank you for your attention.

Xin cam on.



KEYNOTE ADDRESS

GOVERNING THE MARKET IN A GLOBALIZING WORLD

Prof. Robert Hunter Wade, London School of Economics

"The most important thing in life is to have a goal, and the determination to achieve it." Goethe, the motto of Taiwan's Industrial Development Bureau

"If the most efficient way for the U.S. to get steel is to produce tapes of 'Dallas' and sell them to the Japanese, then producing tapes of 'Dallas' is our basic industry." Herbert Stein, chairman of the Council of Economic Advisors during the Reagan years

1. Introduction

What is the viability of different models of capitalist development in our rapidly integrating global economy? My guess is that majority opinion in national ministries of finance and industry, in the global economic multilaterals (GEMS) like the World Bank and the IMF, and in university economics departments, would agree that only the broad model of Anglo-American capitalism, often called "neoliberalism", has continuing viability in these conditions; and would agree that East Asian countries' dismantling of the developmental state, especially since the financial crisis of 1997-98, is evidence for the broader claim, as also the 15 year stagnation in Japan and the 10 year stagnation in the European Union, notably Germany and France.¹

The more subtle variants of neoliberalism recognize that the neoliberal mode of regulation does not imply a minimal, nightwatchman state. As many World Bank reports recognize, contemporary neoliberalism is about state transformation and the building of market institutions, not state retreat. It is

1. As a recent example of this kind of thinking, see Frits Bolkestein, "France's verdict tells us that Europe has been oversold", Financial Times, 31/5/05. "The true heirs of the capitalist revolution now live in Asia [in contrast to Europe]. We must meet their challenge. Corporatism is no answer. Nationalism is no answer. Protectionism is no answer. The only way forward is to improve our competitiveness by letting in competition and making markets more flexible".



about creating systems of property rights, corporate governance standards, bankruptcy and accountancy laws, transparency in corporate and government accounting; about public provision of physical infrastructure, basic education and primary health care; even about protecting social stability by means of minimal welfare safety nets; and creating incentives for private actors to investment and take risks in the expectation that they will reap the rewards (incentives given by proportional rather than progressive taxes, for example). This is a big agenda of neoliberally-justified state action.

Within the institutional framework thus created neoliberalism justifies far-reaching trade liberalization, financial liberalization (e.g. free entry of foreign financial service firms), privatization of state-owned enterprises, and floating or semi-floating exchange rates. The common denominator is the drive to strengthen the discipline of competitive markets over resource allocation and to extend the range of goods and services and domains of life subject to market discipline ("commodification" for short). On a world scale, neoliberalism is about creating the conditions in which *assets can be bought or sold world-wide on the same terms, irrespective of the identity or nationality of the transactors*, which implies removing the ability of a state to put a wedge between the national economy and the international economy by such devices as trade protection or discrimination against foreign service firms in the domestic market. The list of policy prescriptions for developing countries known as the Washington Consensus—latterly augmented to encompass the institutional ingredients mentioned earlier—is derived from the key ideas of neoliberalism.

The norms of neoliberalism are caught in the quip of Herb Stein, chairman of the Council of Economic Advisors during the Reagan years, "If the most efficient way for the U.S. to get steel is to produce tapes of 'Dallas' and sell them to the Japanese, then producing tapes of 'Dallas' is our basic industry";² and in the remark of Terence Burns, chief economic advisor to Mrs. Thatcher, "If we can't make money by manufacturing things, we'd better think of something else to do". The norms expressed in such statements run against the idea of a government taking an active role in accelerating industrial upgrading and promoting some activities ahead of others. Only in special cases of "market failure" could such intervention be justified; and then the potential gains would still have to be weighed against the likelihood of "government failure", as implied in the often-heard slogan, "governments can't pick winners".

The multilateral development banks have long championed a neoliberal approach to development, emphasising the benefits of market liberalization and the hazards of government "intervention". I want to illustrate what their championing means at the level of hard-nosed decisions about finance (as distinct from the soft-nosed writing of reports), by telling two stories from the coal-face end of the interaction between developing country governments and the GEMS.

2. Cited in Wade, "East Asia's economic success: conflicting perspectives, partial insights, shaky evidence", *World Politics*, 44, 1992, 270-320, at p.320.



This interaction is one of the main channels through which neoliberal norms and institutions are given legitimacy and influence in developing countries.

1.1 The Mongolia story

The first story is about Mongolia. The government that took power in Mongolia after the end of communism in 1991 swung to the non-communist extreme and embarked on a program of rapid economic liberalization, making it a star pupil of the Washington Consensus. The result was a collapse of the industrial sector, fast-rising urban unemployment, an influx into pastoralism, a resulting fall in pastoral yields, and a sharp deterioration in “social indicators” (that had been relatively high in the era of protected industry, relative to Mongolia’s per capita income).

However, the government did want to retain one “industrial policy” instrument, namely a tax on the export of unprocessed wool. The Asia Development Bank offered the government a big loan – provided the government dropped the export tax. The government obliged, removed the export tax, the textile mills closed, and now all Mongolia’s wool is processed in China. Mongolia continues to struggle with very high unemployment and a low-yield pastoral economy.³ Mongolia’s experience illustrates that the alternative to an “inefficient” industrial sector, when measured in world market prices, is often not an “efficient” industrial sector, but no industrial sector, which may be worse.

Fast forward to 2002, when a German Development Bank mission arrived in Ulan Bator to help with Mongolia’s WTO accession. The mission discussed Mongolia’s situation with the World Bank country director. It floated the idea of restoring an export tax on unprocessed wool. The World Bank country director put his foot down. As recalled by a participant he said, *“That would be going backwards. We don’t want the government to intervene in the economy. We want the government to stick to free trade.”*

1.2 The Sri Lanka story

The second story takes us from Mongolia to Sri Lanka. In Sri Lanka the Bank and the Fund led a consortium of donors in holding out the carrot of a \$2 bn grant for civil-war reconstruction after the peace deal of 2003. The Bank’s country director informed the government – orally, not in writing – that it would have to stop work on its “interventionist” industrial strategy as a condition of the grant.

Earlier, the government of 1989-1993 had formulated and implemented a remarkably successful industrial policy aimed especially at promoting

3. Erik Reinert, “Globalisation in the periphery as a Morgenthau Plan: the underdevelopment of Mongolia in the 1990s”, in Reinert (ed.), *Globalization, Economic Development and Inequality: An Alternative Perspective*, Cheltenham, Edward Elgar, 2004.



manufactured exports. The assassination of the prime minister in 1993 triggered the fall of the government, and the new government brought the whole pro-industrialization project to an end.

But the government at the start of the new century restarted work on a pro-industrialisation strategy as a part-alternative to the Bank-Fund-sponsored Poverty Reduction Strategy Paper (that emphasised poverty alleviation, primary education, primary health care, and the like). The Bank and Fund wanted the government to abandon any notion of a pro-industrialization strategy and stick strictly to the PRSP with its Washington-derived priorities (though presented as the result of Sri Lankan participation). The prime minister faced an awkward choice: to continue with the industrial development push, or win a sizable grant. His ministers and coalition partners would have mutinied had he chosen the former—for the grant would provide kick-backs aplenty.

So the Industry Ministry reluctantly dismantled the cadre of experts who had been recruited to develop the alternative pro-industrialisation strategy. In the event the Bank/Fund/donor consortium did not even have to pay up since the government fell later that year on the issue of devolution of powers to the North and East.

2. The argument

It is not just the World Bank, Asian Development Bank and IMF which are vigorously asserting the norms of neoliberalism. These norms have been institutionalized in the Uruguay Round agreements of the WTO, and even more powerfully in bilateral free trade agreements and bilateral investment treaties between developing countries and the US and EU. I have referred to this institutionalization as the “shrinking of policy space”.⁴

There is no doubt that the government of a developing country seeking to industrialize rapidly faces an international “environment” that is hostile to active industrial policy. The bottom line of this paper is that the government of a “typical” developing country should not accept the sort of simple free market thinking that is the default position of the operational parts (as distinct from the research parts) of the GEMS.⁵ I shall illustrate that there is considerable scope for beneficial state activism even within the scope of WTO rules, provided the government is prepared to push against the envelope and not accept the strictures of the GEMS at face value.

4. Wade, “What strategies are viable for developing countries today? The WTO and the shrinking of development space”, *Review of International Political Economy*, 10, 4, 2003, 621-44.

5. By “typical” developing country I mean to exclude predatory states, ones that merit the remark of a Burmese citizen, “The British may have sucked our blood, but these Burmese generals are cutting us to the bone”, quoted in William Grimes, review of *Finding George Orwell in Burma*, *International Herald Tribune*, 10 June 2005.



To develop this argument I shall first show how 25 years of world convergence towards neoliberal norms has not generated a tendency towards a reduction in income gaps between developing countries and advanced industrial countries; and in particular that very few countries have managed to rise out of the low level of per capita income into the middle level. The few countries which have risen have tended to practice forms of state intervention well beyond the boundaries of neoliberalism.

This evidence on state mobility in the world income hierarchy underlines how difficult development is, and is consistent with the argument that catch-up development is unlikely to occur “endogenously” provided the state limits its role to building market institutions and extending the scope of free markets.

I then go on to provide a theoretical argument, with empirical illustrations, for why certain minimal kinds of industrial policy are highly desirable—and not necessarily incompatible with WTO rules. The significance of this point is that the GEMS and other centres of development thinking are not emphasising the desirability of even these modest kinds of industrial policy, and not offering developing countries advice on how to do them well rather than badly.⁶

3. State mobility

To understand the nature of the development challenge facing a low-income country like Vietnam it helps to have an idea of the broad shape of world income distribution and trends in national per capita incomes. On the broad shape, Figure 1 shows the shares of the world’s population living in countries at different levels of per capita income, with income measured in terms of purchasing power parity (PPP) exchange rates. The data is for 2000. Vietnam’s per capita income puts its population in the bottom “bin”. The charts for earlier years back to 1960 look remarkably similar, except that since 1980 a big chunk of people moved out of the bottom bin into the third-from-bottom bin (mainly China).

World average income has risen appreciably since 1980. But if we locate states by their per capita income relative to that of one or more rich countries, and examine change in location over time, we find a pronounced pattern of *downward* mobility in the past several decades – the decades of the current era of “globalization” – even as world average income has risen. There seems to be a force analogous to gravity acting at the level of the globalized world

6. The argument made here builds on the argument made in my *Governing the Market: Economic Theory and the Role of Government in East Asia's Industrialization*, Princeton University Press, 2004 (1990), including especially the introduction to the second edition, “Creating capitalisms”.

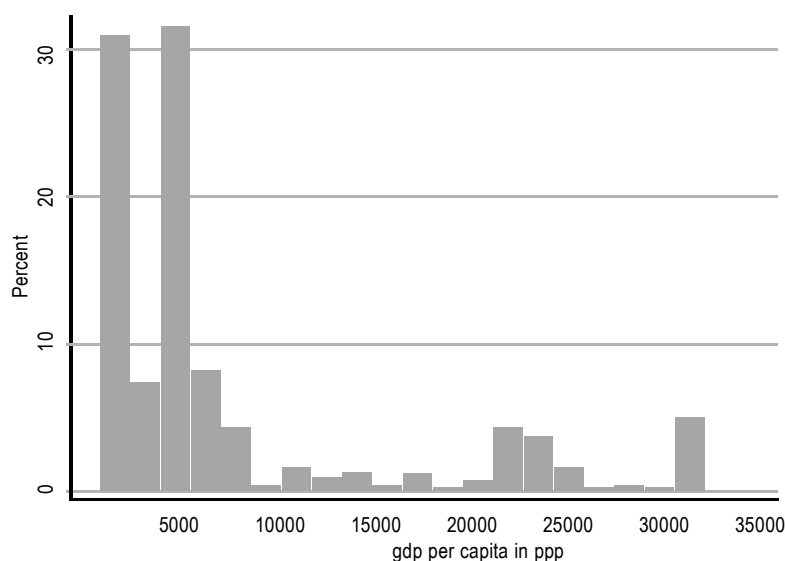


Fig. 1 (Source: Branko Milanovic, *Worlds Apart*, Princeton University Press, 2005, fig. 8.5.)

economy to pull apart the states in the middle and lower income zones from the states in the top zone. This suggests the strength of the Matthew Effect at the world economy level: “to him that hath shall be given...”. In other words, it underlines the difficulty of industrial upgrading and fast income growth for countries at low levels in the world income hierarchy.

Figure 1 shows a summary “state mobility” matrix. It places states by their per capita income (at market exchange rates) relative to that of the US in 1980 and in 1999. There are four income zones: core (states with per capita GNI between 70% and 100% that of the US); semi-periphery (40-69%); periphery (10-39%); and very low periphery (0-9%). Sample size is 150 countries.

Most states (61%) ended the period in the same zone as they began in; stability was the dominant trend. Of the 39% which moved, almost all went down. In the sub-set of countries that could have gone either up or down (that is, excluding the core and the very low periphery), 88% of the movers went down, only 12% went up.⁷

Vietnam was one of the 12% to move up: it jumped from very low periphery in 1980 to periphery in 1999. But analysts of Vietnam should note that the periphery (into which Vietnam rose) is a trap: out of 85 countries in the periphery in 1980, only 5% moved up to the semi-periphery income zone by 1999, while nearly 20% fell into the very low periphery.

This mobility analysis takes states as units and uses market exchange rates to

7. Satoshi Ikeda, “Zonal structure and the trajectories of Canada, Mexico, Austria and Norway under neo-liberal globalization”, Marjorie Cohen and Stephen Clarkson (eds.), *Governing Under Stress*, London: Zed Books, 2004, p.263-290.



convert per capita incomes into a common unit. The results are hardly changed if we use purchasing power parity (PPP) exchange rates. Another recent study takes as the numeraire the per capita GDP in PPP\$ of the country at the bottom of the “old OECD” income ranking (Portugal), and expresses other states’ zonal location as a percentage of Portugal’s.⁸ It uses four income classes: class 1, states with per capita GDP equal or greater than that of Portugal’s; class 2, states with per capita GDP equal or greater than two thirds that of Portugal; class 3, between one third and two thirds; and class 4, less than one third. It compares states across two time periods: 1960 to 1978, and 1978-2000. The sample size was 127 countries in the first period, 130 in the second.

The broad results are much the same result as those of the study just referred to, despite the change from market exchange rates to PPP.

- Most states remained in the same income zone through both periods; about one quarter changed zone in 1960-78, and just over a third (38%) changed zone in 1978-2000. (In the first study, 39% moved zones between 1980 and 1999.)
- Of those that moved, almost all went down: 88% in 1960-78, 86% in 1978-2000. (In the first study, 88% of the movers between 1980-1999 moved down.)
- The bottom class was a trap: in 1960-78, no country escaped; in 1978-2000 5% escaped. China escaped in 2003. (In the first study, 5% of countries in the periphery in 1980 rose to the semi-periphery by 1999.)
- Class 2—which contains the “challengers”, countries most likely to rise into the top income class—shrank in size from 1960 to 2000; and most of the movement was downwards. (In the first study, class 2 – “semi-periphery” – also shrank, and almost all of the movement was downwards.)

These are alarming findings for the neoliberal idea of the world economy as an open system, where lower-income countries can rise up towards the higher-income levels if only they adopt the “right” policies (and of course create the “right” market-supporting institutions). In particular: (1) Countries near the bottom of the world income distribution—which include the large majority of the world’s population—have a very high probability of remaining near the bottom over periods of two or more decades. (2) Countries that made it off the bottom are mostly either small “tax haven” islands or East Asian developmental states. (3) “Challenger” countries--whose per capita income put them close to that of the top category—also have a high and rising probability of falling into a lower relative income category over this sort of time period; indeed the proportion of countries in the “challenger” zone has *fallen* over time.

8. Branko Milanovic, personal communication.



The question is what determines a country's place in the matrix; what configurations of policies, "institutions", classes, external economic conditions, and external political conditions are conducive to upwards mobility; and in particular, what can a state do, through public policies, to accelerate technological "upgrading" in agriculture, industry and services.

Wisdom begins by discarding the standard lens with which development questions are normally viewed—which treats "the state" and "the market" as the key units and asks about the appropriate role of each. Instead, we need to start from the proposition that *the key to development lies in improving the "capabilities" of farms and firms*. It is at the level of the capabilities of farms and firms where the "rubber hits the road". We can talk all we like about "neoliberalism", "development strategies", the Washington Consensus, structural adjustment policies, good and bad governance, rooting out corruption, primary education, and so on; but unless there is improvement in the capabilities of farms and firms, development will not happen, or at least not in a sustained way.

4. Globalization and the transfer of capabilities

In what follows I concentrate on firms rather than farms.⁹ I start from the proposition that the capability of a firm is a positive function of its productivity (as measured, for example, by unit labour costs) and its quality (as measured, for example, by the defects rate). I add a second proposition, that building capabilities at the firm level is difficult and expensive, and, in the general case, takes a long time. This is because the key proximate determinants of capabilities do not take the form of codified knowledge, as embodied in blue-prints; but take the form of "tacit" knowledge held in people's heads—and often, in a collectivity of heads rather than in one head; and also the form of "work practices" or work habits that are shared among a firm's work force.

There is some trade-off between productivity and quality; but there is also some lower quality threshold, such that firms which cannot achieve a quality level above the threshold will not be viable (holding protection constant). In the extreme case, ball bearings below a certain quality level are useless.

This carries the important implication that, in the case of low-wage country B and high-wage country A, B firms may not be competitive relative to A firms in free trade conditions because their wage advantage is offset by their quality disadvantage. As trade between A and B is liberalized (as in country B joining the WTO), country B firms have to raise their quality

9. I am indebted to the research and arguments of John Sutton, professor of economics at the London School of Economics. John Sutton, "Competing in capabilities: an informal overview", typescript, April 2005.



performance if many of them are not to be rendered unviable and their sunk investments lost.

The question for country B firms is how they can upgrade their quality level to place them well above the threshold of viability in competition with higher-wage country A firms. In the general case there is no option but to transfer capabilities from sites where they are already developed to country B firms. This is the process often described as “technology transfer”, which I refer to here as “transfer of capabilities”. But the term “transfer” is misleading because it makes it sound as easy as transferring machinery from one place to another. In the general case, “transfer of capabilities” is very hard to do, for the same reason that building capabilities at firm level is hard and expensive and takes a long time.

Country B firms can buy in technical help from abroad (as Taiwanese firms in the 1980s hired in Japanese quality controllers, some of whom were working for firms in competition with the Taiwanese, who moonlighted at weekends to advise their rivals).¹⁰ They can also seek out country A firms and induce them to transfer their high level capability more directly to country B firms, so as to marry up high capability with low wages.

The institutional channel of transfer might be a joint venture, or a newly established subsidiary of the country A firm. Or it might be ongoing interaction between a manufacturing company in B and its equipment supplier in A (for example, a Chinese steel maker and a German supplier of blast furnace equipment), in which both sides benefit as the equipment maker introduces new ideas into the B firm as to how best use the equipment and B firm’s experience induces the A firm to make design modifications. Or the transfer may occur through the channel of a “demanding buyer”, who puts relentless pressure on its suppliers to improve quality and lower unit costs; and may give various forms of assistance to accelerate the upgrading. The demanding buyer may be a large retailer of clothing, for example, or a multinational car-maker buying in components up a supply chain of tiered suppliers.

Both building and transferring capabilities can occur “autonomously”, through the efforts of individual firms—or of cooperatives of firms—without any direct involvement of state agencies. But precisely because both building and transferring firm-level capabilities are hard to do and take a long time, there is in the general case a vital role for public policy in country B: to accelerate firm-level changes so as to raise both productivity and quality; to accelerate the density of vertical supply chains (of customers and suppliers) within the national territory; and in particular, to accelerate the links between country A firms and country B firms, such that A firms transfer capabilities to B firms in the course of relocating part of their operations in B’s low wage environment.

10. Wade, *Governing the Market*.

There should also be a role for western aid agencies and multilateral development banks here—though in practice the “international development community” is focused on “extreme poverty alleviation” and social sectors, not on anything closely connected to the development of industry in developing countries (which might pose more competition for existing industrial centres).

5. Public policy

To think constructively about industrial policy, one has to distinguish at least three types. The first type are economy-wide “functional” policies, that include exchange rate policies, macroeconomic balance, competition policies (including average level of protection).;The second type are multi-sectoral “horizontal” policies, that include incentives for R&D, incentives for “small and medium enterprises”, investment in port infrastructure, and the like. The third type are sectoral policies, to promote specific sectors or sub-sectors or firms (the Proton auto firm in Malaysia, for example).

My interest here is particularly in the third, sectorally-specific policies; and especially those intended to accelerate the transfer of capabilities to firms. We have a lot of evidence that public policies can work to accelerate the linkages between multinational firms and domestically-based suppliers; or more broadly stated, that states can intervene in order to move chunks of productive activity from existing high-cost sites abroad to host country sites faster than “the market” would.

5.1 China and India — the car industry

Take an example from the car industries of China and India, drawn from research by John Sutton. Beginning in the early 1990s a wave of multinational car makers set up assembly operations in China and India, entering an industry only thinly developed. The respective governments used tough local content requirements (typically 70% in 3 years) to drive the multinational subsidiaries to establish domestic supply chains in place of imports, and hence to work closely with domestic suppliers to ensure adequate quality and price combinations.

The industrial policy worked. Within a decade in both countries, the multinational assemblers were outsourcing to about the same degree as car-makers in the US, Europe and Japan. The *quality* performance of domestically-based first-tier suppliers was close to the world class standard in terms of defects per million parts. The *productivity* performance of the first-tier suppliers was also close to the world class standard (for example, most seat producers in both China and India were able get close to the world class standard of 1-man-hour per seat).



The experience of these multinational assemblers operating in China and India suggests some general lessons. One is that establishing greenfield plants with a newly recruited workforce is a much faster route to world class standards than establishing a joint venture with an established local producer—perhaps three times faster (one to two years, as contrasted with three to six years). This is because the key to world class standards is work practices and tacit knowledge, and especially a system in which each operator is constantly monitoring each component for defects as it comes along. But this runs against well-established work practices based on “inspection at the end of the production line”, a much more costly system because each operator is then adding value to defective parts. These practices and much other tacit knowledge have to be unlearned in joint ventures before the new ones can be learned. On the other hand, though the time scale is longer, the “national” benefits of the “unlearning-relearning” route through existing domestic producers may be higher.

The second general point is that in both China and India, the second- and third-tier suppliers were much less effective than the first-tier ones (in direct contact with the multinational subsidiary). While manufacturing best practice spread quickly to the first-tier suppliers, they spread much more slowly below the first-tier suppliers. The first-tier suppliers were more likely to accept lower quality (as in higher defect rates) in return for lower prices. This suggests an opportunity for targeted government “upgrading” intervention, a point to which I return.

5.2 Mexico – the car industry and the dynamics of multinational corporation location decisions

My next example concerns Mexico, and it shows *why* it is that governments can induce multinationals to shift parts of the value-chain to low-wage countries faster than the market would.

Ford and Volkswagen established assembly and engine plants in Mexico in the 1960s, with a large part of production intended for export. From this experience it became clear to them and to other auto firms that they could reap big cost advantages. Yet by the late 1970s their investments remained relatively small, far from world-scale capacity and far from being integrated into their global sourcing network; and other major auto makers had not followed them in establishing Mexican plants.

So in 1978-79, Mexican industrial policy officials, aware that US car makers were under competitive pressure at home from Japanese imports, decided to enforce a 1977 decree that linked access to the domestic market to exports: “if you fail to meet an escalating export schedule your domestic sales will be cut”. The first to respond was General Motors, which in 1979 announced the biggest one-time investment in its history, to be placed in Mexico. Other auto makers soon followed GM’s lead in announcing plans for major



expansion of exports from Mexican sites, in order not to lose share in the Mexican domestic market.

But this was sixteen years after Ford and Volkswagen first began to show the cost advantages of Mexican sites! *They and the other auto firms had resisted international comparative advantage for a long time, and it took the "jolting" of Mexican officials to break their lock-in to exit costs and other intra-firm rigidities.*¹¹

The general lesson is that corporations operating in conditions other than perfect competition—which is the normal case—are often *slow* to react to price signals at the margin, even when they are well-informed about profitable opportunities to shift locations. This is especially so when rearranging intra-firm operations - as in re-locating production out of the core regions to a cheaper-labour site, or switching suppliers from a high-cost one at home to a cheaper one in a developing region - would incur substantial exit costs.

5.3 South Africa – the car industry

The recent case of car production in South Africa provides another illustration of effective industrial policy. Here the government after 1995 introduced an export-import link system (similar to Mexico's), such that an auto firm's access to the domestic market (with sales of around 350,000 light vehicle units a year and expected to grow) was made conditional on export performance, either of finished vehicles or components in the value chain. In addition, several complementary programs—formulated and monitored by an auto industry development council, comprising representatives of assemblers, component makers, retailers, trade unions, government, plus a few academics - who met every six weeks—helped to improve business organization and labour relations up and down the supply chain. The whole program was designed to harness the rivalry between the big three German auto makers, but also Toyota and Ford, to the benefit of the South African economy. Justin Barnes et al. show that the selective policies targeted at the auto industry were almost certainly effective by several measures of effectiveness, and that they did not require large public expenditures or a bureaucracy making sophisticated calculations.¹² (Note that South Africa was a founding member of the GATT/WTO, and its instruments for promoting autos are arguably non-compliant with WTO rules. South Africa used them anyway.)

11. Theodor Moran, "Strategic trade theory and the use of performance requirements to negotiate with multinational corporations in the Third World", typescript, Georgetown University, October 1991.

12. Justin Barnes, Raphael Kaplinsky and Mike Morris, "Industrial policy in developing economies: developing dynamic comparative advantage in the South African auto sector", Competition and Change 8, 2, 2004, 153-72.



5.4 Taiwan's industrial policy bureaucracy

Taiwan is probably the most successful industrializer in history. I want to sketch some of the public-sector organizational components of its industrial policy, to make the point that there need be nothing very mysterious about how to design an effective industrial policy bureaucracy.¹³

Taiwan has had an Industrial Development Bureau (IDB) comprising, in the 1980s, some 200 engineers and allied professionals, with just a sprinkling of economists. (I shall describe it as I encountered it in the mid 1980s, but much the same picture holds for today.) They organized themselves according to input-output chains. The specialists in the chain that included glass for example, monitored carefully Taiwan's imports of glass, the buyers of imports, and the production capacity of Taiwanese glass makers. As part of their job they were required to spend several days a month visiting firms in their sector. (They were not allowed to have lunch with members of the firm they were visiting.) The aim of their monitoring and visits was to find opportunities to "nudge" the process of import replacement and export promotion, by using various kinds of administrative methods to "encourage" the big buyers of imports to switch from importing to local sourcing – once they judged that domestic suppliers could meet the quality and price of imports, provided they had a long-term supply contract and some technical help.

In the case of a multinational company, Philips, importing specialized glass for its televisions, the IDB officials informed Philips of the potential for switching to a domestically-based supplier, indicated that they would look favourably on other Philips' requests. Philips said no. Then Philips began to experience longer and longer delays in its applications to import the specialized glass, which had previously been granted immediately. Philips protested to the minister, who apologized profusely and said he would look into it. The delays continued. Eventually Philips got the message, made contact with several potential domestic suppliers, offered two of them technical help and a long-term contract. The domestic suppliers undertook the needed step-up investment in quality, Philips switched its sourcing to them, and they later were able to start exporting on their own account.¹⁴ This is a paradigmatic example of successful small-scale industrial policy.

In the early 1980s the government decided that the upgrading thrust had to be intensified. Instead of expanding the IDB it created the "Automation Task Force", with about 40 members, most of them industrial engineers. The great advantage of the "task force" format was that it gave much greater employment flexibility than the civil service (of which the IDB was a part). It could hire recent graduates from MIT at above civil-service salaries, without them having to sit the laborious civil service exams. In addition, the fact that

13. Wade, *Governing the Market*, chapter 7, "The economic bureaucracy".

14. Wade, *Governing the Market*, 2004: 285.



it was new was important: its members did not have established work practices and tacit knowledge that had to be unlearned before more effective ones could be put in place; and it provided IDB with real competition, helping to keep the IDB on its toes.

Interestingly, the task force soon realized that the top priority was not factory automation; it was the much more mundane and cheaper reorganization of factory layouts and shifts in work habits of the kind described earlier—from “inspection at the end of the production line” to “inspection at every point in the production line, by every operative”.

The point is that this sort of nudging of firms into higher levels of quality and value-added products—and jolting of multinational firms and domestic firms to establish *domestic* supply relationships faster than they would if left to their own devices—has been going on across many sectors, case-by-case, for many decades in Taiwan. It has required an honest, competent cadre of public officials with skills in engineering and finance—though not a large one; and an array of instruments on which to draw, which may include some capacity to manage trade (as in the Philips example) but may also include a wide range of non-trade measures for encouraging and discouraging. It has *not* required the sort of complex strategic trade calculations that seem to be required—according to conventional strategic trade theory—in the case of cutting-edge high tech industries in the advanced industrial economies.

There is no question that it is difficult to pin down the quantitative effects of this sort of below-the-radar intervention by public officials—whether positive or negative. All we can be sure of is that a great deal of it was going on in Taiwan over decades, all the time, with a dedicated cadre of public officials to do it.

5.5 Taiwan – the industrial policy apparatus post-WTO

Today Taiwan has reached the technological level of middle-ranking OECD countries—an astonishing, almost unprecedented achievement given its low starting point in 1950.¹⁵ But it remains well behind the world technology frontier in most sectors. For all its commitment to WTO principles (which Taiwan joined in 2002) the state continues to exercise economy-wide foresight, continues to shape the composition of activity within its borders, does not let “the market” take its course (not least because the hostile giant across the straights could easily manipulate the market).

Linda Weiss and Elizabeth Thurbon remark that, “the practice of governing the market is not just about policy—GTM [governing the market] is also,

15. However, see Frank Hsiao and Mei-Chu Hsiao, “Colonialism, learning and convergence: a comparison of India and Taiwan”, *Journal of the Asia Pacific Economy* 10, 2, 2005, 146-177, which challenges, with interesting evidence, the common idea that Taiwan after several decades as a Japanese colony was a “typical” underdeveloped economy.



and perhaps more importantly so, about the normative environment that sustains the *will* to govern the market, and the *legitimacy* of governing the market as perceived by actors in the polity. This is a point often overlooked in the mainstream literature..., which typically bases its claims on observed *policy* changes since the [financial] crisis [of 1997-98—that is, claims that the Taiwan government has given up governing the market since the crisis]. The assumption is often that if a state has relinquished certain pre-crisis policies... it must also have abandoned a commitment to GTM and be acting in ways broadly consistent with the norms of competitive liberalism.”¹⁶

They relate that the entrance to the Industrial Development Bureau is emblazoned with a quote from Goethe, that captures the difference at the level of norms between a government role based on strategic economics and one based on liberal economics: “The most important thing in life is to have a goal, and the determination to achieve it”.

The Taiwan state continues with the organizational structure of the developmental state:¹⁷

- A pilot agency located in the heartland of the state and chaired by the third ranking political leader in the state (the vice premier), called the Council for Economic Planning and Development;
- An operational agency that does the “nuts and bolts” of industrial policy, the Industrial Development Bureau described earlier, located within the Ministry of Economic Affairs;
- Industry associations by sector, membership of which is obligatory, whose secretary is semi-appointed by the government and is responsible for *two-way* interaction between the member firms and the government (and hence not likely to let the association become a centre of political resistance to government).
- Public R&D laboratories, notably the umbrella agency, the Industrial Technology Research Institute (ITRI), with a staff of some 10,000 scientists (by the mid 1980s) organized in more sector-specific labs; and an even bigger military-oriented counterpart to ITRI.

The essence of the political process of national development is intense dialogue between these organizational components of the developmental state. Earlier, the first two tended to call the tune and the others responded; since

16. Linda Weiss and Elizabeth Thurbon, “Where there's a will there's a way”: Governing the market in times of uncertainty”, *Issues and Studies* 40, 1, March 2004: 61-72, at p.63. This same issue has several other papers about governing the market, by political scientists and economists.

17. On the organizational structure of the developmental state (with specific reference to Korea) see Vivek Chibber, *Locked in Place*, Princeton University Press, 2003.



democratization in the late 1980s the balance of power has shifted towards the labs and the industry associations. In particular, much of the brainstorming takes place between ITRI labs and industry associations, which helps to build inter-firm networks with *reliable* collaboration between members.

Commonly, an ITRI lab incubates a specific technology (eg Radio Frequency Information Devices, a type of chip), gets it to pre-commercial stage, takes out patents, and then spins off a sort-of private firm, to which it gives the patents in exchange for equity. Often the senior managers of the firm are ex-ITRI, or part-time ITRI. This technique has been used for many initiatives, including the import-replacement of bottleneck components whose recurrent delays in importing are impairing Taiwan's entry into advanced sectors. In this and many other ways, the state helps to assume a large part of the risks of research and development of technologies to commercialization stage.

Emphasis is given to promoting *nationally-owned* firms, with limits placed on the operation of foreign firms (eg foreign service firms). All the time, the apparatus of the developmental state is looking for ways to maximize technology spillover from foreign firms (abroad or in Taiwan) into the heads and hands of local firms. Equally, however, the apparatus is actively involved in building up a large stock of Taiwan-owned firms operating abroad—building up *outward*-FDI—so that Taiwan is more of a reciprocal partner than if it were only playing the role of a periphery welcoming inward-FDI from the center. Taiwan's outward FDI in China is well known; but it has also built up a large stock in other developing regions as well as in the core regions of the world economy (though not in Japan).

The underlying competitive strategy for the nation is based on recognition that its firms, being some way off the world technology frontier, must seek to capture second-mover advantages. Its firms are mostly unable, yet, to capture the brand-name advantages of first movers. They must be able to chase hot products developed by first movers, push up production of specified items quickly, and exploit scale economies before profit margins become paper-thin. For this strategy, large firms not networks of small and medium enterprises are increasingly needed—large firms which are able to produce in large volumes and which are big enough to be of interest to first-mover firms as subcontractors.¹⁸

The government's role is to push on with industrial policy of *all three* of the types distinguished earlier. In particular, to promote "industrial complexes" or "urban economic commons" or "growth poles"; and to promote moves in many industrial and service sectors—often with sector-specific and even firm-specific instruments—into higher value-added parts of global value chains (such as into manufacturing-related service industries, MRSIs, as part of which the Radio Frequency Information Device mentioned earlier was developed).¹⁹

18. Alice Amsden and Wan-wen Chu, *Beyond Late Development: Taiwan's Upgrading Policies*, MIT Press, 2003.

19. Weiss and Thurbon, above.



5. 6 South Korea – the end of the developmental state?

I have been talking about Taiwan. Singapore, Japan and China also retain major features of the developmental state. South Korea, on the other hand, has gone some way to dismantling what used to be a model of the type. The dismantling began in the late 1980s, with democratisation and the discrediting of military rule—and by the same token, discrediting of bureaucratic rule. Like a swing in fashion, many Korean economists and public officials converted to neoliberal economics of a fundamentalist kind, with US-trained Korean economists in the role of modern missionaries. Their ideas acquired power from their resonance with the interests of the large Korean conglomerates, like Samsung, which by the late 1980s had reached the point of organizational and technological sophistication where they saw the state as more of an obstacle than a help. And the G7 states particularly focused on Korea with demands that it open its markets, to avoid “another Japan”. By 1995 the Economic Planning Board—the pilot agency since the early 1960s—had in effect been abolished, and the capital market had been largely opened up for foreign borrowing and foreign financial service firms.

Yet even in Korea things are not what they seem to be. Norms of “governing the market” continue. That is, the government continues to have a legitimate role in steering and coordinating the strategies of the private sector - it coordinates a governance arrangement spanning government and autonomous but interdependent firms, though not (as before) a commander of specific outcomes.

Take telecommunications liberalization, as an example of gradual liberalization carried out in a way calibrated to retain a substantial presence of nationally-owned firms while facilitating their achievement of world frontier capabilities.²¹ Before the early 1990s telecommunication services in Korea were provided by two public enterprises (Korea Telecom and Korea Mobile Telecom), backed by a history of heavy government regulation in equipment and telecom services. Then in the late 1980s and early 1990s a new technology, digital mobile telecommunications, appeared on the world frontier. This promised a much higher demand for mobile services and accompanying infrastructure. The conglomerates wanted to diversify into telecoms. The US government pressed Korea to open its telecom market to US firms; as did the prospect of GATT/WTO membership. For all these reasons the Korean government had to privatize and liberalize the sector.

But the government recognized that telecoms would be a “leading sector” on a world scale in the coming decades, and that Korea had to maintain a strong

20. On Japan's continuing success in high-technology sectors, see Eamonn Fingleton, “Sun still rising”, *The American Prospect*, May 2005, 31-34.

21. This account of Korea's telecommunication strategy is based on information in Whasun Jho, “Liberalisation as a development strategy: new governance in the Korean mobile telecom market”, Working Paper, Institute of Social Science, Yonsei University, Seoul, 2004.



presence of Korean-owned firms. The Ministry of Information and Communications (MIC) began to liberalize by privatizing the mobile carrier in 1993;²² a year later licensed a second private carrier; two years later (1996) licensed three more private carriers. It allowed foreign telecom firms to invest in the private Korea firms; but only up to a limit of 33 percent of total equity. It also restricted the share of equity that could be owned by Korean manufacturing companies to less than 10 percent. It limited new entrants in their choice of equipment, favouring Korean equipment makers, which constituted an entry barrier for foreign firms; it also limited their technology standards to government-approved ones. The whole process was aimed at developing a strong indigenous telecom capacity before full liberalization, quite contrary to what the US government had in mind when it pressed liberalization—abundant market opportunities for US firms.

At the same time, a parallel project was under way to use a public-private partnership to do the R&D for CDMA (Code Division Multiple Access) digital transmission technology, especially because the leading foreign telecoms firms would not sell advanced technology to the Koreans. The Ministry formed a technology development network, with the government-sponsored Electronics and Telecommunications Research Institute (ETRI) linked to the former public telecom company and to a number of private Korean manufacturers, each with an assigned task. Much of the funding for this network came from the sale of shares in the privatised public enterprise. The proceeds were also used to subsidize the uptake of demand for telecommunications services, including internet access, making a virtuous circle between supply and demand. And a further loop was created by requiring new entrants into the service market to use products and standards developed in this R&D consortium.

As the new entrants proved themselves competitive, several of the measures used to incubate the Korean infants were eased; the limit on the share of equity held by foreign firms and by Korean conglomerates was raised to 49 percent in 1999, and the restrictions on the choice of equipment were also lifted. By this time Korea's signing on to the WTO telecommunications agreement in 1997 was also pushing in the same direction.

The overall results of this "phased liberalization" have been spectacular. Korea jumped from being a nobody in world telecommunications in the early 1990s to being a major player in the early 2000s. It has the highest broadband penetration in the world. The Korean telecommunications case illustrates the virtues of gradual liberalization orchestrated by the state in line with national development objectives, where those objectives give weight to national ownership in important sectors.

22. Also in 1993 the government began to privatize the other public telecom company, Korea Telecom, but slowly. By 2002 it had sold 57 percent of shares of KT stock to the public, including foreigners.



6. Conclusions

I have challenged the validity of the core economic idea of neoliberalism and the Washington Consensus, an idea that remains at the core even after the recent adding on to “right policies” an emphasis on “right market institutions”. Crudely put, it is:

- microeconomic policy reforms (liberalization, privatization, etc.)
- liberalized markets for goods, finance, factors of production
- improved resource allocation
- faster growth.

Of course, no academic economist knowledgeable about developments in growth theory would accept such a crude causal chain;²³ but as my stories about the GEMS in Mongolia and Sri Lanka suggest, the idea retains great force at the level of operational policy. It is the default belief system.

In the present paper my challenge has been rather indirect (elsewhere I have challenged the economics of neoliberalism more directly).²⁴ I have shown, first, that upward mobility in the world income hierarchy has been very uncommon, and especially uncommon from low levels. Although I have not elaborated the argument here, there is no close association between mobility and policy regime; except that of the small proportion of cases of upward mobility. Most, apart from some tiny island states, have been in East Asia and have practiced “governing the market” in the context of a developmental state rather than anything close to a neoliberal mode of regulation.

I have argued, second, that the key to development lies in improving the “capabilities” of firms, especially by raising the productivity-quality trade-off frontier; and that improvement in capabilities generally entails some “transfer” of capabilities from higher-capability firms, probably in another country, to lower capability firms. Building and transferring capabilities is a difficult and time-consuming business, and the state can help a lot. Some methods of help are quite consistent with neoliberal principles, such as public expenditure to create and sustain channels of information and training in international best practice in manufacturing—though not given much emphasis by the GEMS; others, such as domestic content requirements and the use of administrative control over imports, are not consistent, yet can clearly be effective, as the case studies cited earlier suggest.

23. Tim Besley, professor of economics at LSE and co-editor of the American Economic Review, dismisses the point, saying that this chain of causation is “not accepted in modern growth research, nor any growth theory of the past 50 years” (personal communication, 10 May 2005).

24. Wade, “Is globalization reducing poverty and inequality?”, *World Development* 32, 4, 2004, 567-89; “On the causes of increasing poverty and inequality, or why the Matthew Effect prevails”, *New Political Economy* 9, 2, 2004, 163-88.



6.1 An alternative approach to growth and development: microeconomics

To repeat, there is an important role for public policy in accelerating the density of supply-chain linkages between multinational corporations and domestically-based firms, and hence accelerating the transfer of capabilities, beyond the speed of independent market agents on their own. I have illustrated this proposition in case studies from China, India, South Africa, Taiwan and Korea. The fact that some of these methods may now be difficult to use by WTO members, such as local content requirements or export requirements, should only invite the government and firms to seek creative substitutes that are either compatible with WTO rules or can be more readily concealed.

There are many ways by which an energetic “industrial extension” service, like Taiwan’s Industrial Development Bureau and Automation Task Force, can nudge or jolt foreign firms into replacing imports with domestically-produced substitutes, not all of them actionable under the WTO. The earlier discussion about the auto supply chains in China and India suggests that there is particular scope for public action to speed up the transfer of capabilities from first-tier suppliers to second- and third-tier suppliers, because of the observed steep fall-off in quality performance between first-tier suppliers (pulled up by their multinational buyers) and the others.

The main thing is to give high priority to the objective of building and transferring capacities at firm level, and have a competent cadre constantly on the look-out for opportunities of this kind. Of course, the delivery need not be by public officials; private consultancy firms could do the delivery, or some of it, working within state-set guidelines. Hirschman’s analysis of exit and voice in the delivery of public services suggests the desirability of competition between public and private providers of services such as “capabilities transfer”.²⁵ Firms should have some scope to “exit” from reliance on public providers (like Taiwan’s Industrial Development Bureau), because otherwise the bosses of the public providers know the firms have nowhere else to go and the service can become bad; on the other hand, if firms can too easily exit (by paying more money for private services) the firms left behind, which cannot pay more, lose “voice” in reforming the delivery of the public services, and the service can also become bad. The balance between exit and voice in the design of public services is not easy to strike.

Beyond government intervention to accelerate the transfer of capabilities, the larger microeconomic development strategy in the “typical” developing country case should focus on the promotion of manufacturing and food-producing agriculture.²⁶ On manufacturing because, in a nutshell, it offers the greater scope for productivity increases and product diversification and expansion; and on food-producing agriculture because it offers scope for

25. Albert Hirschman, *Exit, Voice and Loyalty*, Harvard University Press, 1970.

26. Howard Nicholas et al., 2004, “The macroeconomics of poverty reduction: the case study of Sri Lanka”, draft report, UNDP, Colombo.



stabilizing real wages. Some manufacturing may be export oriented from the start; other, import-substituting, at least initially (e.g. food processing).

The success of manufacturing depends on costs of production and market access. Costs of production include wages, interest, and inputs like energy, transport, water, and telecommunications. The Washington Consensus says that input costs should be curbed by privatizing the supply, or at the least commercializing the supply by making public providers use full cost pricing. This is a good example of how the Consensus goes astray by imposing a single recipe. The evidence is that many developing countries have experienced significant *increases* in the prices of inputs following privatization or commercialization—for the obvious reason that the newly privatized or commercialized public utilities are often in a position of “natural monopoly” and face little competition. In the alternative growth strategy there is no automatic assumption that public utilities must be privatized or commercialized.

The same can be said for finance. The Washington Consensus says that state long- and medium-term credit organizations should be privatized. But the evidence is that private financial organizations provide little long-term investment finance, particularly in developing country conditions. The result of privatizing state long- and medium-term credit organizations is likely to be a sharp cut in the supply of long-term finance and a fall in investment—just what a pro-growth strategy does not want. Accordingly, the alternative growth strategy sanctions the idea of state development banks. Also, exporters and perhaps some import-substituting manufacturers have to be able to get *concessional* working capital, and this too will require state credit facilities, whether provided through publicly-owned banks or private banks under public regulation.

As for FDI, the Washington Consensus says that developing country governments should welcome FDI with no more conditions than apply to nationally-owned investment, and perhaps even preferential treatment; and it presumes that welcoming FDI should be a high priority, because FDI is a powerful catalyst for growth. In fact, however, FDI inflows are typically very small (less than 10% of total investment), and have rarely been catalytic on their own. Developing countries have to look to other ways of effecting transfer of capabilities to their own firms, in addition to FDI. On the other hand, FDI can be a powerful way of improving market access in sectors where western markets are increasingly restricted. Hence FDI codes should be written not so as to encourage FDI unconditionally, but so as to use FDI to facilitate market access—for example, by placing export requirements.

On trade promotion, much can be learned from the way that East Asian countries did it, and especially from Japan. Japan’s Supreme Export Council, established in 1954, was an elite body which brought together senior politicians, senior bureaucrats, and business leaders. Chaired by the prime minister himself, it included several other ministers, the governor of the Bank of Japan, the head of the Export-Import Bank, representatives of industry associations and trading company associations, and a few academics.

Normally 20 to 30 members attended its twice yearly meetings. "Its highly public function", reports Chalmers Johnson, "was to set export targets for the coming year and to publicize at the highest possible level of government the need to promote exports by all possible means".²⁷ The council awarded export prizes; and oversaw the activities for the annual Trade Promotion Month. Every July, city and prefectural governments, chambers of commerce, and local Trade Councils, organized trade fairs, symposia, seminars, and other promotional activities to underline the importance of exporting for national welfare. The aim was to convince businesspeople up and down the country that they *should* and *could* get on a ship or plane, go to the United States, and utilise the large Japanese trade infrastructure in the US to land export contracts. It was their national duty.

6.2 An alternative approach to growth and development: macroeconomics

My emphasis has been on microeconomics, but it is worth spelling out some leading "alternative" ideas on macroeconomics. These ideas start from the proposition that the "typical" developing country is caught in a slow-growth dynamic that goes like this:²⁸

high current account deficit + high foreign debt/GDP + high currency mismatch

- high risk of inflation and devaluation
- weak acceptance of local currency ("dollarization" + capital flight)
- high real interest rate + low availability of credit + weak domestic banking system
- low investment
- slow growth.

Somehow the country has to create a development dynamic that goes like this:

current account in balance + low foreign debt/GDP + low currency mismatch + capital controls + sterilization policy

- low risk of inflation and devaluation
- high acceptance of domestic currency (low dollarization and capital flight)
- low interest rate, high availability of credit, stable wage costs
- high investment (helped by FDI)
- fast growth

27. Chalmers Johnson, *MITI and the Japanese Miracle*, Stanford University Press, 1982, 230.

28. See Hansjorg Herr and Jan Priewe, "Beyond the Washington Consensus: macroeconomic policies for development", *International Politics and Society* 2, 2005, 72-97.



In short, these are some of the micro and macro components of a pro-growth strategy that departs in important ways from the Washington Consensus, and seems likely to produce better national outcomes than those obtained in the Washington Consensus regime.

Governments should take heart from the case of China. The country exemplifies the alternative approach to micro- and macro-economics just adumbrated. It has *latterly* become a quite open economy in some ways, as in low average tariffs and few QRs. But to focus on its recent trade liberalization misses the bigger picture. It remains, even after WTO membership, a highly regulated, highly “distorted” economy with a high rate of politically managed direction. It retains close state control on entry and exit from many sectors, a large public enterprise sector, extensive conditions on FDI within a generally welcoming stance, capital controls, and a state-owned commercial banking sector. It retains a central industrial strategy, aimed above all at enhancing the competitiveness of local firms relative to foreign firms. When it gives up certain instruments in order to comply with WTO-type conditions it may replace them with substitutes. The government cut tax relief to exporters, in line with WTO demands, but compensated with export subsidies elsewhere. It privatized the Bank of China in line with WTO accession conditions (aimed at limiting the ability of the state to underwrite Chinese exports through the development bank arm of the Bank of China), but it established a new set of regional development banks, more out of sight from international scrutiny.

China’s macroeconomics has been aimed, above all, at stimulating investment.²⁹ Price inflation has been kept low (with the exception of two short periods in the late 1980s and the mid 1990s); the exchange rate has been de facto fixed; the central bank actively intervenes to maintain the exchange rate and control capital flows; monetary policy is “autonomous” and able to stimulate investment; foreign debt is kept very low in relation to GDP and exchange reserves; dollarization is low. The financial system remains dominated by the state, and the state-owned commercial banks provide the state-enterprise sector and the collectively-owned enterprise sector with low interest rates and a certain amount of sectorally-targeted “policy” loans.

South Korea and Taiwan earlier pursued a broadly similar strategy. We may compare the success of all three against the failure of such pupils of the Washington Consensus as Russia, Argentina, and Mongolia; and the worse performance of New Zealand, with its hard neoliberal reforms after 1984, compared to Australia, which liberalized more gradually and less thoroughly.³⁰

29. Tim Besley comments that “In the case of China...far and away the most important forces for investment have been micro-incentives offered to entrepreneurs”, personal communication, 10 May 2005.

30. Stephen Bell, “How tight are the policy constraints? The policy convergence thesis, institutionally situated actors and expansion monetary policy in Australia”, *New Political Economy* 10, 1, 2005, 65-89.



6.3 An alternative approach to political economy

Discussion of the appropriate role of the state in developing countries has been hobbled by a dichotomy between “the state” and “the market”, as though either could exist without the other in capitalist conditions, and as though there is an inherent opposition or pulling apart between them. Rather we should think of a “state-market-firm condominium”. The *market* is created and enforced through the state; and is constituted of actors rooted in the state and in firms. *Firms* operate externally through markets and internally through power hierarchies. And *states* are embedded into market- and firm-based social structures, such that non-state actors influence state policy institutions and the terms of competition between market- and firm-actors.³¹ Think, for example, of the role of industry associations described earlier in Taiwan; their role illustrates the wider point that successful development processes in East Asia, as earlier in Europe and the US, have been based on political strategies that integrate (private or public) market agents into (public) governance institutions.

At some times and in some sectors, government agents may lead and market agents follow. For example, government may initiate a big push into industry X which private firms would not wish to enter. Korea’s POSCO steel public enterprise is an example: it was established in the early 1970s against World Bank advice (“Korea has no comparative advantage in steel”, said the World Bank, conveniently for already struggling US steel makers); by the mid 1980s it had become “arguably the world’s most efficient producer of steel” according to the same World Bank, and was even giving technical assistance to US steel makers.³² Again, in Korea during the late 1980s the government led the private sector in rationalizing the heavy and chemical industry sector, by giving leading *chaebols* strong incentives to cooperate in the form of business expansion and subsidised loans.

Or the government may lead and market agents do not follow, as in Korea during the crisis of the early 1980s, when the government attempted to reorganize the heavy and chemical industry sector without much success, because of foot-dragging by the *chaebols*. At still other times and in other sectors, market agents may lead and the government may follow by giving the private initiative public support of various kinds once it looks likely to succeed.³³

This is not to imply that the integration of public and private preferences is always or generally benign. Increasingly through the 1990s the *chaebol* in Korea became so integrated into state policy-making that the state began to think like a *chaebol*, producing inconsistent policies and structural weaknesses that cost the country dear in the financial crisis of 1997-98. Korea’s financial

31. Geoffrey Underhill and Xiaoke Zhang, “The changing state-market condominium in East Asia: rethinking the political underpinnings of development”, *New Political Economy* 10, 1, 2005, 1-24.

32. Wade, *Governing the Market*, 319.

33. Wade, “Industrial policy in East Asia: Does it lead or follow the market?”, in Gary Gereffi and Don Wyman (eds.), *Manufacturing Miracles: Paths of Industrialization in Latin America and East Asia*, Princeton University Press, 1990, 231-66; and *Governing the Market*, 2004.



liberalization, for example, followed an inconsistent pattern through the 1990s, which then claimed a heavy toll in 1997-98. This was because the powerful *chaebols*, which enjoyed privileged access to the ministries of finance and industry, wanted to maintain financial controls over interest rates and controls on incoming FDI—for fear of higher interest rates, more competition, and dilution of ownership; but wanted the government to remove controls on their own ownership of non-bank financial organizations and remove controls on their access to short-term, cheap foreign loans.³⁴

The Korean case illustrates one of the most important political economy conditions of development: a nationalistically oriented capitalist class. There is a danger point in the trajectory of national capitalist development when the national capitalist class becomes strong enough to “lift free” of the national territory and start to invest—or speculate—abroad, and to shape state policies to facilitate this lifting free. This is what happened in Korea from the late 1980s onwards. Earlier it happened in a spectacular way in Britain during the 19th century (e.g. British investment in North and South America), but not in Germany—a large part of the reason why Germany successfully caught up with Britain as an economic and military power. State power has to be used to discipline national capitalists so that their foreign investments meet a national interest test, and limit the extent to which their necessary integration into public policy making leads to the hijacking of public policy to suit their own ends.

The question, in other words, is how to balance private interests and public purposes in the context of a state-market-firm condominium. We normally think of democracy as a way to keep governments accountable to the electorate. But at least as importantly, democratic institutions of accountability can serve to keep *private* interests accountable to *public* roles, checking the rent-seeking opportunities bestowed on them through the state-market-firm condominium. Such democratic institutions do not have to be based only on *territorial*, as distinct from functional representation.

Finally, back to international rules. At present, the tenets of the Washington Consensus are inscribed into the rules and operating norms of international organizations like the WTO and the World Bank. For example, the WTO’s Trade-Related Investment Measures (TRIMS) agreement rules out the use of FDI codes to place market access conditions on incoming FDI (because the big western multinationals oppose any such restrictions on their freedom of choice). Developing countries have to conceal their departures, or act out-of-compliance and wait for a challenge, or concert their actions in order to change the rules. Acting out of compliance (eg by applying performance requirements on foreign firms) does not necessarily lead to a challenge, and as long as there is no challenge the country will not be subject to WTO penalties. If there is a challenge it may take years to play out. In view of the potential economic development benefits from going against some of the WTO rules, there is a case for a government holding its nerve and not panicking at the first letter from the US Trade Representative.

34. Underhill and Zhang, 14.

Perhaps the new, post-Doha Round coalition of prominent developing countries, the G20+, can concert their actions to prompt a shift in the consensus on development strategy in the direction indicated here. But elites of the G7 states can be expected to resist any attempt to give developing countries, *because* they are developing, scope to pursue the sort of development options suggested here—resist in the name of “fairness”, level-playing field, efficiency, comparative advantage, respect for property rights.³⁵ On the other hand, a prolonged period of turbulence between the major currencies—which seems quite likely in view of the size of the current imbalances—may yet prompt the G7 to undertake an adjustment in their economic policies that puts them in touch with their responsibilities. Analysts can help by formulating alternative approaches to development that can plausibly be presented as furthering liberal ends, as distinct from liberal means.

TABLE 1. STATE MOBILITY BETWEEN CORE, SEMI-PERIPHERY AND PERIPHERY, 1980, 1999

1999, 1980	Core	Semi-P	Periphery	Very low periphery	Total
Core	6 (US, Nor)	13 (Ger, Can)	1		20
Semi-P	1 (Jpn)	17 (HK, S’p, UK)	21 (Rus, Mex)	1	40
Periph		4 (Kor)	65 (China, India, Malay, Bra)	16 (BD, Mongolia)	85
Very low periph			2 (VN)	3 (Eth, Laos)	5
Total	7	34	89	20	150

(Source: Satoshi Ikeda, “Zonal structure and the trajectories of Canada, Mexico, Austria and Norway under neo-liberal globalization”, Marjorie Cohen and Stephen Clarkson (eds.), *Governing Under Stress*, London: Zed Books, 2004, 263-290.)

Note: Countries are placed by their per capita gross national income as a % of that of the US, using market exchange rates. Zonal boundaries (%): core (70-100); semi-periphery (40-69); periphery (10-39); very low periphery (0-9). Countries to the left of the diagonal gained relative to the US between 1980 and 1999; countries to the right, lost. The countries in brackets illustrate the category.

35. See Wade, “What strategies are viable for developing countries today? The WTO and the shrinkage of development space”, *Review of International Political Economy* 10, 4, 2003, 621-44; “The ringmaster of Doha”, *New Left Review* 25, Jan/Feb 2004; “Symposium on infant industries”, *Oxford Development Studies* 31, 1, 2003, 3-20; “The invisible hand of the American empire”, *Ethics and International Affairs* 17, 1, 2003, 77-88; “Failing states and cumulative causation in the world system”, *International Political Science Review* 26, 1, 2005, 17-36; “Bringing economics back in”, in special issue, “Empire by denial? Debating US power”, *Security Dialogue* 35, 2, 2004, 228-36.



PANELLIST PERSPECTIVE

Prof. Vo Dai Luoc, Vietnam Academy of Social Sciences

1. The neo-liberalism and the Anglo-American model.

During the last fifteen years the “neo-liberalism” of the Anglo-American development model has created remarkable stamps in the context of prolonged sluggish Japanese and European economies. This reality has persuaded international organizations such as IMF, WB and scholars to acknowledge the vitality of neo-liberalism “with variants of State renewal and market institutions”, not the withdrawal of the State. The neo-liberalism world-wide supports economic liberalization and international economic integration.

Following the description of new variants of “neo-liberalism”, the author raised two examples of neo-liberalism’s failure in Mongolia and Sri Lanka and came to the conclusion that “government of a typical developing country” should not simply accept free market thinking by default, as operational parts of multilateral economic organizations. The author also thought that “the State can be both active and beneficial to a large extent, even within the framework of WTO rules”.

The author also pointed out that the world convergence during the last 25 years following the direction of neo-liberalism has not been able to create a trend for reducing income gaps, etc. Only a few countries emerged with per capita incomes increasing from a low level to an average level, but these countries utilized State interventions beyond the boundary of neo-liberalism. In the research table on state transformation, the author raised three important comments:

- Most of the countries preserve the *status quo*.
- Among countries witnessing transformation, most of them (88%) changed to a lower level.
- Only 5% of the countries changed to higher level but they did not follow neo-liberalism.



The author was right when assuming that neo-liberalism was unsuccessful in less-developed countries, only alive in Britain and America, and yet to be successful even in Japan and Europe. However, the author did not analyze why neo-liberalism was unsuccessful in less-developed countries but it was successful in America and Britain and yet to be successful in Japan and Europe. In my opinion, neo-liberalism can only be successful under the following two conditions:

- Countries applying neo-liberalism must develop a strong jurisdiction and a perfect market economy, i.e. they must have real visible and invisible hands.
- Governments of these countries must be ready to voluntarily implement neo-liberalism.

The lack of either condition above will make it difficult to implement neo-liberalism effectively. America and Britain might have fulfilled both the two conditions above, so neo-liberalism there is lively. However, neither Europe nor Japan meet these two conditions. The socio-market economy, or welfare state model, has distorted the market economy in these countries even though the jurisdictional state there has developed quite well. Moreover, many European countries criticize neo-liberalism rather than accept it. In Japan, crony capitalism and over reliance on an export-based development model have also distorted the market. In addition, not until recently has neo-liberalism been accepted in Japan.

The less-developed countries seem to lack both conditions mentioned above, i.e. lack a true jurisdictional state, lack a perfect market economy and governments are still too remote from neo-liberalism. So, neo-liberalism cannot succeed in this context. China and Vietnam have recorded achievements and progress not because of neo-liberalism but due to the establishment of a market economy, openness and international economic integration, and the building of a jurisdictional state.

The author argued that “the key to development is to enhance the capacity of companies, especially by improving quality and productivity...”. However, this is only right when the State can perform well all of its functions. In developing countries, generally the States have not carried out their functions very well. In an environment of high taxes and widespread corruption, how can companies be created and developed, not to mention the task of improving productivity quality and transferring capacity? Therefore, in developing countries, the first and foremost key to development is renewal, government reform, i.e. governments must change their thinking and policies to facilitate the establishment and development of companies. Then the second key is to improve the capacity of these companies.

The author believes that public policy plays an important role in promoting the chain of supply among multilateral and domestic corporations, thereby



fostering capacity transfer more quickly than independent markets. This argument was backed up by examples from China, India, South Africa, Taiwan and South Korea. Here the author argued that public policy must give high priority to the establishment and capacity transfer of companies. I agree with this viewpoint.

The author claimed that the micro-economic development strategy of developing countries should focus on developing the manufacturing sector and improving food production. This has been possible up to now. However, the problem is that now only one country, i.e. China, is developing the manufacturing sector at such a high speed to threaten the manufacturing industries in many countries, especially creating a threat of exhausting resources. If all developing countries race against each other to develop the manufacturing industry like China, can the world economy sustain and stabilize this process?

The author did not support the idea that medium and long-term credit organizations of the State should be privatized, otherwise no credit organizations will make medium and long-term investments. I agree that we should not privatize all the medium and long-term credit organizations. However it would be good if some of these credit organizations are equitized to create a competitive environment.

The author believed that “in reality, FDI flows in developing countries are very small, accounting for less than 10% of total investment, and not being catalysts themselves”. This is true to the majority of developing countries. However, the case of Vietnam is different. In Vietnam, FDI used to account for 28% of total social investment and was 18% last year. FDI in Vietnam not only means funds but also has significant implications for the market. FDI enterprises account for 50% of total export value of Vietnam, contributing to technology transfer and being catalysts for development, etc. The role of FDI in China is even greater than in Vietnam.

The author recommended governments to pay attention to the case of China. He commented that even after joining WTO, the Chinese economy to a large extent is still highly regulated and with a “distorted” political management. When giving up certain tools to meet WTO conditions, China can replace them with alternative measures. The Chinese macro-economy policy is to promote investment. The things that the author mentioned about China are right, but the issue is how China can achieve and sustain such a high growth rate for so long? Are the things like strong regulations, highly “distorted” market, strongly promoting investment, or is strong intervention by the State really the reason for such high growth? Are these lessons for other countries?

In general, I highly appreciate the author’s thoughts and interpretations. However there are some points I would like to further discuss with the author to make the interpretations more complete.





PANEL I: LAW REFORM, STATE-SOCIETY RELATIONS AND SOCIAL ORGANIZATIONS IN ASIAN COMPARATIVE PERSPECTIVE

Keynote Presenter: **Prof. Mark Sidel**, Prof. of Law and International Affairs, University of Iowa; Visiting Prof. of Law, Harvard Law School (2005-06)

Panellists: **Prof. Dao Tri Uc**, Director of the Institute of State and Laws, Vietnam Academy of Social Sciences

Dr. Neil Jamieson, author of Understanding Vietnam

Dr. Borje Ljunggren, Sweden's Ambassador to China

THE REGULATION OF SOCIAL ORGANIZATIONS IN ASIAN COMPARATIVE PERSPECTIVE

Prof. Mark Sidel

I am delighted to be here to join you at this important symposium – a meeting that reflects the major victories of twenty years of *doi moi* in Vietnam. In the first twenty years of Vietnam's renovation policies, Vietnam has become a more prosperous society and a more powerful nation, widely respected in its region and around the world. There is much to celebrate in these twenty years of *doi moi*.

In my field, law, Vietnam's legal reforms have occurred within legal institutions, in extensive legislative development, in constitutional reform typified by amendments to the Vietnamese Constitution, in the government's increasingly effective regulatory roles, and in many other ways. Both the Vietnam Academy of Social Sciences and UNDP have played significant roles in these legal reforms and in developing important newer areas of inquiry, such as access to justice and popular participation in legal reform.

There are, of course, substantial challenges remaining as well. Others at this symposium and other meetings will discuss those challenges in the arena of economic policy, political reform, social issues, regional and international



relations and other areas. I focus here today on one aspect of the challenges facing state-society relations in a number of countries – the role of law in fostering stronger linkages between political authority and a nation's citizens, what we sometimes call state-society relations.

There are multiple aspects to state-society relations and its legal regulation. Enhancing popular participation is one important element of state-society relations. Vietnam has both worked to enhance citizens' participation in the work of the state and has encountered certain issues in this area. Decrees 29 and 79 and their implementing documents are an important aspect of this work.¹

Another important aspect of the legal regulation of state-society relations is the emergence of popular associational activity – clubs, organizations, social service groups, and a wide range of other such social organizations. These come by many names and terms – social organizations, non-profit organizations, nongovernmental organizations, community based organizations, voluntary organizations, charities and charitable organizations, public benefit organizations, civil society organizations, and many others. Vietnam has also developed policy and begun to legislate in this area as well.²

I will not attempt to broadly differentiate these definitions or to engage in the sometimes overly detailed foreign debates about definitions of social organizations. I treat all of these groups and definitions as expressions of popular desire to enhance prosperity and social life through activity separate from and complementary to the state – activity that complements and enhances the efforts of the state to provide a better life to Vietnam's citizens.³

I focus here on the legal forms through which the state regulates social organizations and its relationship with that sector, as an important aspect of state-society relations. I would like to provide some data that may be of use in continuing and deepening reform in the area of state-society relations with a focus on the role and regulation of social organizations. In particular, I would discuss some of the various ways in which Asian states –

1. See Decree 29/1998/ND-CP (Regulations on the Exercise of Democracy in Communes); Decree 79/2003/ND-CP Promulgating the Regulation on the Exercise of Democracy in Communes; Circular 12/2004/TT-BNV Guiding the Implementation of Government Decree 79/2003/ND-CP on the Regulation of the Exercise of Democracy in Communes and Applicable to Wards and District Townships, all available at www.un.org.vn/donor/civil/. When I use the term "state" in this paper I am generally including both the Communist Party and the state apparatus within the more general term "state."
2. For the initial recent legislation (pending adoption of a national law), Decree 177/1999/ND-CP Promulgating the Regulations on the Organization and Operation of Social Funds and Charity Funds; Decree 88/2003/ND-CP on the Organization, Operation and Management of Associations; Circular 01/2004/TT-BNV Guiding the Implementation of a Number of Articles of Government Decree 88/2003/ND-CP on the Organization, Operation and Management of Associations, all available at www.un.org.vn/donor/civil/.
3. Nor do I intend to diminish or underestimate the substantial conflicts in Vietnam over the role of religious organizations of various kinds and various viewpoints, and the role of groupings of individuals that may hold political views that challenge those of the state.



particularly China – are grappling through law and regulation with the broad and rapid growth of social organizations. A comparative sense of these legal and regulatory methods for calibrating relations between the state and social organizations may, I hope, be of some use as Vietnam considers its own developments in this area. And they may, as I indicate briefly at the end of this paper, shed some light on important questions of broader legal reform.⁴

Legal reform, state-society relations, and the regulation of social organizations come together around six key levers for regulating the relationship between the state and social organizations. Put in another way, in most of the countries of Asia, most state regulation of social organizations takes place in six different key areas. And state responses in each of these areas can be viewed as a kind of spectrum, ranging from more flexible and allowing the social organization sector more autonomy on one side, and across the spectrum toward providing less flexibility and autonomy to the social organization sector (and more discretion and power to the state) on the other side.

These key six areas of state regulation of the social organization sector include:

1. The registration and status of social organizations

Are social organizations required to seek approval for their existence, or merely to register? Are there limitations on the “right to association”? If there are approval or registration requirements, must organizations do so with one government organization or with multiple agencies? Is there a “dual control” structure in which social organizations seek approval from and/or register and/or report both to a professional state agency (i.e. Ministry of Health or provincial health bureau) as well as a functional state agency responsible for this generic work (i.e. a Ministry of Civil or Home Affairs or a provincial civil, home or other bureau)?

Are there multiple channels for approval or registration available to social organizations (sometimes termed “multiple silos”) and does that create flexibility and opportunity for social organizations? Are the provisions for approval and/or registration clear and defined or are they murky and ill defined? Are there long waits, or time limits? Does government have substantial or limited discretion in making approval, registration or other relevant decisions? Are there problems in the definitions of “social organization,” “charity,” “non-profit” or other relevant terms? Is there an “overlay” problem – organizations subject to registration and other statutes

4. Parts of this paper are adapted from a volume that I have recently edited with Bangladeshi colleague Iftekhar Zaman - *Philanthropy and Law in South Asia* (Asia Pacific Philanthropy Consortium, 2004), particularly the introduction to that volume co-authored with Ifti Zaman. I am grateful to Ifti Zaman and to my colleagues in this project from Bangladesh, India, Nepal, Pakistan, and Sri Lanka for their superb work.



that may be inconsistent?

2. The purposes and activities of social organizations: prohibited purposes and required activities

Are there purposes or activities that are forbidden to social organizations? Are those defined clearly and in limited ways, or are they defined generally and in ways that provide the state with wide regulatory discretion? Are the forms of government action with respect to purposes and activities well-defined, or does government have wide discretion in enforcement?

Are social organizations allowed to engage in “business,” how is business defined, and under what conditions may organizations engage in for-profit activities? Are the leaders or members of social organizations allowed to retain any form of personal benefits arising out of their activities in such organizations, and under what terms?

3. The fiscal (tax) regime for social organizations

Is there clarity in the tax treatment of social organizations that allows for clear planning and incentives, or wide state discretion? With respect to tax exemptions for social organizations, are exemptions available to such organizations and are they automatic on registration, nearly automatic, or subject to application and approval? Is there a frequent exemption requalification requirement that can lead to excessive state discretion? Are they available to all organizations and, if not, are there clear or discretionary criteria for differentiating among exempt and non-exempt organizations? Are all taxes exempt or are some taxes not exempted (i.e. VAT or sales tax), and are those distinctions rational and consistently applied?

Are religious organizations tax-exempt? Is there a requirement that social organizations spend a minimum amount (or amount of their donations) to receive exempt status? Is there political pressure against exemptions for social organizations? Is there accountability in the exemption process (i.e. exemption sanctions for operating prohibited businesses)?

Is exemption decision making clear and in writing, with limited time available to tax authorities to make relevant decisions, with appeals available? Is there a judicial role in reviewing exemption decisions and revocations?

With respect to the tax deductibility (to the donor) of donations to social organizations, are such tax deductions to the donor automatic, nearly automatic, or subject to extensive application and approval procedures? If they are subject to application and approval, are these processes efficient or are they subject to decision making at multiple levels? Are they time limited?



Are there multiple deduction levels in place, and multiple approvals (i.e. special, higher deductions for national priority projects)? Are there equal, higher, or lower deductions available for religious giving? Are deductions limited to donations to certain organizations? Are there deductions for giving in kind?

Are deduction decisions clear and in writing, with limited time available to tax authorities to make relevant decisions, with appeals available? Is there a judicial role in reviewing deduction decisions and revocations?

Given the tax base and number of taxpayers, are deductions important? Will they become more important?

4. Resource mobilization and capital formation

Are there minimum capital requirements or norms for social organizations? Are organizations required to spend a minimum proportion of their assets or income each year on their social or charitable activities? Are social organizations limited in the investment vehicles they may use?

Are there any constraints or limitations or restrictions on fundraising from domestic sources? Are there any constraints or limitations or restrictions on fundraising from foreign sources, or on the treatment of foreign funds raised?

5. Governance and accountability

Governance

Are there statutory requirements for organizational governance arrangements, relating to duties and meetings of the governing board, criteria or requirements for management, and approval of specific organizational activities? Are there restrictions on board members or employees deriving personal benefit from the social organization? Are there requirements for clear bylaws? Are there provisions for handling violators of governance requirements? Are violations handled by government, the judiciary, or some combination?

Accountability

To whom are social organizations accountable? The government, society, their members, their donors, or others? Are tax returns or other government filings required for all organizations, or certain organizations with a certain minimum turnover or donations? Are there special accountability requirements for social organizations dealing in foreign funds?

Must government filings, annual reports or other organizational reports be



disclosed to the public or published? Are there well-understood, consistent accounting standards applicable to social organizations? Are violations of accountability requirements handled by government, the judiciary, or some combination?

Self-regulation

Are initiatives or experiments in non-profit self-regulation underway (i.e. codes of conduct, accreditation ranking or rating systems, other self-disciplinary systems, etc.)? Are they underway to protect the sector from increasing state regulation, to improve standards and professionalism in the sector, or for mixed or other purposes? Do they involve non-profit umbrella organizations? Is the government supporting, encouraging or partnering in such self-regulation initiatives? Are they primarily a function of large, national organizations that receive foreign funding, or smaller community-based organizations, or other types?

6. State intervention, dissolution, termination, and takeover of the management of Social organizations

Are the grounds for government intervention, dissolution, termination or takeover of a social organization defined in very broad and discretionary terms (i.e. "unlawful purpose" or "anti-state propaganda") subject to discretionary and highly flexible interpretation by the state, or are those grounds defined more narrowly, permitting less state discretion in intervention, dissolution, termination or takeover?

Is government intervention based on clear legal standards? Is notification governed by law and does it require notification in writing, or by oral meetings, or no notification at all? Is there a judicial role in reviewing intervention, dissolution, termination or takeover, i.e. an opportunity to appeal state decision making?

Is the treatment of organizational assets clearly governed by statute, or is the state allowed wide discretion over disposition of assets? Is there a judicial role in deciding upon or reviewing the disposition of assets?

China

The Chinese world of social organizations has rapidly expanded since the late

4. These include "minjian zuzhi" (people's or civil or popular organizations, "feizhengfu zuzhi" (nongovernmental organizations), "shehui tuanti" (social organizations), which are largely synonymous according to the NGO Research Center at Tsinghua University in Beijing, as reported by the U.S. Embassy in Beijing to the Congressional-Executive Commission on China (CECC) in 2003.



1980s. Known by multiple names with similar and overlapping meanings,⁴⁰ social organizations in China have begun to help the state deal with its fiscal constraints, draw upon the population's altruistic spirit, provide channels for more marginalized groups to claim rights and resources, and even serve as a workspace for retired officials.

According to the Chinese Ministry of Civil Affairs, social organizations are comprised of academic associations (*xueshu*), trade groups (*hangye*), professional associations (*zhuan ye*), federations, often of business or professional organizations (*lianhe*), and foundations (*jijinhui*).

Social organizations may take other legal forms as well, including private non-enterprise organizations (*minban fei qiye zuzhi*, abbreviated as *minfei*). Private non-enterprise (or non-commercial) organizations may include schools, hospitals and other institutions.

At the end of 2001, the last year for which detailed statistics are available, there were 129,000 social organizations registered with the Chinese authorities and 82,000 private non-enterprise organizations. Estimates of unregistered social organizations ranged from 1.4 million to over two million. The number of government-organized nongovernmental organizations (*banguanfang zuzhi*) is unknown but presumed to be sizable.⁵

1. The registration and status of social organizations

The Chinese government has taken a somewhat different position on the spectrum between restriction and encouragement, at least *vis-à-vis* registration, approval and status of social organizations. With certain exceptions all social organizations and private non-enterprise organizations must seek registration and approval prior to initiating operations.

The only exceptions (for social organizations) are specially-designated people's or mass organizations at the central level; certain social organizations specially approved by China's State Council (such as the Writers Association and the Journalists Association), a few statutory organizations (such as the Chinese Lawyers Association), and the important category of "internal" organizations, those affiliated with and subservient to other registered institutions such as universities or businesses.

1.1 Obstacles to registration; restrictions on social organizations

Registration and approval is not a pro forma process. It may be carried out at the county, provincial, municipal or national level, but it is cumbersome,

5. Idem.



relatively non-transparent, and highly multi-staged so that registration may be delayed or sidetracked at any one of several points in the process.

One reason for the difficulty is the Chinese legal requirement that social organizations (as well as private non-enterprise organizations) have reporting relationships to two different government entities – one, a professional agency (such as a Bureau or Ministry of Health) and second, a registration management agency (the Ministry of Civil Affairs at the national, provincial or county level). This “two masters” or dual supervision system is a means both to control registration and to maintain control over organizations during their operations.

In addition to the dual supervision system, Chinese social organizations may not establish branches outside the area in which they are registered. So, for example, national social organizations cannot generally establish “lower” branches at the provincial level outside Beijing; organizations registered at the provincial level cannot establish themselves again in other provinces; and county-approved organizations may not establish branches in other counties or above the county level. The general policy is to limit social organizations to the area and scope for which they were originally approved.

Third, an individual may not serve as legal representative for more than one social organization. Fourth, there may generally not be more than one social organization approved and registered in any particular field in the same administrative area, a provision that was intended to slow the growth of the sector and prevent competition among social organizations but is now widely criticized within the Chinese non-profit sector for helping to dampen creativity and increase political clientelism between social organizations and the state.

Finally, a threshold requirement for approval and registration is that at least fifty persons or thirty groups must be signed on as members.

There are other restrictions on the registration of social organizations in China that indicate the place on the spectrum of control that the Chinese authorities seek to exercise – while allowing literally millions of registered and unregistered social organizations to operate, raise funds, and carry out services and activities. Under internal guidelines, the Ministry of Civil Affairs will not approve social organizations that are to be founded by and represent certain distinct social groups, such as “migrant labourers, laid-off workers, ex-servicemen.”⁶

1.2 “Silos”?

China’s structure of legal forms for the registration and status of social organizations does not arise out of colonial legacies or other long-lasting models. Partly as a result of that history, the legal forms for social

6. Yiyi Lu, Chatham House (February 2005).



organizations in China are considerably narrower than the multitude of forms (or “silos”) available throughout most of South Asia. The primary forms are social organizations (the primary institution discussed here); registration as a private company; and registration as a private non-commercial organization.

So the Chinese regulations generally force incipient social organizations into one of a very limited number of legal forms, rather than permitting wide choice among the myriad of forms in countries emerging from colonial law. But – an important but – this is often balanced by substantial flexibility accorded to social organizations in practice – a flexibility that extends as well to the hundreds of thousands of unregistered but active social organizations in China

2. The purposes and activities of social organizations: prohibited purposes and required activities

China also asserts a broad statement of the purposes and objectives for which a non-profit may not be formed, and a strong assertion of discretion in interpreting that standard.

The *Regulations for Registration and Management of Social Organisations* (1998) provide that “social organisations must observe the Constitution, state laws, regulations and state policy; must not oppose the basic principles of the Constitution; harm the unity, security or ethnic harmony of the state, or interests of the state and society, or the lawful interests of other organisations or citizens, or offend social morality.”⁷

This formulation provides, of course, both for broad prohibitions and broad requirements. And the Chinese authorities assert strong discretion in applying these broad prohibitions and requirements. By the terms of the 1998 Regulations, it is not even clear that these requirements and prohibitions apply only to registered organizations; registration is not mentioned in this article of the Regulations, and by its terms these mandates may well be applied to unregistered organizations as well.

The prohibited and required purpose mandates are similar with respect to private non-commercial organizations. But interestingly, the prohibited and required purpose clause is different in the case of non-commercial institutions, which are required to “respect the Constitution, laws, regulations and national policies” but without the other detailed and murky provisions of the social organization regulations.⁸

7. Article 4, Regulations for the Registration and Management of Social Organisations (State Council, 1998), available in English translation at www.chinadevelopmentbrief.org.

8. Article 4, Provisional Regulations for Registration and Management of Non-Commercial Institutions (State Council, 1998), available in English translation at www.chinadevelopmentbrief.org.

9. Article 4, Regulations for the Management of Foundations (State Council, 2004), available in English translation at www.chinadevelopmentbrief.com.



In the most recent context – new regulations on foundations – China has returned to a modified version of the 1998 purpose requirements: Foundations “must abide by the Constitution, the law, rules and regulations and national policy; they must not endanger national security, national unity or the unity of [China’s] nationalities, nor must they transgress social morality.”⁹

3. The fiscal (tax) regime for social organizations

Does the state use fiscal levers (tax incentives) to encourage the growth of social organizations? To discourage their growth? To differentiate among social organizations, encouraging some more than others?

The tax regime for social organizations in China has long been confused and uncertain. In the early years of the development of social organizations in China, the Chinese tax authorities showed no substantial interest in developing an exemption or deduction regime. In recent years the situation has become somewhat more complex, and some reports – understandably in a country of China’s size and complexity – have been contradictory. But the recent publication of a major study on China’s tax regulation of non-profit organizations will go a long way toward clarifying the picture.¹⁰

3.1 Tax exemption for organizations

In earlier years, some registered social organizations were treated as taxable and some social organizations registered as companies were also levied tax under corporate tax regulations, though often at lower rates than true corporates. Generally unregistered social organizations did not pay tax.

The 1998 Regulations on Social Organisations did not provide for either tax exemption or deductions, even in conceptual terms. 1999 Public Welfare Donation Law endorsed tax exemption as a concept but without details.¹¹ Until 2004, information was largely scattered: A few exemption privileges were said to have been made available in the 1990s and the early part of this decade. The U.S. Embassy in Beijing reported that interest earned by foundations on their assets was tax exempt, as were “donations from abroad

10. Leon E. Irish, Jin Dongsheng and Karla W. Simon, China's Tax Rules for Not-for-Profit Organizations (A Study Prepared for the World Bank, December 2004), available at <http://www.worldbank.org.cn/English/content/NPO%20Tax%20Report-En.pdf>.

11. “Corporations and other enterprises that...make donations to public welfare undertakings, will...enjoy business tax benefits. (Article 24) “Individuals and private small businesses that...make donations to public welfare undertakings, will...enjoy personal tax benefits (Article 25). The Public Welfare Donation Law of the People's Republic of China is available in English translation at www.chinadevelopmentbrief.com.

12. U.S. Embassy communication with the Congressional-Executive Commission on China (2003), www.usembassy-china.org.cn/sandt/ptr/ngos-prt.htm.



if routed to humanitarian or poverty organizations approved by the State Council.” And some ten foundations, including some of the most prominent in China such as the China Youth Foundation, Soong Ching Ling Foundation, and the Chinese Red Cross, were granted special exemptions from taxation.¹²

The current situation for tax exemption has been substantially clarified by a study prepared for the World Bank at the end of 2004. The study’s authors make clear that China’s Enterprise Income Tax imposes tax liabilities on Chinese social organizations and other recognized nonprofits, and that deductions for “costs, expenses, and losses associated with the generation of taxable income” as well as certain salaries and other expenses are available to registered nonprofits under the Enterprise Income Tax. Non-profits are also liable to pay Business Tax on income derived from certain services (i.e. culture and sports); Value Added Tax if they add value to goods under VAT law; tariffs (customs duties); Real Estate Tax; Vehicle and Vessel Usage Tax; Urban Land Usage Tax; Land Value Added Tax; Farm Land Occupation Tax; Deed Tax; Vehicle Acquisition Tax; City Maintenance and Construction Tax; and Stamp Tax.¹³

In turn exemptions are available under most of these taxes. Interest income for public welfare foundations is exempted under Enterprise Income Tax. Business Tax is exempted for nursing, medical, educational services, admissions fees, membership fees and certain other income. Certain instruments and equipment used by nonprofits or in research and education is exempt from VAT. “[G]oods, supplies, and equipment donated as free gifts by foreign governments and international organizations are exempt from tariffs.” Some real property owned by nonprofits is exempt from Real Estate Tax. There is a full exemption from Vehicle and Vessel Usage Tax, some exemptions from Land Usage Tax; for farmland used by nonprofits under the Farm Land Occupation Tax, and so on for virtually all taxes levied.¹⁴

3.2 Tax deductibility for donors

In earlier years there was no significant tax deduction policy except in limited circumstances on donations from abroad made by certain domestic taxpayers to certain domestic humanitarian or poverty organizations.

The 2004 World Bank study also substantially clarified the tax preferences (or deductions) available to both enterprise and individual donors. Enterprise donors “for community benefit and relief undertakings” through “certain social organizations” as named are deductible under the Enterprise Tax Law up to 3% of taxable income. The exemption is higher (10%) for donations to “cultural, historic, and scientific undertakings” through government agencies. Individual

13. Leon E. Irish, Jin Dongsheng and Karla W. Simon, China’s Tax Rules for Not-for-Profit Organizations (A Study Prepared for the World Bank, December 2004), pp. 7-12.

14. Id., pp. 12-16.

15. Id., pp. 16-19.



donors may deduct “up to 30% of taxable income for the amount of donations made for education, civil affairs undertakings, natural disaster relief, youth and teenager activities, old age assistance, art, science, technology, cultural or historical preservation or memorial, or similar undertakings.”¹⁵

In some cases deductibility is tied to donations made to certain state-designated nonprofits or non-profit intermediaries. And the situation is confused, uncertain, and with insufficient incentives. As the authors put it, “China’s NPOs have obviously entered into a new stage of development, and the old preferential tax policies for NPOs can no longer meet the newly arisen needs” as well as a range of more specific issues: the lack of a “unified and comprehensive tax system” for nonprofits, low compliance and enforcement rates, discrimination in deductibility based on state-designated organizations, lack of any policy on taxing nonprofits for their profit-making activities, and discouragement of donations because of low deduction rates.¹⁶

3.3 The road forward in China

Both the current situation and the road forward in China have been clarified by a study recently published by the World Bank that both described the current system in clear terms and called for reforms in the tax regime for Chinese social organizations and other nonprofits. The report calls for differentiation between for-profits and nonprofits; a further clear definition between “public benefit” nonprofits and regular nonprofits; “fair and effective” regulation of social organizations and other nonprofits; stricter regulation of the sector; and enforcement of the “principle of legality” that “similarly situated entities (e.g., all PBOs [public benefit organizations]) should be treated the same, and differently situated entities (e.g., NPOs [non-profit organizations] and PBOs) should be treated differently. All persons of a particular kind (e.g. enterprises or natural persons) receiving tax preferences for donations should be treated the same.”¹⁷

The report further recommended that nonprofits and public benefit organizations should be exempt from Enterprise Income Tax (China’s main business tax) for “gifts, grants, and membership dues,” with further exemptions from EIT for income from investments, and related business activities for the PBOs. PBOs should be subject to EIT on unrelated business activities and nonprofits should be subject to EIT on net profits from other sources.

The consultants also recommended that public benefit organizations be exempt from business tax, customs duties and import VAT, and real estate tax, as well as certain other taxes, and receive a rebate from VAT. In exchange for these benefits, PBOs “must be devoted exclusively to one or more public benefit purposes and unrelated activities, including unrelated business activities, may not constitute

16. *Id.*, pp. 19-21.

17. *Id.*, p. II.

18. *Id.*, p. III.



more than an insubstantial part of the activities of the PBO; and that there can be no direct or indirect distribution of profits to anyone at any time..."¹⁸

The study further recommended that tax deductions be limited to donations to public benefit organizations, and that the deduction limit be raised to 10% for enterprises (an increase from the current 3%), and 50% for individuals (an increase from the current 30%). Carry forwards should also be allowed. Governance should be substantially strengthened, including statutory requirements, bylaws and a code of conduct. And the study's authors recommend establishing a "Public Benefit Commission" to be "responsible for registration, oversight, and regulation of PBOs."¹⁹

4. Resource mobilization, capital formation, and the drive toward flexibility in development and investment options for non-profit

In China, regulation of resource mobilization and capital formation for social organizations has often lagged well behind practice, in part because the government has sought to facilitate substantial foreign funding and in part because of more general lags in state regulation. The registration and management agency responsible for annual inspection of social organizations seeks reporting on foreign funding, and social organizations are required to report receipt of foreign funds in accordance with finance and banking law.

But the Regulations for Registration and Management of Social Organizations (1998) contained no specific provisions on approval or reporting on foreign funding, and China does not have the legacy of a Foreign Contributions Regulation Act as in India. The Chinese Public Welfare Donation Law (1999) contained only a general provision requiring compliance with state procedures. There are considerably more detailed recent provisions for foreign foundations that seek to establish a branch or office in China (under the 2004 Regulations for the Management of Foundations), but that is of course a different matter from donations to domestic institutions.

The result is that it can be considerably easier for Chinese social organizations to take in and use foreign funds than it can be for a range of Indian organizations – what may seem a paradox to foreign observers who may often regard Communist Party-led China as a stricter regulator than India. One key difference is that the methods of knowledge and enforcement are more diffused in China, not limited to an FCRA-type mechanism. Social organizations report through the "dual administration system," are subject to extensive finance and banking controls, and in many cases are indirectly tied to government agencies.

19. Id., p. IV, V.



5. The struggle to transform non-profit governance and accountability governance

In China, there are general statutory norms for the governance of social organizations stipulated in the 1998 *Regulations on the Registration and Management of Social Organisations* and a number of other regulatory documents. These may delve into governance requirements in great detail, including the structure and role of boards, responsibilities of board members and senior employees, and a number of other governance responsibilities that must appear in organizational charters.

In a situation somewhat different from South Asia, there is some general consistency in the governance norms for social organizations across the several types of organizations. Monitoring and enforcement, however, may be different because different government branches may play differing roles with respect to social organizations, foundations, private non-enterprise organizations and others.

Most Chinese social organization practice seems, like South Asia, to result in relatively weak boards, relatively strong founder or successor executives (who are often retired government cadres) and – specific to the Chinese context – a high degree of dependence on state agencies. In other terms, although generalizations across the vast range of Chinese social organizations may be foolhardy, accountability to the state is relatively strong, but accountability to members, donors or the public may be relatively weak.

As in South Asia, the solutions for these governance issues may include revamping and further detailing of laws and regulations that were very general in their initial iterations; training and awareness-building; or moving toward an “umbrella” or “comprehensive” system of non-profit regulation. Current proposals for a revamping or major shift in non-profit regulation in China (such as proposals for a new definition and regulation of “public benefit organizations”) would lead to heightened governance requirements as well.

5.1 Accountability

In general terms, the accountability of social organizations in China to the state may be often stronger in China than in South Asia. But accountability to members, donors, other specific constituencies and to the public may often be relatively weak. As in South Asia, accountability within the fiscal and tax realms is weak, as is audit accountability. For a subset of Chinese social organizations, and because of the importance of foreign donors, responsiveness to donors and compliance with donor requirements may be a relatively strong form of accountability. Monitoring and enforcement remain an issue, affecting accountability.



5.2 Self-regulation

Social organizations are much newer to the Chinese scene, of course than various forms of non-profit and voluntary organizations are to South Asia. As a result of that longer history in South Asia and other factors, discussions, experiments and initiatives in non-profit self-regulation have moved considerably further in South Asia than in China. But there have been extensive discussions of non-profit self-regulation, often termed “self-discipline” (*zilu*) in China as well. One well-known effort was made by Prof. Shang Yusheng and the Chinese NPO Network. In 2001, Prof. Shang proposed “Nine Standards for NPO Self-Regulation”:²⁰

To uphold the public-good mission to promote progress and justice of society

To insist on NPO's non-political and non-religious nature

To stick to organizations' not-for-profit principle, not to pursue interest for any individual or family

To insist on financial transparency and to expose annual reports to the public

To insist on information exchange, resource sharing and mutual cooperation.

To respect copyrights of NPO colleagues

To insist on self -autonomy and independence and to build a regular board of directors

To follow fair and reasonable sponsorship and evaluation, not to abuse written rules and processes with any excuse

To insist on NPO's moral standard in performance and to work wholeheartedly for public benefit

The Chinese discussion of non-profit self-regulation appears to stem from several motivations: on the one hand, a possible desire to forestall more rigorous government regulation, but on another, an attempt to improve the quality of work in the non-profit sector so that the state is more willing to recognize, and perhaps even protect, its useful role in China's development.²¹

20. Supplied by Prof. Shang and translated by the China NPO Network.

21. I am grateful to Prof. Shang Yusheng, Putnam Barber and others for discussion of the Chinese scene. For more on the motivations for self-regulation in the Chinese context, see Shang Yusheng and Zhu Chuanyi, *Zhongguo Minjian Gongyi Zuzhi Zilu yu Lianhe Hulu zhi Lu* (The Road to Self-Discipline and Mutual Supervision in Chinese People's Public Benefit Organizations) (2003).



6. State discretion in the termination, dissolution, or government takeover of non-profit organizations

In China the state has relatively wide discretion under the *Regulations for Registration and Management of Social Organisations* (1998) and a host of other regulatory documents to terminate, dissolve or take over the assets of social organizations. There is, as in India, relatively little accountability to this process. A number of specific violations that can lead to cancellation of registration are stipulated in the 1998 Regulations, but state discretion is expressly broader than those named violations and can lead to fines and criminal sanctions as well as cancellation. There may be, in certain cases, a level of informal protection available to organizations that are strongly linked to government agencies through the “professional” arm of the “dual administration system,” but that protection serves also to emphasize the strong links that such organizations have to the government rather than independence.

7. Conclusion

Our objective here is straightforward: To indicate that Vietnam, like virtually all other countries, has a range of options and choices before it as it seeks to calibrate state-society relations in the important area of regulation of social organizations. The decisions are complex but the regulatory options and tools are relatively straightforward, and they have been well understood in Vietnam as in other countries around Asia for some time.

Vietnam’s calibration of its place on this spectrum between restricting and encouraging social organizations is Vietnam’s decision alone. But Vietnam’s choices may well benefit from a detailed examination of experience (including changing experience and conflict) in other Asian countries. The resolution and calibration of these issues is crucial for future state-society relations in Vietnam, and for just and sustainable economic, political, social, and cultural development in Vietnam in the decades ahead.

The *substantive* choices that are made in this calibration of state-society relations through legal mechanisms are important. But also crucially important are the *procedural* ways in which these choices are made. In every country there is a question as to whether these important choices will be made in ways that give the subjects of regulation (social organizations and the public) a real opportunity to contribute to the formulation of policy and law, or whether participation will be limited and formalistic. Vietnam, like the countries of South Asia and China, will face not only the choices of *which legal policy*, but also choices of *how that policy and its legal manifestations should be formulated*.



PANELLISTS' PERSPECTIVES

Prof. Dr. Sci. Dao Tri Uc

First of all, I would like to express my great honour for the opportunity to read Prof. Sidel's paper and comment on this very concise and interesting article. I personally had the honour to meet Prof. Sidel over ten years ago when he was the Representative of the Ford Foundation and recommended by the Vietnam Ministry of Foreign Affairs to visit our Institute of State and Laws. As a researcher, I highly appreciate Prof. Mark Sidel's interest in Vietnam's laws and political science. His paper showed a constructive observation of the reform and *doi moi* process in various fields of Vietnam.

He has correctly assessed basic efforts of the State of Vietnam in the social democratization process that improved the State-society and State-citizen relations. The Communist Party and the State of Vietnam has no other purpose than providing prosperity and happiness to its people. Economic, political system reform and democratization are not for one's own purpose but to serve people's prosperity. Therefore, I totally agree with the generalized idea of Prof. Sidel that social activities are separate but complementary to the State to enhance state capacity in providing a better life for the Vietnamese people (p.2).

The author was right when considering simultaneously two sides of the State-society relations. The first, is the participation (that he called popular participation) of people in social life. In Vietnam, we have a mechanism named "people know, people discuss, people do, people inspect". The second, are social organizations and groups. The author has rightly emphasized social organizations and groups, regarding them as important bridges linking State and society. The State needs to recognize social organizations as its "informers" to listen to people's expectations, know the interests of different social classes and quickly respond through policies and laws. On this matter, I would like to exchange experience with the foreign colleagues about such important issues as referenda and inspection mechanisms of society.

I especially appreciate and admire Prof. Mark Sidel's knowledge on the legal framework that Vietnam has strived to achieve during the *doi moi* process in order to adjust the two above-mentioned aspects of state-society relations. He has also pointed out the current issues in continuing this adjustment and clearly pointed out the potential challenges in the new context of development.



Based on the comparative research on South Asian countries and China about six key groups of issues in the State-society relations, i.e. "Registration and legal position of social organizations", "Purpose and activities of social organizations", "Financial (tax) regulations towards social organizations", "Resource mobilization and capital formulation"; "Management and accountability", "Intervention, dissolution, termination and take-over of State in managing social organizations", the author raised six main axes through which we can understand the essence and extent of state-society relations in each country.

I believe that appropriately adjusting these six groups of issues can create a legal framework for an extremely complicated relation between the State and society. Facts, events, issues and methods for legal adjustment in South Asian countries and China provided by the author are really helpful for our reference in the policy-making process, law development and their implementation.

I think that the nature of the state-society relations, the extent and methods of legal adjustment on issues emerging from those relations are firstly dependent on the political and economic system in each country. A political system that gives prominence to people's command requires the State to follow social demands, from an administrative governance to administrative service. A free, open, equal and fair economic system requires the use of social interests and demands as measures of growth. In this context, efforts to create a good relation between the State and society should focus on establishing, improving and enhancing the good nature of the political system and foundation of the socio-economic system.

The achievements of nearly twenty years of *doi moi* in Vietnam have also touched upon these two important aspects. Moreover, there has been a great effort in adjusting the legal framework for both of these aspects. Therefore, I can say that a relatively consistent and harmonized legal framework has been established though future development requires a greater effort.

In recent years, the international community, especially the UNDP, has provided help to Vietnam's legal reform process. So now I hope to hear the author's assessment on two issues. Firstly, according to the author, how is the current legal system of Vietnam given the requirements from the reform and integration process? Secondly, how is the current assistance of the international community in legislative activities and judicial reform?

In my opinion, when acknowledging state-society relations, it is necessary to determine what the society needs from the State and vice versa, and how the State needs society in general. I think that the main function of the State towards society is to adjust and manage so that society can follow the correct track of sustainable development and stability. Society has the rights and capability to monitor the State so that the State can correctly carry out its management and service functions. Here I would like to stress the current policies and solutions of creating a legal foundation for the inspection and monitoring by the people, society and social organizations towards the operations of the Party and State



of Vietnam. I hope the research and assessment of these efforts will allow us to see more clearly the essence of the social democratization process.

To conclude, allow me to bring up a question to Prof. Sidel: to what extent can we exchange experience on methods of social inspection, monitoring and critique, not only in Asian countries but also expanding the comparison to America and European countries?

Dr. Neil Jamieson

First of all, I would like to thank UNDP and the Vietnamese Academy of Social Sciences and my Swedish friends for making it possible for me to be here today. I have often been a critic of many dimensions of renovation in the past, so it is a pleasure for me to have this opportunity to publicly acknowledge the very real and important achievements of the renovation process in Vietnam, and especially the progress that has been made in the social sciences.

I would like to emphasize how much things have changed and how much things will continue to change. In particular, I would like to call attention to what a very different place Vietnam is today compared to twenty years ago, or fifty or sixty years ago. When Ho Chi Minh proclaimed the independence of Vietnam in 1945, the population of Hanoi was only several hundred thousand, and all of Vietnam contained little more than twenty million people. There was grave concern about having enough food to eat. Huge numbers of people had just starved to death. Most Vietnamese were illiterate peasants, living in rural villages. Few people could even afford a bicycle. They had no access to information about the larger world.

When the Democratic Republic of Vietnam took over Hanoi fifty years ago, there was a terrible shortage of money, of infrastructure, of expertise. Vietnam seemed to be very poor, very small, very backward, very vulnerable. In these circumstances institutions and habits of thinking and working came into being and to some extent survive to the present day. But things are very, very different now.

Vietnam today is not a small nation. It is about the size of Germany, bigger than France or the United Kingdom or Thailand. It is bigger than north and south Korea combined, and three times the size of Taiwan. There is plenty of food to eat and even to export. The city streets are crowded with motorbikes and automobiles. Tourism is flourishing. Urbanization is progressing rapidly.

Much has changed and is changing. Above all else, the Vietnamese people have changed and continue to change. Almost everyone can read and write. Many people have high school and even college educations. Many Vietnamese have been educated in some of the finest universities in the world and many more are now studying abroad. Newspapers and television, cable networks and the



internet link growing numbers of Vietnamese to the wider world. Some three million Vietnamese living overseas send over three billion dollars back to Vietnam every year, along with information and ideas. Vietnam is a very different place now than it was just several decades ago. Especially, the Vietnamese people are much better educated and much better informed than ever before. Renovation is unevenly but steadily achieving industrialization and modernization in Vietnam.

But modernization is not just about technology, not just about economics. Modernization brings many benefits, but seldom does it bring real stability. Ways of life are changed. As Karl Marx observed, "All that is solid melts into air." People change. Relations between people change. As a result, the state also changes, and relations between people and the state change. Institutions and habits of thought and action must be constantly re-examined as change continues, some planned for and hoped for, some unexpected.

In this changing world, people must find new kinds of identities and create new kinds of communities in which to live together with bonds of mutual affection and mutual obligation (co tinh, co nghĩa). This is never easy, and every culture, every society, must find its own way.

How do we judge renovation in Vietnam today, in this drastically changed and still changing context? If we compare Vietnam today with Vietnam fifty or sixty years ago, or twenty years ago, then the improvement is dramatic. If we compare Vietnam with other nations, we see that Vietnam is still relatively poor and has many problems, but is catching up, slowly, with other nations. But I suggest two other measures more appropriate to evaluate the new Vietnam that is emerging.

First, I think we should compare the actual situation in Vietnam not with other countries but with the potential of the Vietnamese people. In just about every field we can think of, Vietnam has the potential to do better, often much better. Again, I'm not talking only about economics or science or politics. I'm also talking about sports and literature and the arts, about architecture, about education, about protecting the environment, about all kinds of human activity. The goal is to unleash the full potential of the Vietnamese people in every area.

Second, related to the first, we should ask to what extent the Vietnamese people are participating in the construction of a new, stronger, richer, more beautiful Vietnam. Everyone here knows the saying: "No matter how difficult, when the people act it can be done" ("kho van lan, dan lieu cung xong"). Participation of the people is essential to having a successful country.

To obtain the active participation of the people, nothing is more important than building a firm legal structure that enables full participation in a wide range of activities, including social organizations. State-society relations must be even more firmly rooted in the rule of law, and this should include a legal foundation for letting people do things and give voice to their concerns and



aspirations outside of state-dominated frameworks, which still tend to be top-down in their approach..

Over the past twenty years or so all over the world—and especially in some Southeast Asian countries such as the Philippines, Thailand, and Indonesia—non-governmental organizations (NGOs) have played an active and useful role in many areas: speaking for the poor and disadvantaged, providing honest and independent assessments of a variety of social issues and government performance, reducing poverty, and protecting the environment.

In the mid-1980s, about twenty years ago, I attended a meeting in Jakarta at which there were representatives of nearly one hundred and fifty Indonesian NGOs that were in one way or another concerned with the environment. The Indonesia Minister for Population and Environment, Dr. Emil Salim, went to this meeting and spent over an hour in frank and lively discussion with these young Indonesian citizens. If such a meeting were to be organized in Hanoi now, how many organizations would be present? How many will there be to attend such a meeting five years from now? Ten years from now?

To ensure full participation by the people, to truly take the people of Vietnam as the root in the modernization and development of Vietnam, I think there is a need to have much more transparency and specificity and clarity in both the writing of laws and in their implementation. In Vietnam it is often difficult to distinguish between a “freedom” or a “right” or a “privilege.” The Vietnamese constitution and many existing laws give the citizens of Vietnam many freedoms and many rights. However, these legal guarantees of rights and freedoms are almost always followed by a “but.” These “buts” generally attach very vague and general conditions which can be interpreted in a variety of ways. The “but” often impedes achieving the full potential of the Vietnamese people. These vague conditions may often cause people to be reluctant to exercise their rights and freedoms, reluctant to participate, because too much power remains in the hands of anonymous bureaucrats who may interpret the law in an arbitrary and sometimes self-serving manner. To further clarify the rights that people have does not take any power away from the state or from the people; it only restricts the arbitrary exercise of power by individuals within the state apparatus.

One widespread view of the relationship between people and the state in Vietnam is expressed by the saying “Nhat than, nhi the, tam tien, tu che.” The institutional structure comes after relying on family and friends, after relying on powerful contacts, and after relying on using money to buy influence. To the extent to which this is still the way things work in Vietnam, then just to that extent must the further reform of laws and institutions be vigorously pursued. The institutional structure must be placed in the highest position in all relations between the people and the state—nhat che, nhi che, tam che, tu che—creating conditions in which all people can have their voices heard, in which all people can realize their full potential. That is the only way to really take the people as the root, to achieve a strong country and a prosperous people, to enable all the Vietnamese people, each in his or her own way, to work together to build a society that is really equitable, democratic, and civilized.



Dr. Borje Ljunggren

Mr. Chairman, colleagues, dear friends,

Allow me first to say how happy I am to be back in Hanoi and to be back for such an important conference on how to further deepen the Vietnamese reform process. Like many of the international participants, I have had the privilege of interacting with Vietnam for a long time. An important moment for me was back in 1971 when I, as a young regional economist at SIDA, participated in the first discussions in Stockholm with an official Vietnamese delegation on Swedish support for the reconstruction of Vietnam. The war was still going on but the construction of a pulp and paper mill in Bai Bang, Vinh Phu province, was already a central theme on the agenda. During the 1980's I would come to Hanoi many times as head of Asia at SIDA, and in 1991 I participated in the second Swedish-Vietnamese Round Table on reforms. Pham van Khai, Minister of Planning at that time, was among the participants and I recall that general Giap sat through the entire conference. At the time I was a visiting scholar at Harvard (HIID) and my colleagues, knowing my views on America's policies towards Vietnam, found it quite amusing that then Prime Minister Do Muoi thought that I was American and asked me to convey to the American people that Vietnam had no feeling of hatred towards them and wanted good relations with the US. Three years later I became Swedish Ambassador to Vietnam, a job that gave me many opportunities to try to find ways for Sweden to provide support to the Vietnamese reform efforts.

Looking back, it is striking to note how much Vietnam has changed since then and how much Vietnam has achieved since *doi moi* was launched close to twenty years ago. Economic development has been quite remarkable and poverty has been reduced significantly. Socially, the picture is more mixed. In some fields, especially health and education, the government has clearly not lived up to what one could expect of a country with Vietnam's commitment to social justice. It is, it seems to me, high time for Vietnam to become a more "inclusive" society in the core senses of the word. Equity can be pursued in ways that sustain growth. It is clearly wrong to believe that growth only can be achieved at the expense of equity.

Also, Vietnam has, of course, become a much less "mono-organizational society" than it used to be, and a civil society is emerging. Political reforms are, however, hardly keeping pace with the country's socio-economic transformation. A major task waiting to be addressed is how to reform the party-state and move towards a society that is founded on more open institutions. Given Vietnam's history of liberation of its people, that is what its people have reason to expect - especially as the international environment must be considered highly conducive. Especially since 1995, when Vietnam harvested its triple crop - membership in ASEAN, normalization with the US and an agreement with the EU - Vietnam's international relations have developed very



well indeed. Prime Minister Pham van Khai's successful visit to the US and steady progress in the negotiations with the WTO confirm this trend.

Given these developments, it is natural to ask how the reform process could be deepened and, not least, how state-society relations could be enhanced. Vietnam is no doubt in a position to show the world that it has the capacity to take *doi moi* to new stages of development. If you don't do it, it would be because the vision of the party allowed for less. In his keynote speech professor Wade showed how difficult it is to move from the global periphery to being a middle-income country. While that is true, I still strongly believe that Vietnam can become one of the exceptions, a positive deviant adding new experiences to the notion of where farsighted policy choices can take a country.

I will not comment in any detail on professor Sidel's paper. Let me only say that I found it very useful in the way it structured key issues regarding state-society relations. At the same time, it obscured more systemic questions. One could get the impression that the differences that existed between the situations in China and India are just technical while they in fact are substantial and qualitative. India has a much richer civil society than China and state-society relations that, I believe, in the long run are more viable than the ones prevailing in China. Of course, China is changing, and I will now try to give you an idea of how I perceive the current situation in China. I do so since I know that China is of considerable interest to you. Living as you do by the tail of the dragon, many of you know much more about China than I do. Hopefully, my perspective might still add a few things to your picture. "China" is not a subject that is easily exhausted. Let me add, that I won't speak as Dr. Borje Ljunggren but rather as Ambassador Ljunggren.

China has no doubt undergone a remarkable development since the reform and opening up policy was launched in the late 1970s. The other day, I listened to professor Jeffrey Sachs who noted that there is no other example in recorded history of a country that has grown so fast – 9 percent a year on average – for so long – more than a quarter of a century by now. As a result, China has become the world's fifth largest economy and, in fact, already the second largest economy - second only to the US - if you adjust prices in order to get purchasing power parity (PPP). GDP per capita has reached USD 1,200 (USD 5,000 in PPP-terms). Poverty has been reduced dramatically, but roughly 100 million people still live on an income below one USD per day. Income distribution has become highly skewed; the Gini coefficient having reached 0.45 is still on the increase. Very uneven access the health care and education adds to the picture of aggregated inequalities. In reality, a poor peasant has to pay the full costs of curative treatment, often being forced to get deeply indebted, or to abstain from treatment. No fewer than 140 million are so called floating workers, floating from poor regions to Beijing, Shanghai, Guangzhou and other major cities where they work at assembly lines, in garment factories, at construction sites, in restaurants or as maids. They have the right to float but not yet to register in the place where they work.



The SARS-crisis in 2003 led to a new sense of urgency as regards what to do about the grave social injustices that characterize today's China. Growing inequalities were, together with other imbalances such as the critical state of the environment, seen as conditions that could destabilise society. So was wide-spread corruption. To build a "harmonious society" has become the prime catchphrase of the new leadership. Development should be "people centred". Within the party, a major "refresher program" is going on right now and the question of how to build a harmonious society is at the core of this major party building effort.

Public protests against injustices are, in fact, frequent and growing in number. They often involve peasants who, as a last resort protest because they have had to give up their land without receiving proper compensation or the job that they were promised, or laid-off workers who find nowhere to turn. In 2003, 58,000 such incidents occurred according to official sources. The number has probably increased further since then. Recently, an incident occurred outside Beijing in which at least six protesting peasants were beaten to death by thugs hired by the local leaders. At a recent seminar in Beijing, a leading Harvard-based political scientist/sinologist noted that poor people often found that nobody paid any attention to their grievances as long as they acted peacefully. It was only when they turned to violent means that they managed to attract the attention of the authorities, who were then eager to put out the fire. A concept in the political science literature that is deemed to catch the nature of current government policy is "repressive responsiveness". When an incident occurs, the government intervenes to isolate the event and identify possible "ring leaders" at the same time as they try to identify corrupt local party and government officials and to seek ways of doing something to remedy the situation. The poor people involved are often left with a deep sense of powerlessness, unable as they are to organize themselves in more effective ways. A key question is how local leaders can be made accountable. What incentives do they have to act differently?

If a society changes so profoundly as the Chinese society is, the political system can clearly not remain unchanged. Certain reforms are also undertaken at the same time as the party is seeking ways of strengthening its role, determined as it is to maintain the party-state for decades to come while modernizing China and achieving the first stage of what is called Xiaokang, "a moderately well-off society in an all-round way". The legal system is being developed, even though legal security and due process of law remain distant possibilities. The administration is being reformed and professionalized at the same time as the party remains present in every individual unit of the administration. The media is undergoing a quantitative explosion while becoming increasingly commercialized. Social evils like corruption are getting increased attention, but ultimate control of the media remains with the party. The media cannot "break the news" in the way that is necessary if corruption is to be fought in an effective way. There are examples of "investigative journalism" but much too few for the media to be a watchdog. The rapid development of information technology is probably having more far-reaching effects on society. 20 years ago, there were 20 million telephones in all of China. Today, the number exceeds 650



million and more than half of them are increasingly advanced mobile phones. New ways of horizontal communication emerge that may result in networks between scattered groups that seek effective ways of bringing their concerns to the attention of party and government.

A more comprehensive political reform is clearly not in the offing. The Chinese political system is for years to come likely to remain a system without proper checks and balances. Emerging power groups, such as the urban elites, seem content with sharing the fruits of success here and now, leaving a vacuum in society that conveys an impression of an absence of credible social values and moral fabric that can function as a uniting adhesive for the vast social body that is China.

Is a civil society then emerging? Prof. Sidel gives ample evidence that popular organizations are indeed becoming increasingly common. The policy of the government contains clear promoting, as well as controlling, elements. In the absence of for example, functioning rural health care, the government sees a role for NGOs. Examples of NGOs pursuing advocacy also exist, especially in the field of the environment, and professional organizations play an increasingly interesting role. The potential of social organizations as a dynamic factor in society will, however, remain unfulfilled as long as the party remains committed to controlling and fragmenting civil society. A crucial dilemma for the party and the government will be how to maintain this control as society becomes increasingly urbanized, diversified and technology-based. One way that the government is going in order to be more accessible is to become more transparent by establishing web-sites and institutions where grievances can be heard.

Compared to China, Vietnam's ongoing transformation is clearly less dramatic, albeit rapid. Society appears more cohesive, urbanization less rapid, income gaps growing but not as wide, health care and education are no doubt inequitable and possibly almost as skewed as in China. An important difference is, of course that Vietnam has no "1989". I like to think that Vietnam is a more "accommodating society" than that of the Chinese. At the same time, there is no want of similarities. Similarities are obvious not least when it comes to the nature of the one-party-state and the corruption that inevitably exists in such a state. One strength is, of course, that Vietnam holds national elections, even though they are elections that do not offer much of a substantial choice. Legal reforms are, as in China, a crucial element of current efforts to develop the system and progress is made, even despite being constrained by the political system. (In China, like in Vietnam, Sweden does, I am happy to say, pursue long-term cooperation in the field of legal development and human rights.) Like in China, a civil society is emerging in Vietnam, seeking a larger role for itself. A key question for Vietnam, in the same way as for China, is whether political reform shall remain of such a limited nature as has been the case until now. At a conference at Fudan University that I attended a few months ago, a Chinese political scientist spoke about China's current strategy as a "post-socialist survival strategy", a



policy of “muddling through” without any other clearly defined goal than that of maintaining the one-party state while modernizing society and developing a prosperous society and a strong state. Until now, that also appears to be the strategy of the Communist Party of Vietnam (CPV). The alternative would be to develop a more comprehensive approach to political reform and lead a transformation of the political system towards a transparent and institutionally accountable system in which people could feel genuine trust. Ultimately, only a democracy with a vital civil society can provide the basis for state-society relations of that nature.

Given Vietnam’s dramatic modern history, it is natural for Vietnam to attach great importance to stability. Societies with a rich flora of NGOs may on the surface appear disorganized and messy. In fact, they – like my own – are rather among the most stable in the world, offering scope for new ideas and new organizations to emerge – and die – as circumstances change. In Sweden, we have more than 100,000 NGOs, some big and some very small, some national and some local, some in existence since many decades, some quite recent, some broad in purpose, some focused on a single issue. Together, they form the very fabric of our society. Many persons are – as I am - a member of a number of organizations, sometimes working actively for an organization, sometimes just providing financial and moral support.

Let me give you one example of the role these organizations can play. In the 1960s, Sweden began to face environmental problems that were quite serious. A new way of thinking was required in order to meet the challenge effectively and it would, I dare say, not have happened without NGOs – old and new – putting the problem squarely on the agenda through their actions and their commitment. In a constructive dialogue between government, political parties and civil society, a new development paradigm emerged, often threatened but still increasingly rooted in our notion of what a decent society should look like.

The rules surrounding NGOs in Sweden are very simple. We could create one here right now, define its purpose and statutes, elect a board, a chairperson, an accountant, a secretary, someone to audit the accounts, and be in business. I do, of course, not suggest that Vietnam over night should adopt the same set of rules, but I do suggest that Vietnam’s goal should be to create state-society relations in which civil society could thrive. Vietnam would then have a society that would be as vibrant and dynamic as its people.

For a country with Vietnam’s history of fight against colonialism, imperialism and poverty it should be natural to want to create the conditions for human development that, ultimately, only a democracy ruled by law can provide. Vietnam has surprised the world many times in the past, not least in 1954 and 1975. You could do so again, and the CPV could choose to lead such a process. Vietnam’s goal should be to be a prosperous, equitable and democratic society for others to envy. Only then can the country’s potential be fully realized. Nothing less should suffice! If you don’t build such a society you will have chosen not to do so. Politics is a matter of choices!



PANEL II: THE POLITICAL AND ECONOMIC CAUSES OF RISING INEQUALITY

Keynote Presenter: Dr. Scott Fritzen, National University of Singapore

Panellists: Dr. Prof. Do Minh Cuong, Ministry of Labour
Invalids and Social Affairs

Prof. Brian Van Arkadie, co-author of Vietnam:
Transition Tiger

Dr. Mary McDonnell, Executive Director, US Social
Science Research Council

VIETNAM INEQUALITY REPORT 2005: ASSESSMENT AND POLICY CHOICES⁵⁹

Dr. Scott Fritzen

This paper presents the results of a team of researchers including Scott Fritzen (team leader), Caroline Brassard, Bui Thi Minh Tam, Ngo Duc Huy, Nguyen Phuong Nam, Nguyen Minh Tuan, Adam McCarty and Vu Bich Thuy. The paper was written by Scott Fritzen and Caroline Brassard with background papers or written commentaries submitted by all team members (for a complete list of background papers, see Annex A of this report). A research Steering Committee, comprising Le Dang Doanh (Government Advisor), Jonathan Pincus (UNDP), Carrie Turk (World Bank) and Gita Sabharwal (DFID), played an active part guiding the team's work, commenting on outlines and drafts, sharing works in progress and contributing data analysis. Excellent research assistance was provided by Hoang Thanh Huong, Nguyen Quynh Hoa and Zheng Ling. The team's appreciation extends to the Steering Committee and to British DFID for funding this timely and provocative policy study.

The views expressed in this report represent those of the authors and are not necessarily accepted by DFID.

59. Mekong Economics Ltd. Synthesis Paper of the "DFID Drivers of Inequality in Vietnam" Project



Executive Summary

We are not afraid of shortage, only of distributing what we have unequally.

President Ho Chi Minh

This paper explores the tensions and opportunities surrounding Vietnam's attempt to reach the goals of rapid economic growth while also being a Socialist "fair society." It does so by looking at the phenomenon of inequality in the process of economic transition and development. The ultimate goal of this paper is to inform government policy choices – to examine how the actions of the government can have an impact, in a market economy context, on the achievement of equitable, balanced development.

The historical record and the state of inequality in Vietnam

There is inequality in every society, just as there is corruption in every society, and the policy challenge is how to minimize these negative phenomena whilst also maximizing economic development and modernization. The development experience of East Asia in recent decades has shown that this is possible. South Korea, Taiwan and even Indonesia have experienced rapid growth without a significant rise in social and economic inequalities. Yet inequality is high in the Philippines and has risen rapidly in China in recent years. Which way will Vietnam go?

It is difficult to predict trends in inequality. The historical record shows that there is no 'natural' or necessary tendency for aggregate economic inequality to increase rapidly for countries at Vietnam's level of development. Inequality is not strongly correlated across the globe to rates of economic growth or to levels of per capita wealth. There are, for example, rich countries with relative economic equality, and others with high inequality.

The current level of aggregate economic inequality in Vietnam is moderate if one uses international comparisons. Decollectivization in the early phase of *doi moi* had an important positive impact on broadly based growth and equity. Vietnam's most recent Gini coefficient (the most common measure of income inequality) places it 51st out of 123 countries for which Gini coefficients are reported by the World Bank. Inequality is, however, rising, and the speed of the increase is as yet difficult to predict. But current levels and rates of increase of inequality are consistent with those experienced by China in the early 1990s, at the beginning of a period of sustained and pronounced "unequal development" which is seen by many analysts and policymakers to underlie much of China's increasing rural unrest. It is plausible that current trends could vault Vietnam (like China before it) into the group of Asian countries with relatively high inequality over the next 10-15 years.

In Vietnam, the measured increase in inequality during 1993-1998 was due to a widening gap between rural and urban areas. During 1998-2002, however,



inequalities within urban areas and within rural areas explained most of the ongoing increase. This change in the cause of inequality reflects the process of socioeconomic differentiation based on access to human capital – which is still highly unequally distributed at the higher levels of the education system. It also underscores the variability in the quality of local governance, which ongoing decentralization is likely to exacerbate.

Within the overall picture of rising inequalities in Vietnam some problems stand out as particularly alarming. Some groups, particularly ethnic minorities, are being “left behind” as the rest of the country develops – despite the efforts of targeted assistance by the Government. The data shows that the poverty gap measure – a reflection of how far from the poverty line poor minorities remain – has barely moved between 1998 and 2002. This means that poor minorities are on average not getting any closer to the poverty line; they are stuck in a cycle of structural poverty, with the gap between them and both poor and non-poor Kinh continuing to rise.

Another concern is that a significant elite class in urban and some rural areas has emerged in recent years. Most Vietnamese want to be wealthy, and this is certainly not a crime. But if wealth often comes – or even is perceived to often come – from networks of patronage and corruption, then it can lead to social instability. Only proper and transparent implementation of the “rule by law” can solve this problem and make growing rich ‘legitimate’.

Drivers of inequality in Vietnam

Every policy has some impact on inequality. We identify and examine seven of the most prominent “drivers of inequality” in the Vietnamese context.

State-sector bias: Reducing poverty in Vietnam is inextricably linked to policies that promote extensive use of the primary asset owned by the poor – their labour. Yet the significant levels of protection afforded the sector under an import-substitution industrialization policy, coupled with preferential access to state credit, have arguably hurt sectors with the potential for more rapid employment growth.

Urban bias: Despite the existence of targeted, anti-poverty programs, the overall pattern of public expenditure has been biased towards selected urban areas and their immediate hinterlands. Direct income taxes like personal income tax and real-estate taxes – primarily borne by higher income individuals – contribute an abnormally small share to budget revenue (3%), while the combined incidence of various taxes, fees and contributions in rural areas varies widely across provinces and appears to constitute a significant burden for many low-income households.

The secondary education bottleneck: Even as the demand for a more diversified workforce has increased, the supply of university graduates – though growing – is still very limited in Vietnam, particularly in comparative



international perspective. The relatively few graduates are therefore able to establish substantial wage premia, driving up inequalities.

Limited access to safety nets: Formal safety nets cover only a small portion of Vietnam's population, and are poorly targeted. The level of population coverage is rising, but at a very slow pace.

Gender bias: Signs of a remaining gender gap are evident. Representation of women at local government level in Vietnam is low and, by some reports, declining over the transition period. Significant variations in the ratio of female to male earned income for similar work are observed in some sectors. School attendance for females aged 15-17 is decreasing compared to males, primarily due to girls seeking wage employment in greater numbers than boys.

Multiple, reinforcing vulnerabilities of ethnic minorities: Despite the economic successes of Vietnam as a whole, ethnic minority communities show signs of considerable distress. Roughly 75% of ethnic minority people fall below an international poverty line, compared to 31% of the Kinh majority. The gap in living standards has been widening across some 'leading indicators' of future inequality, such as school attendance above the primary school level.

Corruption: Corruption, and the limited effectiveness of current accountability mechanisms, constrain Vietnam's efforts to build a society based on the rule of law. They may also affect citizen perceptions of the legitimacy of Vietnam's current distribution of economic opportunities and outcomes, and by extension may negatively influence sociopolitical stability itself. There is little evidence to suggest that current policy measures are capable of bringing the corruption problem under control.

What can be done?

In the short term it may be difficult to halt or reverse the rise of economic inequality in Vietnam. But international experience shows that rapid growth does not require high inequality: growth and equity can go together. Many countries have been able to sustain high levels of economic growth without seeing the rising inequality that China is experiencing. There are policy interventions that promote equity and are also fully consistent with the further development of a market economy. These include (among others discussed in the report):

- A more rapid downscaling of the SOE sector. Among the most important policy instruments for doing this are the removal of biases (e.g. in the allocation of scarce credit) towards capital-intensive, import-substituting industries, primarily those in the SOE sector.
- Facilitation of private-sector investment and small- and medium-scale enterprises.
- Public finance reforms. Expenditure reforms such as increasing allocations to the rural development sector and enhancing



financing of fiscally weak provinces and districts are essential. On the revenue side, the current tax structure should be reformed so as to tax at predictable, enforceable rates the incomes of the better-off while monitoring closely the burden of taxes, fees and contributions on low-income households.

- Measures to address the ‘crisis of affordability’ of basic services to the poor, particularly in education and in health care. Use of the ‘socialization’ approach should be accompanied in each case by careful investigation of the potential impact on poor households. (Such impacts are often greater than anticipated.)
- Development of an integrated national system of social security. Expansion of social insurance coverage should focus in the short- to medium-term on addressing household vulnerabilities to infirmity and old age. Non-contributory social pensions and the distribution of health insurance cards to poor households are two measures that show promise.
- Development of special models for service delivery in minority areas. Such models need to be articulated for all important sectors. For example, the special challenges of boosting educational attainment of minority girl children should be diagnosed and addressed. Attention to issues of ‘voice’ and political representation in minority communities may also be increasingly important as such communities continue to fall behind the pace of development in the rest of the country.

Some reforms highlighted in the report, such as more rapid state enterprise reform and the further removal of impediments to private sector development can be expected to promote more sustainable and more rapid growth. These, of course, are familiar pro-growth recommendations, but we repeat them in the context of also being pro-equity recommendations. Other reforms, such as strengthening the administrative capacities for decentralization in poor regions, and boosting overall expenditure on (and more equitable access to) education, will need to be balanced against other demands for public resources. Yet others, such as a more externally-oriented approach to Vietnam’s anti-corruption strategy, are propositions that are already being actively debated among Vietnamese academics and policymakers. A gradual move from a reliance on internal oversight systems (the Party policing itself) to external and horizontal systems of transparency and accountability (strengthening an independent judiciary and the involvement of civil society) would strengthen the equality of opportunity and protection that are so important in the current context.

Vietnam has left behind an egalitarian age when it was expedient to pursue, whether in practice or rhetoric, equality of outcomes. Regional development outcomes in Vietnam will never be equalized; household incomes will never be equal; minorities are unlikely in any scenario to achieve income parity with the majority – if only because of the geographical challenges posed by upland



environments. This is well understood by policymakers and, one senses, Vietnam's citizens. But the challenge of progressively improving, step by step, the equality of opportunity for all Vietnamese to better themselves – however vaguely defined this must be at the aggregate level – is of profound social and political significance to the Vietnamese polity. This, we argue, is not only a question of whether, on average, livelihoods continue to improve in Vietnam. It is at least as much an issue of whether the rules of the economic, political and social game are perceived to be fairly applied to all, regardless of who one is or knows. The lived experiences of social inequality will revolve around everyday questions: whether school fees block access to a university place, jobs are available following graduation or corruption and red-tape plague the new entrepreneur.

In that sense, inequality is a much broader concern than just slowing or reversing the rise in aggregate income inequality. It also has sociological and political dimensions. Aggregate measures of inequality do not capture the significance of the issue to Vietnamese citizens. They do not resent wealth as such, but “unfair wealth”. They do not resent government officials as such, but the few officials who abuse their position of public trust. The rural poor do not resent urban growth, but obstacles and policies that stop them moving to urban areas and sharing in the development. The ethnic minorities do not resent the Kinh being richer, but rather the huge problems they face in getting good health, education and improving their lives.

Much remains to be done to promote equity and address the core drivers of inequality in Vietnam at present, and much can be done. Vietnam can achieve rapid development with equality, but in doing so needs to evaluate policies with both objectives in mind.

Introduction

In the context of a country ravaged by war, Ho Chi Minh once said, “we are not afraid of shortage, only of distributing what we have unequally.” Two decades of economic transformation have brought Vietnam far from the days of chronic shortages and shared sacrifice that motivated that eloquent statement. Yet the question of what makes any given distribution of income or life chances just has itself never lost relevance. The vision of a “fair and civilized society” has represented a fundamental commitment of the Vietnamese Communist Party since its endorsement of this program in 1991. And the fundamental question of who gains and who loses – even in relative terms – is still a powerful one in the minds of both policymakers and citizens. Indeed, perceptions of social and economic equity still lay at the core of the legitimacy of this “Socialist Republic”.

But what is the problem of fairness when applied to a period of rapid economic growth and poverty reduction, such as Vietnam has experienced over the past decade? This paper explores the tensions and opportunities surrounding



Vietnam's attempt to reach the goal of being a "fair society." It does so by looking at the phenomenon of inequality in the process of economic transition. The ultimate goal of this paper is to inform government policy choices – to examine how the actions of the government can have an impact, in a market economy context, on the achievement of equitable, balanced development.

The paper has two parts. Part I provides a brief, descriptive overview of unequal development in Vietnam. It places the question of how fast economic and social inequalities are rising in Vietnam against an international backdrop. We find that Vietnam's inequalities are rising moderately, not dramatically; its growth experience has been broadly shared. However, there are signs that the pace of inequality generation is accelerating. A hard core group of poor – especially ethnic minorities – coexists uneasily with a newly arising class of the superrich, and this may threaten socio-political stability, particularly given the perception of endemic corruption frequently described on the pages of Vietnamese newspapers. The question may not be how fast inequalities are growing, but what is the growing economic, social and political significance of these inequalities.

The paper then moves in Part II to some key drivers of these inequalities. Root causes of inequality are those that:

- Determine the economic opportunities that some groups or individuals can take advantage of;
- Make some groups more resilient to shocks and economic fluctuations than others;
- Weight the interests of some groups in national and local decision-making more heavily than those of others.

Some sources of inequality relate to how individuals with different bundles of assets and capabilities, located in areas with vastly different levels of market-serving infrastructure, interact with new economic conditions and opportunities brought by the shift to a market economy. The role of the state in this process is complex. Governments do not control all of these "drivers of inequality". For example, social norms determining gender roles and ethnic relations are only partially amenable to government influence. Some factors lie almost entirely outside of government control in the short run (such as natural resource endowments and international economic fluctuations). But some inequalities are created or reinforced by the effect of public institutions, and are thus potentially amenable to policy reform.

After exploring each driver, Part II considers potential policy and institutional reform choices. A common misunderstanding is that inequality is natural, even necessary in a market economy and that the costs of intervention to reduce inequality would be prohibitively high in terms of economic growth. This section asks the question, are there areas of government policy that if reformed would benefit both growth and equity? The answer is decidedly 'yes'. That does not mean that reforms would be painless. But the primary costs of the

policy choices would be measured in terms of the political will necessary to overcome inertia and vested interests rather than in monetary or 'growth' costs.

Part I. A profile of rising inequality

Inequality is a controversial subject in Vietnam's context. To some observers, it is rising quickly; to others, rather slowly.ⁱ This section reviews available evidence on inequality levels and trends in Vietnam from both an economic and social perspective.

Economic perspectives

The growth and poverty reduction figures from Table 1 tell a familiar story: on both scores Vietnam has placed among the top performers in the world since the advent of the *doi moi* reforms. Growth has ranged above 6% for 9 of the past 11 years, and has had a strong impact on poverty; the Vietnam Living Standard Survey traces a decline in the poverty headcount from 58% in 1993 to 29% in 2002%. Inequality of household expenditure has also increased over this period, but slowly.ⁱⁱ Vietnam's expenditure Gini increased from .34 to .35 in the five years following 1993 – a relatively modest rise, and another .02 from 1998 to 2002, suggesting an accelerating pace of increase.ⁱⁱⁱ

The current level of aggregate economic inequality is moderate in international perspective. Vietnam's Gini placed it 51st out of 123 countries for which Gini coefficients are reported for recent years in a statistical

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- i. For example, the NCHSS study, using data from routine GSO reporting (and income, rather than expenditure-based Gini) paints an alarming picture, while analysts such as Gallop (2002) as well as that contained in the Vietnam Development Reports (e.g. 2000) has seen inequality as increasing only moderately.
 - ii. The purpose of the Vietnam Living Standard Survey (VLSS) is to collect data on living standards in order to evaluate the socio-economic development of the country and to formulate policies to raise living standards. It comprises three types of questionnaires, gathering information on households, communities and prices. The household questionnaire gathers information on income, expenditures, health, education, employment, assets, housing, migration and demographics. It consists of over a thousand questions collected in two rounds, over a two weeks interval, in order to obtain more accurate information on expenditures. The community questionnaire includes over 200 general information questions on demography, the economy, basic infrastructure, education, health and agriculture in each rural commune. Finally, for each rural commune, the price questionnaire includes three price quotes collected for two hundred goods, to provide essential information on the cost of living.
 - iii. The Gini coefficient is the most commonly used measure of income or expenditure inequality in the literature. Applied to income or expenditure distribution across the whole country, the index captures in a single number the state of inequality, ranging from 0 (perfect equality of expenditure) to 1 (perfect inequality, i.e. one household owns everything). It is difficult to obtain reliable measures of economic inequality; the Gini coefficient becomes most valid in the context of a comprehensive, carefully designed living standards survey. For Vietnam we have the Vietnam Living Standards Survey (VLSS) results from 1993, 1998 and 2002.



Table 1. Poverty reduction, growth and inequality in Vietnam 1993-2003

	Poverty Rate	GDP Growth Rate	Gini Index
1993	58.1	81.1	
1994		8.8	
1995		9.5	
1996		9.3	
1997		8.2	
1998	37.4	5.8	0.35
1999		4.8	
2000		6.8	
2001		6.9	
2002	28.9	7.1	0.37
2003		7.3	
2004			

Source: Vietnam Development Report, various editions

compendium. Taking another common measure of economic inequality – the ratio of the top to bottom 10% of earners – Vietnam’s ratio of 8:4 stands out as roughly in the lower range of a pack of regional and international comparison countries, even given the recent increases.

How are we to assess Vietnam’s rate of increase of economic equality against the yardstick of other countries’ development experience? International economic theory puts Vietnam’s rate of increase of economic inequality into perspective. The influential “Kuznet’s inverted-U theory” in early development writing held that over the course of a poor country’s economic ascent, inequality would first rise considerably as a natural outcome of the shifting composition of employment, before eventually, at mid-income levels, beginning to subside.^{iv} Many observers drew the conclusion that there is an equity-growth trade-off, which made high levels of inequality in the early stages of economic development unavoidable. This debate matters because Vietnam remains a very poor country in economic terms; thus, if the earlier theory is accepted, significant rises in measures of Vietnam’s economic inequality could be considered unavoidable and, in the long run, reversible. They would be nothing to lose sleep over, at least from the perspective of economic theory.

Most comparative international studies suggest there is no systematic relationship between growth and inequality, or, to be more precise, between the growth in GDP per capita and aggregate measures of expenditure or income inequality such as the Gini coefficient.^v For some countries, a Kuznets-

iv. Kuznets, 1955

v. Ravallion, 2001. Fields and Jakubsen (1994) demonstrate that, although it seems to hold for a few developed economies there is in fact very little time-series evidence to support Kuznets hypothesis. More recently, Barro (1999) finds that, although the Kuznets curve emerges as a clear empirical regularity in panel data, per capita income does not account for much of the variation in inequality across countries or over time. Thematic paper 1 (see note in Annex 1) includes further discussion on this topic.

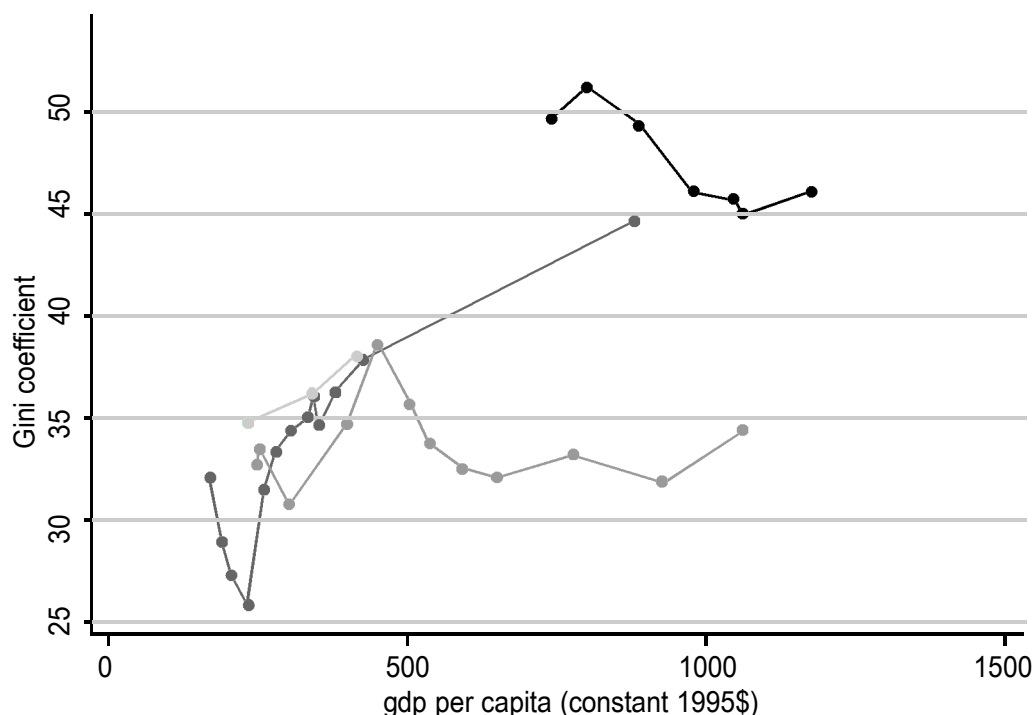


type pattern is observed, but when a large number of countries are analyzed, a country's per capita income does not explain much of the variation in inequality across countries or over time.

Figure 1, below, provides some perspective by examining the manner in which the Gini measure of inequality changed in several countries over the course of their economic development. In a broad sense, the development trajectory of each country shown has to be understood in terms of its own context, against a historical, political and social background. But the figure is suggestive of the lack of correlation between inequality and economic development levels or pathways found in much larger sample. China's rapid rise in inequality since the mid-1980s stands out as somewhat unusual in this sample; other countries shown have seen a narrower range of fluctuation and actual declines in inequality over periods of otherwise significant growth. While the time-series data available are incomplete, for Indonesia at least a period of sustained reduction in the Gini coefficient began at approximately the same level of per capita income as found in Vietnam at present, and which marked the meteoric growth in China's Gini.

Vietnam's relatively low income and moderate inequality both stand out in the few data points shown in Figure 1. But overlaying Vietnam's three points next to China's is at least evocative, suggesting it is on the same general 'unequal development' path that China has experienced, and which is seen by many analysts and policymakers to underlie much of that country's increasing rural

Figure 1. Gini Coefficient and GDP per capita over time, selected countries



Sources: Denniger and Squire's 'high-quality' dataset until 1995 and World Development Indicators



unrest and fears of socio-political instability. The pace and direction of inequality generation in Vietnam, while too early to pin down, could vault the country into the relatively high-inequality group of Southeast Asian comparators.

The countries listed in Figure 1 have clearly followed very different trajectories in their Gini coefficients as they developed, and this underlines the findings of a number of comprehensive surveys of the issue.^{vi} There is no 'natural' or necessary tendency for aggregate economic inequality to increase rapidly for countries at

Vietnam's level of development. It is also important to keep in mind one of Kuznets main contributions that is still relevant (and often forgotten) today: the biggest problem in linking inequality to the level of development is the poor quality of the available data. Despite some recent improvements that are reflected in Figure 1,^{vii} many estimates of aggregate inequality are based on very small, non-systematic samples. In addition, some analysts mistakenly compare Gini estimates based on expenditure and those based on income - a without noting that the latter tend to be systematically higher by construction. No one figure can adequately capture inequality levels or trends in a country, nor their significance for political and social stability and welfare. With that point in mind, we now turn to more disaggregated and contextualized figures.

Measures of human development inequality: human development indicators in Vietnam are generally better than expected given its income level. And Vietnam has continued to make progress on these human development measures through its economic ascent, unlike some other transition countries (primarily in Eastern Europe and the former Soviet Union) which saw reversals in social indicators over the 1990s.

But substantial variations in human development outcomes are also evident. One type of variation is regional. Infant mortality, for instance, varies in provinces from 85 per 1000 infants – as bad as most least developed countries, for instance – to below 20 for several cities and delta provinces, on par with some of the most economically advanced states in Asia. Differential access to social services and infrastructure account for much of this variation. For instance, access to improved sanitation facilities is both an important goal in itself and a key determinant of long-term health outcomes; it too varies dramatically by province, from less than 25% in some mountainous and coastal provinces to over 95% in several cities and delta provinces. This scale of disparity is found across many types of social indicators.

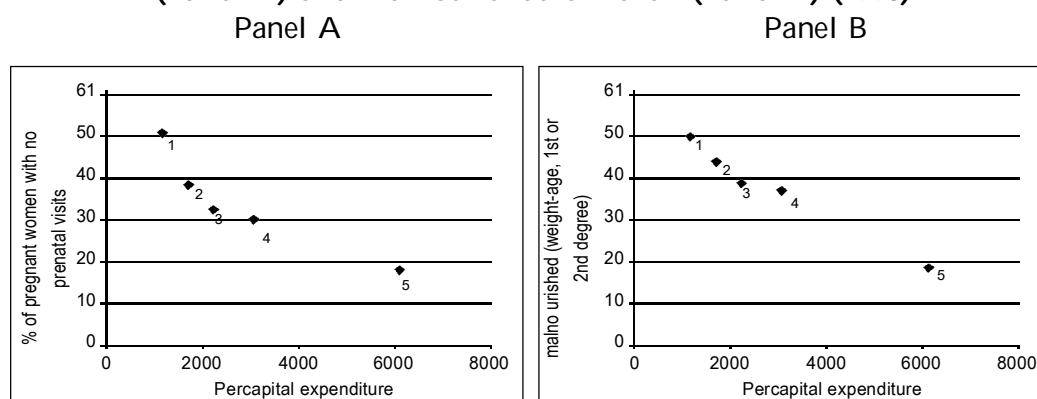
vi. Ravallion, 2001. Fields and Jakubsen (1994) demonstrate that, although it seems to hold for a few developed economies there is in fact very little time-series evidence to support Kuznets hypothesis. More recently, Barro (1999) finds that, although the Kuznets curve emerges as a clear empirical regularity in panel data, per capita income does not account for much of the variation in inequality across countries or over time. See thematic paper 1 for more discussion on this.

vii. For years up to 1995, Figure 1 uses the Denniger and Squire 1996 'high-quality' dataset for China, Indonesia and Malaysia, which includes only survey sources that are nationally representative and systematically sampled. More recent data points are updated from the World Development Indicators.

Another way of disaggregating human development is by household expenditure quintile, highlighting the differential outcomes of economically better-off and poorer households. In Figure 2, the *outcome* of interest is malnutrition in Panel A, while Panel B presents a related *service coverage* indicator, access to prenatal care. Substantial disparities mark both; astonishingly (given the near universal coverage of health centres in the countryside), over half of pregnant women in the poorest expenditure quintile still fail to access prenatal care.^{viii} Causation is complex in these cases, but the figures side by side emphasize that some classes with greater expenditure levels have greater access to critical services that drive differential human development outcomes.

Another source of variation is by ethnicity. It has sometimes been stated that all regions and ethnic groups are gaining from *doi moi*, simply at different rates. Minorities have clearly benefited from improved coverage of social infrastructure, particularly where coverage is measured by physical accessibility. For example, virtually all communes now have at least one primary school and a public health clinic, and coverage of the electricity network in minority-dominated households has also improved, from 7% in 1993 to 43% in 2004. Yet especially in terms of the *utilization* of services, minority coverage gaps continue to loom very large. Although minority students have gained better access to education at all non-tertiary levels over the past 15 years, the absolute gap in educational attainment between them and Kinh students has remained constant at lower secondary education and grown at the upper secondary level.^{ix} And as noted below, the pace of their poverty decline seems to have largely frozen between 1998 and 2002; the poverty gap measure, for instance – a reflection of how far from the poverty line poor minorities remain – has barely moved in this period (Figure 4 below). The question of ethnic minorities is one to which we return to several times in this report.

Figure 2. Expenditure quintile as predictor of the access to prenatal care (Panel A) and malnourished children (Panel B) (1998)



Source: VLSS, 1998

viii. Income is not necessarily the main cause of disparities in nutritional indicators. Factors correlated with income that are highly influential in this case (such as the situation of minorities in remote areas and the education of mothers) are in turn highly correlated with income.

ix. Calculated from net enrollment rates table in Vietnam Development Report 2003, p. 63.

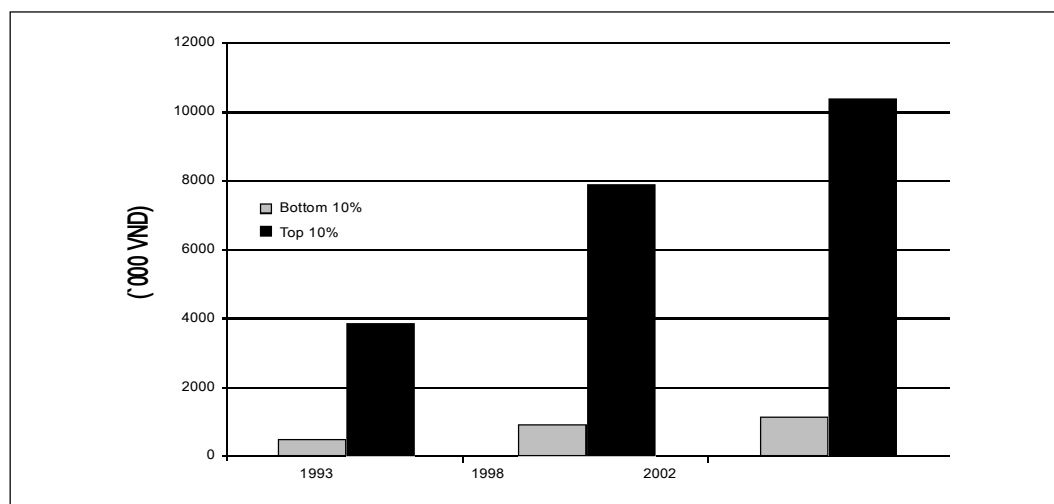


Social and political perspectives:

Figure 3 shows the improvements in economic conditions – quite modest in absolute terms for the poorest 10% of households,^x and dramatic for the richest. Consider now the social tensions suggested by such the polarization depicted, as the consumption patterns and preferences of that richest group diverge from a segment of the population that, despite gains, is being left way behind on the road to prosperity.

There are several ways to explore the political and social *significance* of Vietnam's rising inequalities. The pursuit of social fairness has always played an important role in political rhetoric and policies, but emphasis and interpretation have changed over time. The pre-*doi moi* focus was on *egalitarianism*, or fairness understood as 'equality of outcomes'. This focus fit well with the need to cement social solidarity during decades of shared sacrifice. It was reflected in various land reform programs and the promotion of peasants within the Party apparatus.^{xi} The transition to a market economy has brought some conceptual tensions to the fore. Greater economic differentiation is to be tolerated so long as it is part of an overall process of economic development benefiting the majority of the population. Equality in this sense may have more to do with *equality of opportunity* for everyone to participate in the market economy and to raise their standard of living. Yet two conditions are essential to this vision: that initial conditions not be so grossly unequal so as to preclude class mobility and that the 'rules of the economic game' be applied fairly to all. We examine the evidence on each score briefly below.

Figure 3. Per capita expenditure of top and bottom 10% of households, 1993-2002



Source: VLSS

x. Note this is not a panel dataset, but a snapshot of the richest and poorest 10% of households for the three periods sampled.

xi. Taylor, 2004. See also Ngo Huy Duc's commentary (listed in Annex 1).



Economic mobility. The degree to which households or individuals can rise up the economic ladder – including in relative, not just absolute, terms – is an important indicator of how “structural” poverty is in a country. It is also an important determinant of how *accepting* the population will be of any given level of inequality.

Two pieces of information on economic mobility in Vietnam are both rather troubling. The first is the *poverty gap* measure for minorities, which gives a sense of how far from the poverty line those households in poverty remain.^{xii} As Figure 4 suggests, this indicator has stayed persistently high for ethnic minorities, even as it has dropped for other households. One interpretation is that poverty for minorities is more structural and persistent than that for other groups, and that the relationship between growth and poverty reduction may operate differently for minorities than for other groups (a point explored further below).

A more general indicator would be to examine household mobility from one expenditure quintile to another over the three VLSS rounds. Early analysis based on the VLSS 1993 and 1998 rounds suggested that mobility up and down the economic ladder was considerable, with some 40% of households moving upwards one or two quintiles, and 19% moving downwards; only half of the population that was in the poorest quintile in 1993 remained there by 1998. More recent analysis has cast methodological doubt on these estimates:

Almost one half, and perhaps even more, of economic mobility is an artefact of measurement error and is thus illusory. This implies that Vietnam’s worries about increasing inequality cannot be dismissed by pointing to high economic mobility, because such mobility is much lower than simple calculations suggest.^{xiii}

Fair rules of the game. A significant elite class in urban and some rural areas has emerged in recent years. Analysis of the top 1% of households sampled in each of the VLSS suggests the geographic distribution of the new elite. Over half is concentrated in Ho Chi Minh City, up from one-third in 1993; this marks its emergence as the economic engine absorbing a significant share of Vietnam’s GDP growth.^{xiv} Fully 96% is urban. Other signs of the new elite are frequently observed but as yet untabulated,^{xv} for example:

Some ten thousands of Vietnamese studying abroad on the basis of self-financing, starting from primary school to post graduate education;

xii. The poverty gap expresses the average difference between the expenditure of the poor and the poverty line as a percentage of the poverty line.

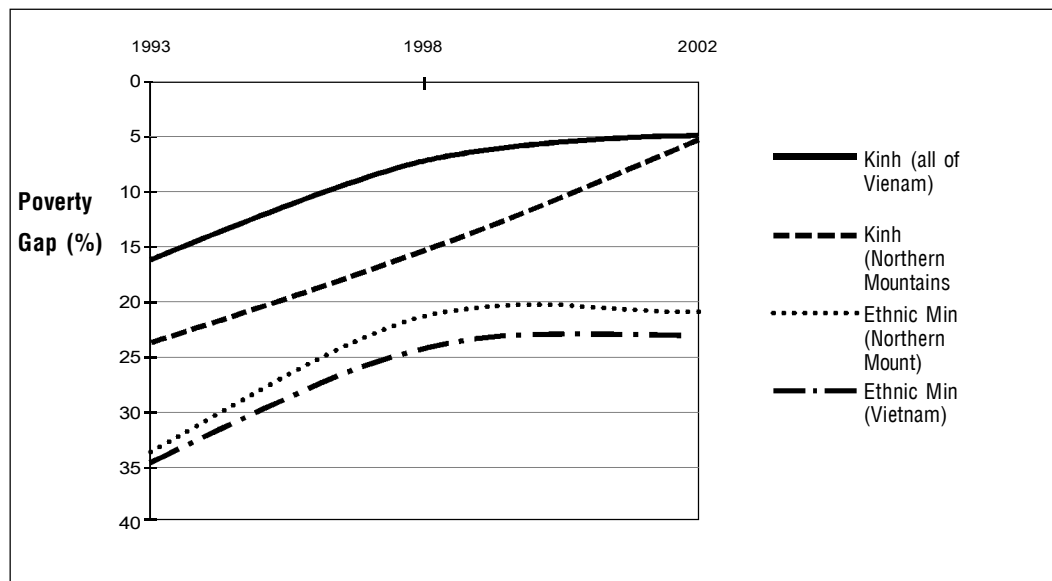
xiii. Glewwe and Nguyen, 2002

xiv. In 2004, it was estimated by the Department of Planning and Investment that Hochiminh City’s GDP accounted for just under 20% of total GDP in Vietnam (DPI, 2004). If the city’s immediate environs were included in the figure, it would undoubtedly be several percentage points higher still.

xv. Le Dang Doanh, personal communication. See Annex 2 for suggested research program on the ‘voices of the rich’



Figure 4. Poverty gap for ethnic Kinh and minorities, 1993-2002



Source: reproduced from Swinkels and Turk, 2004 based on VLSS

The number of Vietnamese tourists going abroad, likely to have increased exponentially in recent years, as has the sale of private cars to Vietnamese, including luxury models.

Some of what is interesting about the elite concerns the ways in which they exercise political and social influence, and their overlap and interactions with officialdom. The pattern of this influence goes directly to an important political economy issue: how do urban-based elites with disproportionate access to decision-makers shape policies and, to the extent that corruption is endemic in a given political system, distort governance mechanisms in ways that may contribute to unbalanced and inequitable development? To the extent that corruption is endemic in any polity, it is likely to benefit such urban elites, and in this way to undermine overall confidence of non-elites in the legitimacy of social, economic and political institutions.

We know relatively little about these issues in the Vietnamese context. For example, it is only this year that the country's first systematic study of corruption, which was carried out with technical assistance by SIDA, is to be published. And we can learn relatively little about the elites from survey sources. Both income and expenditure are almost certainly systematically underreported for rich households in the VLSS. The rich have highly diversified asset holdings and sources of income as well as a tangible motivation, given a tax regime that can be unpredictable, to hide their assets from view. It seems plausible from anecdotal evidence – such as the level of press attention devoted to the issue – that the *perception* of many citizens is that the level of corruption in Vietnam is high and possibly rising throughout



the transition period; this appears to be true for many external analysts and foreign investors as well.^{xvi}

Inequality is a dynamic phenomenon in the Vietnamese context. While for some areas (such as the extent to which corruption is a differentiating factor) we lack data, some points are clear after almost two decades of reform and one decade of detailed socioeconomic studies. Poverty continues to decline from high initial levels. Social service delivery systems have not broken down during Vietnam's economic transformation, and indeed human development outcomes have generally improved. However, as this review has shown, the gains have been unevenly shared across regions and socioeconomic groups; in particular, the gap for minorities has widened even as an economic elite, as yet poorly understood, continues to rise. The next section examines some of the forces shaping these outcomes.

Part II. Drivers of inequality and policy choices

A large number of factors could be seen as related to inequality: almost all interventions and market factors have differential impacts on social groups. The challenge is to focus on those most likely to be fundamental in a given socioeconomic setting. Here, seven such factors are considered in the Vietnamese context. They were selected based on two factors: the leverage they exert throughout the chain of causes and effects in the system of inequality, and/or their potentially *growing* importance, including for socio-political stability. There are both positive and negative developments to report in each of the six areas, and there are also limitations of existing data and interpretation that must be addressed.

Following an overview of each 'driver', we turn to policy choices. Our intention is to focus attention onto broad areas of public sector reform likely to have the greatest impact on mitigating disparities. All of these areas are being publicly deliberated to some extent. One cross-cutting theme heard against the backdrop of these discussions concerns the appropriate role of the state in addressing inequalities that to a substantial degree are generated by market processes. The danger, well understood by Vietnamese policymakers, is that an overly interventionist strategy to promote equity will have the unintended side effect of blunting incentives to grow. This could happen if the equity strategy is heavily redistribution-oriented (since excessively taxing the rich or the most productive sectors of the economy would reduce incentives to invest) or if public investments lack a strategic

xvi. The Corruption Perceptions Index measure should not be confused with the actual incidence of corruption in the economy, which is difficult to measure directly, as measured by Transparency International's Corruption Perceptions Index; Vietnam's corruption perception index score deteriorated slightly from 1997 (the first year of its inclusion) to 2004, and was second lowest score among South and East Asian countries (Indonesia's score was lower). Source: www.transparency.org/



focus on building up the long term competitiveness and productive capacities of the economy.

One response to this conundrum is to emphasize policies and reform approaches that do not blunt incentives to grow, but in contrast contribute to equitable development. This is what we seek to highlight below: policies both likely to substantially contribute to improved equality over the coming decade and that are consistent with Vietnam's strategy of rapid economic expansion as the driver of its modernization and poverty reduction. In what follows, an assessment of each driver is followed by an overview of reform approaches that are likely to be both growth- and equity-enhancing.

Driver # 1: State-sector bias

Assessment. A structural change in the economy away from agriculture is occurring in Vietnam, as in virtually all agriculture-dominant economies that experience prolonged economic growth. The agricultural sector share in GDP continues its inevitable decline; its share of overall employment has declined from 73 % in 1990 to 67 % in 2001, while the proportion of own farm employment has decreased from 64 to 47 % in the five years between 1998 and 2002 alone.

There is an important implication for inequality in the picture above: since incomes in the non-agricultural sector are in general more unequally distributed, income inequality will continue to rise assuming within-sector inequality does not change. *How much* this inequality will rise as a result of the agricultural transformation will depend heavily on two factors: the rapidity of employment generation in the rural non-farm and industrial sectors, and on what happens to those remaining in agriculture and the rural sector generally.

Growth has clearly generated significant increases in employment in industry, construction and services, and wage employment has driven incomes higher for a substantial segment of the population. But there is some controversy among researchers as to whether one could reasonably expect the growth to be generating significantly *more* off-farm employment than has been the case to date. Several analysts are suggesting the rate of employment generation has slowed in recent years.^{xvii} What is the evidence?

Labour-intensive enterprises have declined as a proportion of all industry from 58 to 51 %, and account for only one-third of exports (in contrast to China, for instance, where it accounts for half of all exports). The overall growth in industrial-sector employment has been modest, growing at an average rate of 4% between 1993 and 1997 and 8% from 1997-2003; both figures are low compared to industrial GDP growth. Labour-intensive

xvii. Le Xuan Ba et al. 2001, Belser, 2000



industry only accounts for a third of exports, as opposed to China where it accounts for half of all exports.^{xviii}

Two factors help explain the pattern observed. The first is the continued slowness in pushing through State-Owned Enterprise (SOE) reform. These enterprises are concentrated in capital-intensive industries which have seen significant expansion with relatively little employment generation. These enterprises have certainly been exposed to increased competitive pressures. Yet the significant levels of protection afforded the sector under an import-substitution industrialization policy, coupled with preferential access to state credit, have arguably hurt sectors with the potential for more rapid employment growth.

Second, the environment for the private sector – while without doubt improved since the early transition period – has yet to become fully enabling. The small but growing private sector suffers from variations in the quality of provincial regulatory environments, which results in a high level of “informality”, meaning essentially that the sector is not effectively regulated or supported by state interventions. The scale of this informality may be astonishing: it is estimated that for every dollar of official GDP, up to half a dollar goes unrecorded.^{xix} High levels of informality are detrimental to Vietnam's development objectives. Informality is caused by excessive regulation and binding rules and weak implementation capacities. It thrives because businesses in different ownership types and sizes are treated unequally. Smaller and private enterprises have more difficulty than public and larger enterprises gaining access bank financing, land and information in general.

The constraint on private sector development is probably the more serious of the two. Vietnam began its reforms more than 10 years after China, which still suffers from a similar or worse SOE problem and from contract and property rights shortcomings. The case of Taiwan also suggests that the private sector can ‘grow around’ an inefficient, capital-intensive SOE sector when the overall enabling environment is sound.

Reform approaches. Reducing poverty in Vietnam is inextricably linked to policies that promote extensive use of the primary asset owned by the poor – their labour. It is estimated that the Vietnamese economy must absorb well-over one-million new labour entrants per year,^{xx} while returns to labour must increase over time for incomes to be rising and poverty falling. In Vietnam and many other countries, the primary engines of employment generation are labour-intensive industrialization and – explored in the next section – the promotion of higher incomes through higher productivity in the smallholder agricultural sector.

There are a number of strategies that can help accomplish greater labour-intensive industrialization. The first is a more rapid downscaling of the SOE

xviii. Figures are taken from World Bank, 1998; Le Xuan Ba et al, 2001; and Belser, 2000.

xix. Tenev, Carlier, Chaudry and Nguyen, 2003:xiii

xx. Webster, 1999



sector. Among the most important policy instruments for doing this are the removal of biases (e.g. in the allocation of scarce credit) towards capital-intensive, import-substituting industries, primarily those in the SOE sector. The second important area is the facilitation of private-sector investment and small- and medium-scale enterprises. Performance in these areas is mixed and the subject of much controversy. Vietnam has made some progress in establishing a legal framework for the private sector, which is now acknowledged in its new (2001) constitution to play a pivotal role in development. Beyond such policy statements on the role of the private sector, however, some analysts find deep contradictions in the overall policy and regulatory environment towards private enterprise, and in the application of existing laws. Reform of State-Owned Enterprises, and related banking sector reforms, are perceived by many analysts to be generally sluggish, though the pace appears to have stepped up in the past three years. By 2003, 1766 SOEs had been restructured, accounting for around one-third of total SOEs.^{xxi} Among them, 905 SOEs had been equitized. Given Vietnam's endowment in natural and human resources, Belser (2000) argues that there is potential to triple manufacturing exports and to create around 1.6 million manufacturing jobs in the near future.

These are reform agendas with high feasibility, because they touch on incentives that are quite strong for growth. But they will have their critics as well, including those who will say that we must hold back for reasons of equality itself. They are wrong. Levelling the playing field for the private sector while encouraging greater economic integration are essential to accelerate income growth for the bulk of the population moving out of agriculture – and hence to reduce the polarization separating them from the rapidly rising incomes of their peers.

Driver # 2: Urban bias

Urban bias is a common phenomenon in developing countries. In the context of this paper, it refers to institutional arrangements that, broadly speaking, disadvantage the rural and agricultural sector. Evidence is strong that urban bias is a serious problem in Vietnam, despite a formal government commitment to rural development since Eight Party Congress in 1996.

Assessment. Agricultural decollectivization created strong incentives for 10 million farming households to make long-term investment and expand agricultural production, and the productive response was astonishing. The agricultural sector has performed impressively over the past ten years, with an average growth rate of 4%. For this reason, the sector has been one of the key engines behind the country's economic development and poverty reduction. A decomposition of changes in overall poverty revealed that between 55 to 60 % of the reduction in poverty between 1992 and 1998 was due to higher agricultural incomes.^{xxii} This is important especially because

xxi. CIEM-FES, 2004

xxii. Bales and Phung, 2001



income generated in the agricultural sector has an equalizing effect – it tends to mitigate disparities, an effect seen strongly in the case of China.^{xxiii}

Yet several analysts point to an unfinished agenda of agricultural and rural development reform, as seen in several areas:

Terms of trade. The terms of trade for agriculture may be worsening; from 1997-2004 levels of protection of the agricultural sector have been reduced relative to those for industry.^{xxiv} The question is whether the sector could do substantially better with less import-substituting protection to the industrial sector.

Public finance. The pattern of public expenditure has been biased towards selected regions and urban areas, while revenue collection has significant regressive (anti-poor) characteristics.

Overall interprovincial transfers are equality-enhancing throughout Vietnam when measured at the provincial level, but the intra-provincial distribution to districts and communes is often not based on poverty criteria. In addition, larger-scale infrastructure funded through the government's master Public Investment Program (PIP) is skewed even in per capita terms towards more densely populated lowland and urban areas. Figure 5 demonstrates this by placing maps depicting provincial poverty rates side by side with Public Investment Program expenditure per capita. There are some countervailing tendencies in public expenditure. Expenditure on a range of targeted anti-poverty programs has generally focused on rural areas and within them, on relatively poor regions. Yet these investments are generally considered to be too small to make a significant impact on the overall regional pattern of development. The "growth pole" strategy that focuses scarce investments specifically onto three sub-regions (centred on the urban anchors of Hanoi, Danang and Hochiminh City) adds to the regionally unbalanced nature of growth.

On the revenue side, there is evidence that burden of income tax and fees may be disproportionately borne by the rural population. Direct income taxes like personal income tax, and real-estate tax contribute an abnormally small share to budget revenue. Personal income tax contributes only 3% to total tax collections. Yet the combined incidence of various taxes, fees, and contributions (TFC) of rural populations varies widely across provinces and may be regressive; for example, the highest TFC incidence is in Thanh Hoa (9.2 percent) and the lowest in two of the richest provinces in the country, Hochiminh City and Tay Ninh (1.8 percent).^{xxv} Another study^{xxvi} estimated taxes in one village

xxiii. Khan and Riskin, 2001

xxiv. Minot et al., 2003

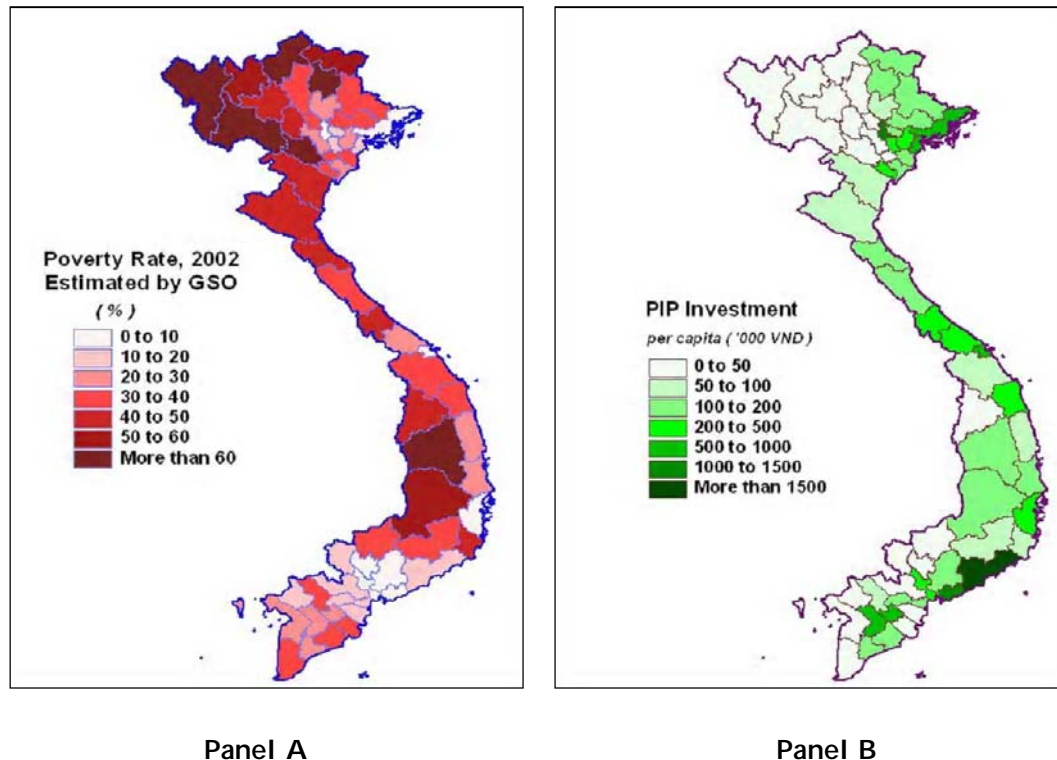
xxv. World Bank, 1999

xxvi. A participatory poverty assessment undertaken by Action Aid in Ha Tinh province in 1999 indicated that taxes and fees accounted for an average of 28% of the income of a "rich" family, 35% of income for a "middle" family, and 39% of income for a "poor" family. These figures are not as quantitatively grounded as those in the VLSS, which place the average figure for North Central region households at 5.4% of expenditures for all taxes and fees. →



of Ha Tinh province to amount to fully one-third of household income, with no effective exemption mechanism for poor households.

Figure 5: Provincial poverty rate (Panel A) and Public Investment Program expenditure per capita by province (1996-2000) (Panel B)



Sources: reproduced from Swinkels and Turk, 2004 based on GSO data

Institutions mediating access to land. Within the agricultural sector, one important controversy concerns the impact of land distribution on inequality. The connection between land and inequality is a mixed one. Clearly, the quality of forest and land endowments varies for Vietnam's regions. Yet at the advent of the *doi moi* reforms, it was the relative equality of the distribution of land holdings – the results of the country's long experience with agricultural collectivization, except in the Mekong delta – that enabled so many rural households to broadly participate in the process of economic growth.^{xxvii} Households made immediate productive use of the assets that were devolved to them in the process of decollectivization. This follows a pattern observed for other countries as well – where the distribution of rural

→ However, the huge gap between these estimates emphasizes the need for better research on this topic. The results suggest that households in many poor localities may not be able to finance more local services from contributions, as the 'socialization' strategy may imply.

xxvii. Something about agricultural collectivization

land holdings was initially relatively equal, the benefits of growth could accrue broadly throughout society.

Without this initial equity in land holdings, inequality would have been much greater. One analyst^{xxviii} finds that land and fixed farm assets are a relatively minor cause of increasing inequalities at present, which is to say that the rather equitable initial distribution has generally helped mitigate disparities. In fact, land plays an important part as a safety net for many households perched just above or under the poverty line.

This positive situation is changing for some regions, notably the Mekong Delta and Central Highlands. Nearly a third of the poorest 20% of rural households in the Mekong Delta have no access to land whatsoever, and the overall landlessness picture has doubled from 21% to 43% from 1993 to 2002. In the Central Highlands, the figures of the landless are much smaller, but the issue is perhaps more potentially explosive, since unequal land distribution is being driven by migration and a cash crop bonanza from which minorities have benefited little if at all.

Institutions mediating access to productive services. Another fundamental constraint has been the slow development of rural institutions that can lower the costs of accessing productive services. This is particularly important for the poor. Without equitable, strong rural institutions, the poor are effectively 'priced out' of the market for services such as extension, marketing and crop insurance; or they are disadvantaged in their access to infrastructure that is collectively produced, but to which access is typically distributed unequally, such as irrigation systems. In the pre-*doi moi* period this role was played by cooperatives, but despite their resurrection as voluntary, "new style cooperatives" in the mid-1990s, the share of cooperatives in economic production has dropped to less than one % of GDP.^{xxix}

Other institutions have arisen on the rural scene over this period, but their effectiveness has been mixed. Rural credit institutions are one example. The Vietnam Bank for Social Policies (VBSP) is the latest incarnation of state-supported institutions to bridge the credit gap separating credit-worthy low income households from sources of credit to fund productive investments. While this objective is appropriate, the financial services offered by the VBSP are so heavily subsidized as to call into question the sustainability of the approach.^{xxx} Moreover, while 2.75 million households across the country received VBSP loans, data from the VLSS 2002 indicates that only some 5% of poor households successfully accessed subsidized credit.^{xxxi}

xxviii. Heltberg, 2002

xxix. Van Arkadie and Mallon, 2003

xxx. Izumida, 2003

xxxi. Sepehri, 2005



Differential impacts of migration. One area linking the rural development picture with that of the rapidly changing requirements for labour is migration. Some analysts have long argued that the migration process should be viewed as a positive contribution to the development of the market economy rather than a pressing problem, and Chinese policy is now formally encouraging it. Migration permits the poor to travel to where they can earn greater returns on their limited human capital, serving an important mechanism that allows for a more balanced regional development. Yet rapid urbanization creates stresses, and policy-makers have put into place mechanisms that often restrict, *ad hoc*, the ability of the poor to move, or their ability to integrate into local labour markets once they have moved. Such policies – such as a household registration system in urban areas that serves to drive many migrant households into the same ‘informality’ as was described for private sector firms – unwittingly serve to bolster urban bias.

Much about the situation of migration is unknown in Vietnam. Several indications suggest it may be working at present to heighten, not reduce, disparities, especially within urban areas. *De facto* restrictions on migration have contributed to considerable wage premia in Hanoi and Hochiminh city; ^{xxxii} they may also contribute to the finding that migrant workers tend to earn only 88% of what non-migrant workers earn in both the domestic private and foreign invested sectors. Some analysts claim that poorer provinces have yet to capitalize on migration to centres of export-oriented manufacturing in the growth pole regions, due to the absence of backward linkages to the hinterland economies^{xxxiii} and due to the disparity-increasing impact of worker remittances, which have been larger for urban than for rural households, and greater both in absolute and relative terms for higher as compared with lower expenditure quintile households.

Reform approaches. Reducing urban bias is best seen as a theme in itself with a number of different elements.

Institutional reform in the rural sector. Uniting most of the recommendations above – particularly those relating to access to productive services – is the need to strengthen broadly-based, participatory and democratic rural institutions, both State- and non-State-based. Without strong rural institutions, households will not gain broad, equitable access to productive and social services. Most countries which have been successful in rural development – e.g. to differing extents Taiwan, Korea, Malaysia and Sri Lanka – did so partly on the basis of participatory rural institutions which mediated relatively equitable access to productive and social services. And ultimately, opening to civil society and boosting people’s participation is likely to be the most effective way to enhance the capabilities of the State to effect poverty reduction and other social goals.

xxxii. Gallop, 2002

xxxiii. Nguyen, 2002

Emphasis should be placed on the development of more sustainable approaches to credit delivery, including building on the myriad informal revolving schemes operated informally by women, and on further boosting investment in agricultural research and development, particularly on sustainable upland farming systems. In addition, development of a targeted strategy for addressing the trend among poor farmers towards landlessness trend in the Mekong Delta.

Rethinking regional policy. The 'economic focal point' model currently being pursued has both advantages and disadvantages. The hope is that strong linkages between growth zones and surrounding rural areas will materialize, but it is not apparent that this is the case. To the extent that these focal point regions absorb significantly greater shares of scarce public investment than their share in national population, the strategy may run counter to the government's rural development objectives. Policy would be better focused on trying to create overall enabling conditions rather than picking or creating "winning" regions and economic sectors.

Public finance reforms. A number of reforms to both the expenditure and revenue sides deserve consideration:

- c) Increase allocations through the Public Investment Program to rural development and sector.
- d) Reform interprovincial finances, towards enhanced financing of fiscally weak provinces. Boosting fiscal capacity in poor provinces will likely necessitate increases in interprovincial fiscal redistribution, but such increases should be consistent with aggregate fiscal discipline and should avoid distortionary effects on local fiscal effort.
- e) Spread investments more equitably *intra-provincially*, taking into consideration the rural-urban distribution of expenditure. Large investments made in provincial town infrastructure can at times be out of proportion with provincial population structures, let alone the distribution of poverty. A concerted focus is necessary on *rural* areas within provinces, and particularly on relatively more remote districts and communes within these.
- f) Undertake more complete analysis of the social impact of alternative public investments, in particular the impact on direct and indirect employment generation, prior to making any large public investments. The decision-making with regard to large public investments should require analysis of alternative options and be open to public scrutiny and potential criticism.^{xxxiv}

xxxiv. This is especially important with regard to industrial zones - many of which have remained largely empty of investments and have had limited generation of employment, with the exception of the Hochiminh City area. But the need for social impact assessment and improved public consultation applies equally to other major infrastructure investments, such as road placement decisions, irrigation projects, reservoirs, ports etc.



- g) Reform current tax structure. Two steps are particularly urgent. First, better mechanisms are needed to tax personal income, which necessitates more accurate data collection on the various sources of income, especially for the top income quintile. The second is the reduction of rural taxes, fees and labour contributions faced by rural households.

Driver # 3: The secondary level education bottleneck

Assessment. Education mediates access to wage employment in a market-driven and increasingly diversified economy; and regular access to wage employment is an important factor driving the income differentials found between the industrial, service and agricultural sectors. Some analysts^{xxxv} find the return to university education in particular to be among the foremost predictors of socioeconomic mobility and status through Vietnam's transition period.

Even as the demand for a more diversified workforce has increased, the supply of university graduates – though growing – is still very limited in Vietnam, particularly in comparative international perspective; the relatively few graduates are therefore able to establish substantial wage premia, driving up inequalities.

Table 2 shows one important reason behind this supply-demand imbalance. While coverage of upper secondary education is growing fast it is still low overall and restricted to a significant degree to better-off households in urban areas. Indeed, the absolute differential in this regard with better-off students has risen since 1993, as opportunities have expanded far faster for the better off. The poor are almost entirely locked out of higher education; not due to overt discrimination, but to the combination of the lack of pro-poor spending on scholarships as well as the pool of eligible students from poor backgrounds – those making it to the upper secondary level. Clearly, this “secondary level bottleneck” in the educational system is constraining access by the poor to the upper levels of the educational system, thereby accelerating inequalities.

The primary reasons for this relate to the impact of public expenditure patterns, in ways that have resonance with several other social services. Education was historically provided by the state. Economic reforms and the limited state budget opened up opportunities for education socialization. The provision of education services by non-state sector was liberalized in 1989. The 4th Plenum of the Communist Party of Vietnam (CPV) in 1992 came up with several important decisions for the development of education and training in Vietnam, including plans strengthening public education, encouraging people's schools at all education levels and legalizing private schools at pre-school level and vocational training. The development of non-state education establishments has reduced the burden for state budgets in both terms of

xxxv. Heltberg, 2002

service provision and financing as they helped to increase the number of pupils/students without requesting transfers or less transfer from the government as all recurrent or operational costs of non-state schools are covered by tuition fees from pupils and students. The higher up in the educational chain, the greater the percentage of school fees collected. As result, the public sector accounts for only slightly more than 50% of total expenditure on education.

Table 2: Net Enrolment Rates 1993-2002

	Primary			Lower Secondary			Upper Secondary		
	1993	1998	2002	1993	1998	2002	1993	1998	2002
Vietnam	87	91	90	30	62	72	8	29	42
Poorest	72	82	85	12	34	54	1	5	17
Near Poorest	87	93	90	17	53	71	2	13	34
Middle	91	95	92	29	66	78	3	21	43
Near Richest	94	96	94	38	72	79	8	36	53
Richest	96	96	95	55	91	86	21	64	67
Kinh and Chinese	91	93	92	34	66	76	8	32	45
Ethnic Minorities	64	82	80	7	37	49	2	8	19
Urban	97	96	94	49	80	81	17	55	59
Rural	85	91	89	26	58	70	5	23	38

Source: World Bank (2003:62)

The policy of “socialization” (*xa hoi hoa*) has implied drawing on private and social sources of funding for education as in other public services. In these terms, one cannot argue against the notion of ‘socialization’ itself, but there is a major potential problem with the application of user fees in the social sectors. The organizational capacities and/or local political will necessary to exempt the poorest from these payments are still inadequate to ensure access to essential public services by the poor. Limited access of the poor beyond primary school is thus both a cause and consequence of a public expenditure skewed towards the better-off. Table 3 demonstrates how out-of-pocket expenditure on schooling for the very poor consumes a higher share of discretionary income than it does for the better off.^{xxxvi}

xxxvi. This problem is similar when looking at the effect of user fee introduction in the health services; the poor are much less likely to seek medical treatment when ill compared to the better-off, despite the existence of both health insurance and other fee exemption mechanisms, which are implemented unevenly across local governments and which can lead to ‘second class’ status in clinics and hospitals.



In short, it is economically advanced households who are at present capturing the lion's share of benefits from expenditure on higher education. Few poor households can afford to educate their children through to upper secondary level, where they would have a chance of entry to universities, due to the significant school fees that must be paid and the lack of effective targeting mechanisms.

Table 3. Average annual out-of-pocket school expenditure per child as % of household annual non-food consumption expenditure, by expenditure quintile

	Per capita consumption expenditure quintile					
	Poorest	Near poorest	Middle	Near richest	Richest	Average
Primary	6.3	5.3	4.5	4.3	4.8	4.4
Secondary	11.0	8.9	7.2	6.7	6.8	7.4

Source: VHLSS, 2002, reproduced from Sepehri (2005)

Reform approaches. The growing importance of educational opportunities suggests the need for a "big push" to address educational inequalities. Of all the social sectors, perhaps it is reducing the inequalities in the access to education that may have the biggest impact on inequalities. Disparities in the quality and access to education are stark, as is the *rising* importance of human capital in determining economic outcomes. Several strategies will be important to address social fairness in education.

One is to refocus the role of the state, and boosting overall expenditure on, basic education. Although the percentage has been rising, Vietnam still spends less on education, on both per student and as a percentage of GDP than several countries in the region. How can increases in spending on basic education be accomplished? One method is to gradually reduce *general* subsidies to tertiary education while means-testing scholarships to a greater extent; budget support to primary, lower and upper secondary education should, in turn, be increased. Another approach is to *target existing expenditure* to a greater extent. Even within primary education, shifting funding towards the first few years could have an appreciable impact on drop-out rates. And targeting increases in public expenditure to the weakest links in the service delivery chain – minority areas and, within such areas, to girls in particular – is an important cross-cutting strategy.

A related approach is to address the 'crisis of affordability' of basic services to the poor which is another key area. This implies encouraging a shift in expenditure, towards primary and lower secondary education, as the best means of increasing access by the poor. A particularly strategic gap to be filled is that marking the richest from the poorest quintile in *lower and upper*



secondary education. The basic strategy is thus to increase central-level transfers for funding lower levels in the educational system, particularly in poor areas: less “socialization” of fees for primary and lower secondary education, replaced by greater budget transfers for these levels.

Efforts to reduce or eliminate user fees for basic services should be rooted in overall fiscal reforms aimed at strengthening the hand of local governments as service providers. Demanding exemptions as an “unfunded mandate” imposed by the central government on local service providers is likely to hurt the quality of services and fail to boost access substantially.

A third strategy is to improve service coverage and quality in the poorest areas of the country. Strategies for improving basic education in the poorest areas of the country include both fiscal and non-fiscal elements:

- h) *Refocusing onto basic education*, as recommended above, is crucial to overcoming gender gaps in secondary level education, since it will prepare girls better to enter the secondary level.
- i) *Curriculum reform* is needed as major initiative, particularly in (but not limited to) ethnic minority areas. In particular, expansion of *Alternative Basic Education* (ABE) curriculum, together with gradually raising current standards to reach eventual integration with the normal curriculum. (In other words, this curriculum should not serve, for difficult-to-reach sub-groups, as a permanent sub-standard alternative to the normal one.)^{xxxvii}
- j) Above all, there is an urgent need (in light of the limited improvements in their access to education reported by recent rounds of the VLSS) for a special approach to mobilize *minority girls* in particular to go to school. This may include direct subsidies or ‘bursaries’ for girl students at lower secondary level. Focusing on *pre-school* as a priority intervention will have major pay-offs as well, for two reasons: a) it provides girls with a chance to practice the Vietnamese language before starting Grade 1 textbooks (which are written in that language), and b) it reduces dependence on older daughters’ caring for younger siblings.

Finally, a range of interactions might focus on expanding vocational education and making it more market-responsive. While Vietnam’s labour force is in general young, hard-working, and relatively well-educated – and therefore quite capable of quickly adapting to new technologies – most workers are ill-

xxxvii. At present, Vietnam lags significantly behind typical international practice in terms of the number of hours of instruction contained in the curriculum. Internationally, students attend school and have face to face instruction for considerably longer than is required in Vietnam; for example, international face to face instruction for students is approximately 1000 hours per year, while in Vietnam the same figure is 752 hours (under current rules) and 627 hours (according to a “new teaching plan” soon to be introduced). The curriculum in ethnic minority areas is significantly shorter, in turn, than the figures above. Fritzen, 2004. Better-off children are also able to pay for “extra classes”, often offered by their day-time teachers for private tuition, yet another driver of educational inequalities.



trained in practice and have a low level of vocational proficiency; this has a negative effect on investment as well. Higher-quality vocational education linked to the demands of the private sector may play an important role in increasing overall supply of skilled labour.

Driver # 4: Limited access to safety nets

Assessment. Two facts stand out when examining the need for safety nets in Vietnam's context. First, fully 40% of the population is vulnerable, poised just above or below the poverty line. Second, the movement towards wage employment and increasing landlessness described above means that some of the props households have traditionally relied on for protection are changing. Both facts underline the need for sensible social protection instruments that protect people against risk and vulnerabilities in a market economy.

Table 4 sums up available data on government poverty and safety net programs for a number of vulnerable groups. Though much information is sketchy, four basic conclusions seem warranted. First, formal safety nets cover only a small portion of Vietnam's population. This coverage includes formal social insurance, various poverty alleviation sources and targeted subsidies (the latter two are known collectively as the National Target Programs – NTP). Second, the level of coverage is rising at a rather slow pace. In 1998, only 2.2% of the population lived in households that received a payment from *any* of the poverty programs; that percentage is unlikely to have changed much by 2002 (though program 135 to build commune-level infrastructure is one bright spot).^{xxxviii} Low coverage marks various forms of social insurance as well. In Vietnam, overall coverage of health insurance, social insurance and pensions is estimated to be approximately 15% of the relevant target populations as of 2004, and unemployment insurance is still in the design phase.^{xxxix}

Third, households that are covered receive very limited assistance. Even adding the additional 40% which community contributions form on average within safety net expenditure, overall expenditure constituted on average only some 5% of household income for recipients in 1998. Numerous problems have also been reported by households in attempting to use health insurance cards in various hospitals. Their second-class status is related to the low incentives for serving them under current user fee financing arrangements – incentives which may be unwittingly strengthened by Decree 10 on Financial Autonomy (2004), which grants sweeping discretion to revenue-raising public agencies such as hospitals.^{xl}

Fourth, coverage of social transfers is also generally not effectively targeted towards relatively poor groups (except for several of the specifically anti-

xxxviii. The tables do not allow strict comparisons; the figures in column (a) of Table 4 are not mutually exclusive.

xxxix. Justino, 2005. See also Nguyen Phuong Nam's contribution to this study for further analysis; it is listed in Annex 1.

xl. Sepehri, 2005

poverty programs cited in Table 4). Targeting is currently a problem in Government's programs for the extremely poor and ethnic regions: "... 45% of the households in the Program 135 communes are not poor.... The non-poor households are likely to benefit disproportionately from the large investments in public goods such as commune infrastructure and other benefits."^{xli} The VLSS data suggest that social subsidies and the social insurance fund both benefit better-off households more than poor households, and that this percentage has not increased over a five year period. Various programs within the Hunger Eradication and Poverty Reduction umbrella are somewhat better targeted: some 60% of HEPR assistance received by households goes to the poorest 40% of households.^{xlii}

Table 4. Access to Targeted Benefits in 2002

		Percent Of Beneficiaries Who Are			Percent of the poor who are beneficiaries		Distribution of beneficiaries by quintile				
	(a) %of households with/who	(b) Non-poor	(c) Poor	(d) Food poor	(e) A-mong all the poor	(f) A-mong the food poor	(g) Poor-est	(h) Near poor-est	(i) Midd-le	(j) Near rich-est	(k) Rich-est
Poor-household certificate	3.8	27.4	72.6	36.9	9.5	12.8	58.5	24.7	9.1	6.5	1.1
Health care card	4.0	28.6	71.4	42.0	9.9	15.5	57.8	20.8	13.6	4.6	3.3
Access to subsidized credit	2.2	25.1	74.9	37.9	5.8	7.1	60.2	20.4	13.7	4.4	1.3
Exemption of education fees	5.5	30.2	69.8	39.8	13.2	20.0	56.9	23.3	11.6	6.5	1.9
Live in Program 135 commune	14.8	44.8	55.2	30.1	28.2	41.0	43.5	22.6	15.1	13.6	5.3

Source: Cuong Viet Nguyen (2003); reproduced from Swinkels and Turk (2004)

xli. Molisa, 2004, p. 125

xlii. Molisa, 2004.



Programs designated as social assistance (including the social insurance fund) already comprise roughly 15% of total government expenditure. There are a number of reasons why coverage, despite significant expenditure, is so low. For many programs, there are no reliable means for monitoring eligibility for, and receipt of, entitlements. Many people within the target groups may not even *know* they are entitled to certain assistance by law. And definitions for target group eligibility (the handicapped, street-children etc.) may be unclear. In addition, the system of intergovernmental finance is failing to provide sufficient resources where they are needed the most – the poorest provinces. Since an estimated 43% of the outlays are financed from non-budget resources, including mandatory and voluntary contributions, social assistance programs in poorer localities, which may have a higher percentage of vulnerable populations, are under funded.

Reform approaches. Three points warrant attention. First, Vietnam should strive to develop and invest in an *integrated national system of social security*.^{xliii} ‘Integrated’ implies an attempt to systematically identify vulnerable populations and to build the operational capacities for policy coordination and implementation. Such integration will lead to better prioritization of vulnerable groups for scarce funds and enhanced efficiency in targeting the groups identified. Vietnam’s current programs suffer, in both policy formulation and information systems, from fragmentation across ministries (with several ‘owning’ different pieces of the safety net system) and levels of government.

Integration will be particularly important as Vietnam attempts to maximize the social protection impact of National Target Programs (NTP). As noted above, these at present suffer from coverage *and* levels of effective support that are extremely limited. Better coordination and information sharing among programs should help enhance NTP effectiveness.

The second major point is that Vietnam should aim for significant expansion of social insurance program coverage in the coming years. Two important questions concern the feasibility of this approach and priorities for scarce funding.

Feasibility. Any discussion of formal coverage of social insurance must begin with the acknowledgement that this is an uphill task in a developing country setting, in which such coverage is typically limited to a minority of formal-sector workers (typically less than one-third). There are two basic reasons for this low coverage. First, it is almost always impossible for fiscal reasons for developing countries to provide universal coverage (one of the few recent attempts to do this – in Bolivia – was abandoned within three years). Second, the costs of enforcing collection from a stable group of workers are only sufficiently low in the formal sector – lowest of all for government employees. These factors suggest that expectations regarding the expansion of formal insurance schemes in Vietnam should remain modest in the medium-term.

Yet analysts have suggested that some forms of expansion are fiscally and organizationally feasible in some other developing countries, and should be

xliii. The approaches described in this section draw heavily on Justino, 2005.



explored in Vietnam. In South Africa and the Indian state of Kerala, this has taken the form of non-contributory schemes funded out of general government revenue targeted onto a distinct population (often those working in the informal sector). In other cases, universal provision may be attainable; universal non-contributory pensions for all individuals over 65 in Vietnam are estimated in one study to be “well within the government’s fiscal capacity.”^{xliv}

Priorities. Expansion of social insurance coverage should focus in the short- to medium-term on addressing household vulnerabilities to infirmity and old age – the “leading causes of households falling into poverty in Vietnam”.^{xlv} In the health sector, attempts to extend the coverage of contributory insurance systems have not produced impressive results in reducing vulnerabilities. The major push over the past three years to get health insurance cards in the hands of all poor households shows great promise, but needs further systematic research. And as noted above, non-contributory social pensions are a prime example of an approach that is potentially both fiscally sound and organizationally feasible.^{xlvi}

Driver # 5: Gender bias

Assessment. Many aspects of gender relations in Vietnam are positive in international comparison:

- k) Vietnam has one of the highest levels of female political participation at central government level in the region, with 27.3% of parliamentary seats held by women (compared for example to 20% in China).^{xlvii}
- l) The ratio of female to male earned income in Vietnam is 69%, which is also amongst the highest in the region and comparable to China’s ratio of 66%.
- m) The gender gap in school enrolment and educational attainment has been decreasing.

But ‘gender bias’ still works to increase inequalities between men and women in a number of ways. Some can be quantified and juxtaposed to the positive figures noted above. Representation of women at *local* government level in Vietnam is low and, by some reports, declining over the transition period; fewer than one in six representatives at the commune level are women.^{xlviii} Significant variations in the ratio of female to male earned income for similar

xliv. Justino, 2005, p. 24 referring to study by Weeks et al., 2004.

xlvi. Quoted in Justino, 2005, p. 21.

xlvi. Administrative costs for such a system may be low, since communes - which are already responsible for household registration - would merely have the task of certifying the age of applicants.

xlvii. UNDP, 2003

xlviii. NCFW, 2000, p. 53



work are observed at the sectoral level.^{xlix} School attendance for females aged 15-17 is decreasing compared to males, primarily due to girls seeking wage employment in greater numbers than boys.¹

Other areas in which gender bias is observed are less easily quantifiable, and concern women's voice in society. In the agricultural and rural sectors, women face more difficulties accessing formal sources of credit and land use and property rights, as well as extension programs.^{li} Land Use Right Certificates often bear only the husband's name despite the reissue following the revised Law on Marriage and Family of 2000. This reissuing process has no time limit and has proven to be a lengthy process. Many women still do not understand their legal rights and how to secure them.

Finally, women report experiencing unequal power within the household, including higher workloads, less involvement in decision-making, domestic violence. In general, the responsiveness of state health providers to women's reproductive health needs is reported as a consistent concern.^{lii} Finally, ethnic minority women still have far less access to education than their male counterparts, in a pattern that appears to be changing only slowly over the past five years. The intersection of being female, less educated and of minority education group can become a powerful driver of disadvantage.

Reform approaches. Reforms related to gender issues aim at enabling men and women to have equal status and recognition in society, a key underpinning of equitable and sustained development. Strengthening women's economic status will also help empowering them to participate more in the decision-making process. The main policy areas to consider with respect to gender inequality are as follows.^{liii}

Employment. Labour legislation still includes some gender bias, which can make it more costly to hire women. Boosting the availability of childcare options should be a priority; one study finds that, like social pensions, provision of universal child care is fiscally feasible.^{liv} Consideration should be given to equalizing the retirement age for men and women.

xlix. For example, Brassard (2005) found that in the agricultural sector (where women dominate most household-level production activities), wages for similar work tend to be more equal between males and females in the northern region of Vietnam than in the southern part, except for work that required more physical strength, such as preparing land and harvesting the crop. There is also a statistically significant difference in monthly salary between males and females in the glass, ceramics and cement industry in northern communes and in the food and beverage industry in the southern communes. In contrast, the textile and garments industry, showed a statistically significant different salary between males and females in both regions.

1. Nghiem Lien Huong, 2004, p. 303

li. UNDP, 2004

lii. according to World Bank, 1999 ("Voices of the Poor" study), p. 73

liii. This section borrows heavily from NCFAW, 2000 and UNDP, 2004

liv. Weeks et al., 2004



Credit. Given that non-formal micro-credit schemes have no legal status, there is a need to establish incentive schemes for bank accounts opened and managed by women. Bridges between such schemes and formal sector credit should be built, including through capacity strengthening programs for micro-credit schemes.

Land. To capitalize on the progress made in recent years in issuing land certificates in women and men's names, the household registration regulations should be amended to ensure that women can represent the household in civil transactions.

Health care. A special effort should be made to target health care fee exemption to poor women. There is also a need to increase men's participation in family health care, and to raise men's awareness of their roles and responsibilities in practicing safe sex. One suggestion is to integrate HIV/AIDS communication into other national programs such as HEPR and public education. The provision of legal and counselling assistance to victims of gender-based domestic violence should also be stepped up.

Political participation. The target for women should be raised to 40% at all levels of government.

Education. Vietnam should progressively raise the number of scholarships awarded to girls, striving to reach gender parity. It may be expedient to introduce strong measures to promote the participation of ethnic minority girls at all levels of the education system. Campaigns to increase public awareness of the benefits to girl's education in remote areas should be scaled up.

Driver # 6: Multiple, reinforcing vulnerabilities of ethnic minorities

Assessment. Despite the economic successes of Vietnam as a whole, ethnic minority communities show signs of considerable distress. Roughly 75% of ethnic minority people fall below an international poverty line, compared to 31% of the Kinh majority. Analysts find that "the gap in living standards between the ethnic minorities and the majority population has been widening"^{iv} across many indicators, including critical "drivers of inequality" addressed above, such as attendance above the primary school level and access to wage employment. (Important exceptions include infant mortality rates, primary school enrolment rates and access to electricity and roads, where minorities are catching up with already good national averages.)

Minority issues have played an important part of the discourse of inequality in Vietnam. Inter-ethnic group inequalities have long been seen as a potential threat to national unity and as requiring amelioration, largely by "integrating" minorities into the economic and cultural networks of the rest of the country.

^{iv}. Minot et al., 2003; Poverty Task Force, 2002a



In recent decades, the migration of lowland, Kinh majority households into midland and upland areas has increased significantly; so too has the effective reach of the Vietnamese state into such areas. These developments can be positive, as shown in the impressive gains in primary school attendance in minority areas. They can also bring their own stresses:

Smaller localized peoples who live in upland regions, far from markets, political capitals, and urbanized centres... are deeply disadvantaged in their interactions with the lowland group by their lack of economic power, weak political power, and unfavourable location in a translocal economy.^{lvi}

To what extent can we consider being a minority to be a *driver* of poverty in the current context? Put another way, are minorities poor for the same general reasons that non-minorities may be poor, or are there special factors at work? A recent study on exactly this question found the latter to be the case. The study examined the economic benefits associated with different household characteristics, including the effect of being a minority group, and discovered that the differential due to minority status had grown from 1993 to 2002.^{lvii} A review concluded that

Minority households appear to generate their expenditure levels in a qualitatively different way, which means that anti-poverty programs that are geared to minority groups will in general have to look different from those geared to the majority. This will presumably require considerable amounts of input from minority groups themselves ("empowerment") and from those who have a thorough knowledge of ethnic minority societies.

The minority issue can be seen in terms of the interlocking effects of isolation, poverty, powerlessness, vulnerability and physical weakness long ago posited as a model of the 'poverty trap'.^{lviii} Figure 6 shows some selected comparative indicators for minorities and Kinh in those dimensions. The figure helps underscore why it is probable that poverty reduction among minorities has been so much lower than that for the Kinh majority, and indeed why the rate of decrease in the poverty gap measure for minorities (Figure 4 above) has stalled entirely.

On a broader level, minority-dominant, poor localities face particularly steep governance challenges. Models of service delivery and the exercise of popular participation need to be adapted when applied to upland areas, where low population density, low social development and heterogeneous social composition all raise the costs for households to access services and participate in local decision-making. Yet some analysts of reform attempts^{lix} in mountainous areas note a tendency towards "one-size-fits-all" development

lvi. Taylor, 2004, p. 17.

lvii. Baulch et al., 2002, citing van de Walle and Gunewardena's 2001 study examining the effects of differing characteristics, the return to characteristics, and geography on minority-Kinh inequality trends.

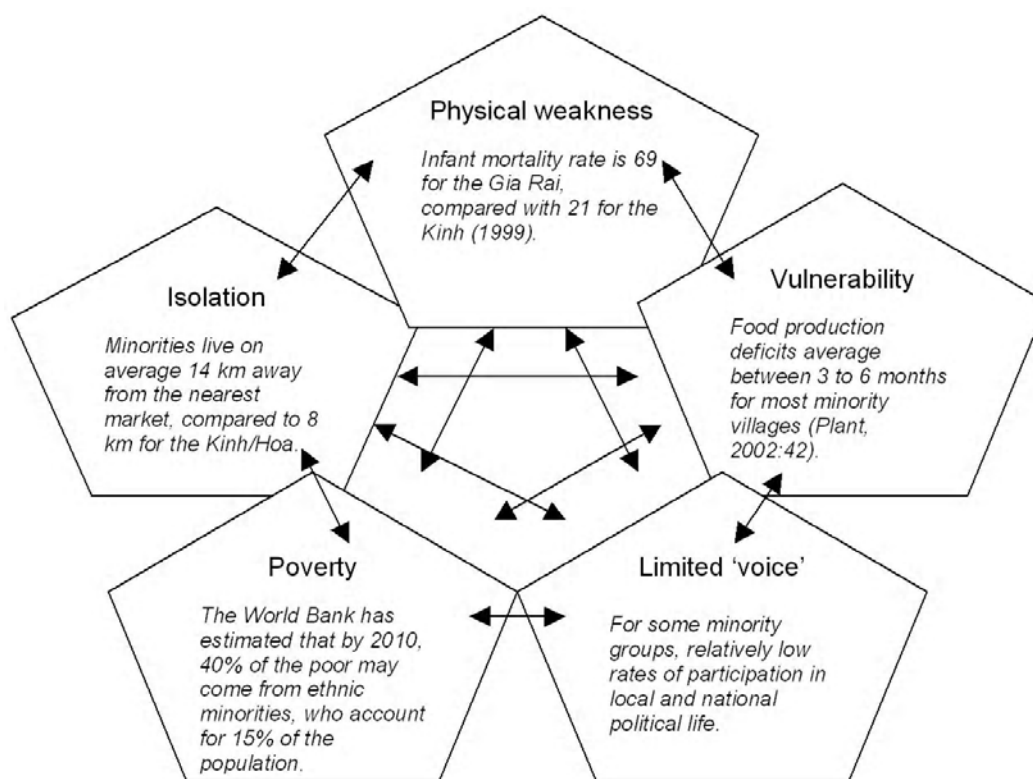
lviii. Chambers, 1983

administration in Vietnam's uplands. Ongoing decentralization reforms should in theory serve to improve the adaptiveness of local administration. But poor areas, where limited finance and weak organizational capacity combine with a passive, top-down administrative culture, face numerous hurdles to make decentralization functional.

Reform approaches. For a set of problems as complex and diverse as those facing minority communities, there can be no 'cookbook' answer, and several full-length publications are devoted to the issue.^{ix} The following are some of the main approaches that might help provide the flexibility for local solutions to emerge.

Expansion of economic opportunities. The overwhelming economic disadvantages faced by minorities are due partly to geography and partly to the reinforcing effects of other constraints, such as language barriers and educational attainment. Policies to reduce urban bias, explored above, will make a contribution towards reducing the disadvantage of minority areas. Additional measures should concentrate on enhancing livelihood security by minorities. This includes accelerating the formal allocation of land use writes over agricultural and forest lands, including to individuals and cooperatives, and investing heavily in upland farming system research and extension.

Figure 6. The minority poverty trap: Selected figures



lix. Rambo, 1995 Fritzen, 2000

lx. Neeffjes, 2001; Rambo, 1995



Special models for service delivery in minority areas. Studies of what it will take to effectively deliver educational and health services in minority areas come to the same conclusion: the models necessary vary significantly from those in non-minority and lowland communities. In education, a range of issues need attention, such as curriculum content and length, the special constraints of minority girl children, and special strategies for boosting secondary enrolment. In health care, the twin challenges are: a) to find ways to strengthen the public health network at the grassroots in areas with low population density and large catchment areas; and b) to boost utilization of curative health services at the commune clinics and district and provincial hospitals, given the severe income constraints and low insurance coverage of minority households.

Attention to issues of voice. Issues of empowerment, participation, accountability and representation need localized strategies in minority areas just as do health and education strategies. Mechanisms to make grassroots decentralization, the role of People's Councils and complaint procedures (explored in general terms in the next section) all need special attention within minority areas, starting with more extensive applied research in these areas.

Making decentralization work in minority areas. Since Vietnam is in the process of handing over increasing administrative responsibilities to provinces, it is vital to understand how it can be made to work in the poorest areas of the country in which minorities are numerically dominant. *Asymmetrical decentralization coupled with capacity building* holds potential as an important general reform approach – one not relevant only in minority areas.

Capacities and the quality of governance vary dramatically between even similarly situated provinces, districts and communes throughout Vietnam. One reason for this – the variable effectiveness of vertical accountability mechanisms – is covered below. Decentralization is clearly a cross-cutting issue, but its relevance is heightened by the special challenges facing minority regions, where different local requirements need articulation. Weaker provinces require reforms, both fiscal and organizational, that will underpin substantially improved service delivery coverage for basic social services. Enhanced funding is a first step. Current interprovincial financing arrangements are pro-poor at the provincial level, but generally fail to ensure minimal standards of service delivery in poor districts and communes.

Yet there are two caveats that go beyond merely beefed-up funding as a solution. First, *models* for service delivery (different from those in the deltas) which make sense for mountainous areas of the country are in short supply. Some of these will be narrow programs sectorally implemented, but most will lie in areas, like primary health care and basic education, which need to flag particularly disadvantaged populations and geographical areas for intersectoral action.

Second, enhanced funding that is not accompanied by more dynamic local administration will not accomplish much. The incentives to target the poor, or

to substantively close service coverage gaps, will be lacking. National program implementation, which constitutes a large percentage of overall provincial expenditure, leaves provinces with little discretion and a fragmented, vertical planning process for basic services. A coordinated capacity development program for poorer localities, focused on strengthening incentives for equitable development administration, will be necessary to bridge the capacity gaps separating poorer from richer, and effective from ineffective, local governments.

Driver # 7: Corruption and weak accountability mechanisms

The last driver concerns corruption and the limited ability to hold officials accountable for safeguarding rights and limited incentives for promoting participation.

Assessment. People in any society have different degrees of effective influence or 'voice'. Differential influence can be analyzed in several ways, including the extent to which people participate in decision-making, the incentives for local authorities to serve the interests of the entire population (including the poor and vulnerable), and the degree to which the powerful can be held accountable for their actions. These aspects affect inequality in multiple ways:

- Limited ability to *participate in local decision-making*, for instance regarding the selection of projects for government anti-poverty investments, may lead to a low effectiveness of such expenditure and to a greater risk to fund misuse.
- Limited development of *effective local representation and the articulation of local interests* may result in weak incentives for local decision makers to provide productive economic services to poor, underserved populations; instead, urban bias may be reinforced.
- Limited *knowledge of rights and ability to utilize recourse mechanisms* when rights are infringed raises the vulnerability of the poor to abuse and undermines the enabling environment for private sector development.
- Existence of *corruption and economic rents* drawn from unequal access to information and public sector decision makers erodes public trust and perceptions of the legitimacy of any given income distribution.

In some ways participation is a strength of the Vietnamese system, with its long tradition of social mobilization behind collective goals. This section focuses on another aspect of Vietnamese governance that we feel exerts an influence on equitable development while strongly affecting common perceptions of inequality: it is the linked issues of accountability, executive dominance and anti-corruption. This paper does not go in significant detail regarding these issues, which require more in depth, institutional analysis. But



a number of points are well-supported by the literature and by current debates ongoing in Vietnam.

First, Vietnam has an executive dominant governance system that in some localities tends to limit the degree of effective 'downward' accountability, i.e. to the end users of services. Observers within and external to the Vietnamese system tend to agree that at present the executive is, relative to the legislative and judicial branches, overbearing.^{lxi} Related to this is a sensitive debate over how the Party relates to the government, with again many observers calling within the context of public administration reform for the Party to focus on overall 'steering functions' rather than actively intervening (as appears to be the norm) in administrative matters.^{lxii} Weak representative functions hamper democratic decentralization, while a weak judiciary limits the scope for holding administrators accountable for delivering public goods in a transparent and participatory manner as prescribed by law. The move from internal to public systems of accountability is also slow. Since the poor have the most to gain from downward and public-based accountability, executive dominance can hamper the articulation of their interests, and thus indirectly accelerate inequality.

Second, both civil society and, to a lesser extent, a dynamic and deregulated private sector are concepts or governance categories that sit uneasily with Vietnamese political culture, though both sectors are growing at present and the government continues to work on a legal framework facilitative of these sectors.^{lxiii}

Third, the classic challenge of multi-sectoral (or horizontal) coordination at lower levels of government (and possibly at the central level itself) may pose particularly difficulties in the Vietnamese transition context, particularly for the poorest provinces.^{lxiv} Such difficulties are in part a legacy of the former system of command and control, when each ministry developed powerful interests in managing economic activities. They are also a function of the as yet unfinished agenda of administrative and fiscal decentralization to lower levels (particularly districts), which has left district 'coordinating executives' (as opposed to what might be termed 'technical executives' or administrators from the line agencies) in a weak position.

The net effect of all of these governance arrangements is to reinforce a system in which accountability is primarily directed upwards (towards higher levels of government) and is, at the same time, somewhat blurred by overlapping spheres of authority and habits of intervention. Accountability, when blurred in this way, tends to preclude the shifting of power from *more* to *less* powerful actors and levels of government, since meaningful decentralization of any kind

lxi. Bring et al., 1998

lxii. Vasavakul, 2002

lxiii. Webster, 1999; Nguyen, 2002

lxiv. van Arkadie, 1993



rarely happens (or remains precarious, as at present in Vietnam) except when backed by enforceable recourse to the rule of law.

This pattern manifests itself in several ways. Procedures for citizens to launch *formal complaints* saw much development over the 1990s. But because the boards which investigate complaints report to the executives of the same or next higher level, their effectiveness in addressing possible systemic or higher-level abuses has been limited.^{lxv}

Grassroots democratization efforts, much discussed in the Vietnamese press from the late 1990s, have aimed at setting minimum standards for procedural democracy at the commune and village levels. Yet the decree focuses attention on the commune level, when in fact corruption is probably a problem throughout much of the Vietnamese system. It also rests for its success almost entirely on the dispositions of district and provincial implementers, who in many cases will be unlikely to enforce its provisions rigorously against errant officials at the grassroots (provided there is no local outcry), or to use the grassroots democratization decree as a major criteria for assessing local government performance.^{lxvi}

The problems of limited accountability and corruption are clearly mutually reinforcing. They can be described in a series of illustrative equations that can have a profound impact on several aspects of inequality mentioned in this report:

Continued prominence of SOEs + weak accounting systems + central ministry and local government incentives = fertile soil for uncontrolled income.

Unevenness of personal income tax collection + with generally ineffectual income declaration and asset disclosure = widespread perceptions of unfairness in public finance and abnormally small budget revenue from income tax.

Moving huge tracts of land from state to private control + shifting rules of the game + limited public oversight = windfall gains to those with access to information and influence, including those within the public sector itself.

"Socialization" of social service financing + weak oversight + limited salaries = widespread "commercialization" of even basic services, exclusion of those with weak purchasing power and uncontrolled collection of illicit payments (e.g. "academic corruption" in universities^{lxvii}).

None of these problems are unique to Vietnam. The point is that Vietnam is in a special and difficult situation in that it is a *transition* society (and therefore

lxv. Cite Minh Tuan's sources.

lxvi. Fritzen, 2005

lxvii. Annex 1 for a thematic paper that focuses attention onto academic corruption..



likely to be even more vulnerable to corruption) that also holds itself up as a *Socialist Republic* with a strong institutionalized commitment to equity. It will have to not only move quickly on institutional reforms that effectively address these problems but also to stay ahead of public perceptions that can be increasingly strident in calling for 'fair rules of the game' in various aspects of social and economic life.

Reform approaches. The set of institutional reforms that might have an impact is long and extremely complicated. The key approach necessary is to *think structurally and institutionally about the problem*. Corruption will not be effectively addressed until it is dealt with in a holistic manner. Specifically, this means moving away from a narrow focus, often observed in government rhetoric regarding the problem, on *law enforcement* (catching the 'bad elements') and *public morality*, to one that also emphasizes *prevention* and *institutional vulnerabilities*. A public dialogue on the corruption issue is ongoing in Vietnam and needs to continue to grapple with difficult questions, such as the following:

- r) Can the Party-State rely on *internal and hierarchical controls* to police itself if *external and democratic* accountability mechanisms, for instance by civil society and an independent judiciary, are weak?
- s) Could the establishment of a strong, independent anti-corruption commission help address the corruption problem? Many such commissions – such as that in the Australian State of New South Wales^{lxviii} – focus equal attention onto capacity building for corruption prevention as they do on investigation and enforcement activity.
- f) How might redress mechanisms, such as 'complaints and denunciations' procedures, be reformed to improve the efficiency and impartiality of dispute resolution? How can this function be given greater teeth than it has at present, where it reports to the executives of the same level of government which may be under investigation?
- u) How can protection for 'whistle-blowers' – those who expose corrupt practices – be strengthened? We know that weakness in such protection is a major factor inhibiting anti-corruption work in other country settings.
- v) How can the increasingly independent role being played by the National Assembly be extended to the representative functions of lower levels of government, and be made into an effective accountability mechanism?

The Asian Development Bank has nicely summed up some aspects of the agenda ahead for equalizing the position of citizens and officials in a law-based polity:

lxviii. See <http://www.icac.nsw.gov.au/> for a comprehensive list of the commission's activities.



Currently all economic sectors are to varying degrees regulated bureaucratically; legislative norms are poorly understood and widely ignored, while courts are considered expensive, corrupt and incompetent. Through deregulatory reforms, the state has signalled its intention to partially shift commercial decision making from bureaucratic to market players. Such a change will require improved legislative drafting, coordination and dissemination, further checks on the discretionary powers of bureaucrats, more independent and competent private legal practitioners and greatly improved dispute resolution fora, bankruptcy and debt enforcement mechanisms.^{lxix}

In short, allowing meaningful local participation in decision-making, institutionalizing checks on local authority and creating facilitative conditions for a level playing field for the private sector are three essential elements of state-society relations in transitional Vietnam.

Conclusions

This strategy paper has presented a large number of indicators, drivers of inequalities and areas for potential reform. Some findings stand out as particularly important.

The first set of findings might be considered 'good news'. Economic inequalities in Vietnam are rising at a moderate pace in the aggregate. Along most dimensions of human development, such as infant mortality and adult literacy, the story of the 1990s is one of continued progress across nearly all groups, though to different degrees. Finally, across many of the reform approaches for reducing inequalities noted in this paper, sound policy initiatives already are under way, and the question is more over the speed of implementation rather than the direction of reform. Yet there are real reasons for policymakers to be concerned over inequality:

1. The pace of aggregate inequality generation may be accelerating, placing Vietnam along a level and trajectory similar to that of China in the late 1980s, during the early stage of its meteoric rise in inequality.
2. While their living standards have improved somewhat over the past decade, ethnic minorities are being left far behind. Evidence suggests that a hard core group of the poor, whose incomes have stagnated well beneath the poverty line, consists mostly of ethnic minorities. There is little in the current development framework that suggests this may change in the near future.
3. Vietnam's continued high growth rates may be masking changes in the nature of employment generation that may be contributing to inequality in access to regular wage employment. Specifically, growth in Vietnam

lxix. AUSAID, 2000, pp. 12-13



may be increasingly capital-intensive, making it difficult to generate the rapid increases in employment that will be necessary to absorb workers displaced in the industrialization process. This is important since the distribution of the opportunity to access regular wage employment is an increasingly important determinant of overall inequality levels. Slow reform of the SOE sector and, even more importantly, difficulties levelling the playing field for the private sector are two important constraints on the generation of employment.

4. Inequalities between similarly situated localities – that is, inequalities *within* urban areas and *within* rural areas – are increasing, in contrast to the earlier transition period. This reflects the process of socioeconomic differentiation based on access to human capital – which is still highly unequally distributed at the higher levels of the education system. It also underscores the variability in the quality of local governance, which ongoing decentralization is likely to exacerbate.
5. The state of social protection against market volatility and shocks to household livelihood systems is rudimentary. Although it is inherently difficult to scale up social insurance in poor country settings, much more can be done cost-effectively to provide effective safety nets.
6. Corruption, and limited effectiveness of current accountability mechanisms, constrains Vietnam's efforts to build a society based on the rule of law. They may also affect citizen perceptions of the legitimacy of Vietnam's current distribution of economic opportunities and outcomes, and by extension may negatively influence socio-political stability itself. There is little evidence to suggest that current policy measures are capable of bringing the corruption problem under control.

To what extent are rising inequalities natural and unavoidable in a rapidly transforming Vietnam? It may in the short term be difficult to halt the rise in Vietnam's Gini coefficient, particularly given the continuing shift of economic momentum away from the agricultural sector.^{lxx} But international experience reviewed in part 1 of this paper suggests Vietnam is *not* locked into inevitable increases in aggregate inequality. A range of countries have been able to sustain relatively high levels of economic growth without seeing the kinds of meteoric rises in inequality that China has experienced. Indeed, the paper has emphasized a range of policy interventions to promote equity that are fully consistent with the further development of a market economy. Some reforms highlighted here, such more rapid SOE reform and the removal of impediments to private sector development, can be expected to promote more sustainable *and* more rapid growth. Others, such as strengthening the administrative capacities for decentralization in poor regions and boosting overall expenditure on education, will need to be carefully calibrated in a context of multiple demands on scarce public resources. Yet others, such as a

lxx. Gallop, 2002



more externally-oriented approach to Vietnam's anti-corruption strategy, are propositions that are being actively debated among Vietnamese academics and policymakers. They will undoubtedly be filtered primarily through the lens of political calculations.

In a broader sense, the question of how fast Vietnam's Gini coefficient will rise is far too narrow. Aggregate measures of inequality will not capture the significance of the issue to Vietnamese citizens themselves. Vietnam has left behind an egalitarian age when it was expedient to pursue, whether in practice or rhetoric, equality of outcomes. Regional development outcomes in Vietnam will not be equalized in ten more years; household economic attainment will never be equal; minorities are unlikely in any scenario to achieve income parity with the minority, given alone the *geographical* challenges posed by upland environments. This is well understood by both policymakers and, one senses, Vietnam's citizens. But the challenge of progressively improving, step by step, the *equality of opportunity* for all Vietnamese to better themselves – however vaguely defined this must be at the aggregate level – is of profound social and political significance to the Vietnamese polity. This, it has been argued, is not only a question of whether, on average, livelihoods continue to improve in Vietnam. It is at least as much an issue of whether the *rules of the economic, political and social game* are perceived to be fairly applied to all, regardless of who one is or whom one knows. The lived experiences of social inequality will revolve around everyday questions: whether school fees block access to a university place, jobs are available following graduation or corruption and red-tape plague the new entrepreneur.

Much remains to be done to promote equity and address the core drivers of inequality in Vietnam at present, and much *can* be done.



ANNEX A: THEMATIC BACKGROUND PAPERS

The following is a list of the thematic background papers and contributory notes that were produced for Mekong Economics as part of the DFID-funded study.

Author(s)	Title	Major contents
Scott Fritzen and Caroline Brassard	<i>Unequal Development: What have we learned?</i>	Three narratives of unequal development: Analytical framework for the study. Economic growth and inequality: the classic 'growth vs. redistribution' The social protection and human rights and institutional integrity
Caroline Brassard	<i>Inequality in Vietnam from a Macro Perspective</i>	Inequality trends and impacts (regional comparisons, pro-poor economic growth, poverty and inequality projections) Drivers of inequality at the macro level (macroeconomic policies, public finance, safety nets)
Caroline Brassard	<i>Sources and Trend of Inequality and Exclusion in Vietnam at the Micro Level</i>	Income, expenditure and wage trends Asset ownership and access to markets Access to services Migration issues
Bui Thi Minh Tam, Nguyen Phuong Nam, Ngo Duc Huy	<i>Policy aspects of inequality</i>	Notes on the historical significance of inequality in Communist Party thought (Ngo Huy Duc) Notes on key policy arenas in the transition period (Bui Thi Minh Tam and Nguyen Phuong Nam)
Vu Bich Thuy	<i>Unequal Access To Higher Education As A Driver Of Inequality in Vietnam</i>	Higher Education System in Vietnam (enrollment, academic staff and research, public finance, quality) Trends in Inequality of Higher Education (social, regional and global perspectives) Policy-Map and Good Governance in Higher Education

ANNEX B: DATA GATHERING FOR POLICY-MAKING AND AREAS FOR FUTURE RESEARCH

1. Current data limitations

1.1. Use and misuse of the VLSS and VHLSS:

Misuse of data and misinterpretations are made as a result of the lack of more specialized datasets and the overuse of the Vietnam Living Standard Surveys (1992/93 and 1997/98) and Vietnam Household Living Standard Surveys since 2002.

The purpose of the Vietnam Living Standard Surveys is to collect data on living standards in order to evaluate the socio-economic development of the country and to formulate policies to raise living standards. These datasets were originally designed to measure the overall quality of life, focusing on the quantitative aspects of living conditions. However, they may not be adequate to answer specific policy-relevant questions for the poorest, based on expenditure data. For the poorest households, payment of all types of expenditures can be in arrears or substantially delayed, depending on the season. Households might not reveal such information, and the expenditure section of the questionnaire does not allow for this possibility.

The main limitations of the empirical analysis using the VLSS are found at three levels. First is the degree of comparability of the surveys, second is the reliability of the data due to measurement errors, and third is the level of statistical significance, reducing the degree of reliability of disaggregated analysis. The biases included in the sampling frame, there are considerable constraints in the level of disaggregation, limiting the scope for empirical analysis. Disaggregation by province is not statistically significant, nor is a disaggregation by ethnic minority. New and migrant households are also unlikely to participate in these surveys due to registration requirements.

In addition, simple statistics on the top earners demonstrate an unrealistically low level of income and expenditure, which clearly leads to an underestimation of inequality. This also indicates the importance of the qualitative information from the community questionnaire to provide a more accurate profile of poorer regions.

Another of the main concerns for researchers is not only the availability of data and its quality, but its continuity. The Vietnam Living Standard Survey has come from large donors' need to access standardized information such



that comparability between countries can be done. However, individual ministries implement their own surveys so as to monitor their projects and development strategies.

1.2. Provincial and rural/urban data:

Up to date, the use of provincial level GDP data produces unreliable estimates since the total GDP figures do not add up to the national figure. Many of the human development indicators necessary to disaggregated analyses at the provincial level are unavailable.

Finally, the distinction between rural and urban areas may also be misleading. Due to the speed of urbanization, it is necessary to reflect the true character of rural areas as they become urbanized. Based on anecdotal evidence in officially rural areas around Hanoi which are clearly urban, there appear to be some problems with keeping the pace with urbanization, which causes an overestimation of rural areas and consequently some biases when computing rural poverty levels.

1.3. Intra-household data:

It has long been argued that 'limiting the analysis of poverty dynamics to the household level appears inappropriate' (Muffels, 2000:168). This is because an evaluation of the incidence of poverty using household income or expenditure data implicitly assumes that all members of the household are at the same income or expenditure level. At the household level, disaggregation by age or gender, to study intra-household inequality is also unreliable. In the VLSS types of datasets, although specific questions are addressed to children, the parent's desire to speed up the process often leads them to reply for their children.

2. Making better use of existing data

2.1 Suggested improvements for the VHLSS

In order to ensure some continuity in data the collection process, here are some recommendations for improvements for LSMS-based surveys. Firstly, there is a need to reduce the level of interpretation of the questions and to make the interviewing process more culturally sensitive, especially for ethnic minorities. This would involve structural changes in the questionnaire and in the guidelines for interviewers and supervisors. In particular, more rigid guidelines on the interaction between interviewers and interviewees, and greater supervision of data quality during interviews, should be required. The selection of interviewers should ensure that interviewers have at least some knowledge of the regional culture in which they conduct interviews, especially

in more isolated areas and with ethnic minorities. In addition, the possibility of hiring local translators instead of using another member of the family would be highly beneficial to data reliability.

Secondly, the possibility of over-sampling for lower income households as part of the sampling methodology should be explored further. This recommendation stems from the difficulty of including lower-income households in the sampling frame. Poorer households were systematically under-represented in the VLSS datasets. Moreover, the multi-purpose nature of questionnaires based on the living standards measurement dilutes the emphasis on questions related to income and expenditures, which further reduces the analytical potential of the survey data to analyze poverty levels.

Finally, the questionnaire should include questions related to changes in household composition between the initial and follow-up surveys. Even though nearly 4,000 households participated in both surveys, the follow-up surveys did not take advantage of this opportunity to ask questions on the reasons for changes in household composition. This change is not necessarily reflected in a different household size. Migration, death, divorce or children leaving to form their own households are highly likely during the five year period between the surveys. Therefore, questions on the household roster should reflect this dynamic context in order to be incorporated in the analysis, since these social changes are a good signal of economic changes in these households. It is also highly recommended that questions on the registration status of households be added to the questionnaires, for a better understanding of 'new' and newly migrated households.

2.2 Commune surveys

Commune level data is an integral part of the VLSS and includes qualitative type of information. In the first two VLSS (92/93 and 97/98) community questionnaire was collected only for the rural communes because it was considered that "many of the questions are more relevant for rural than urban areas".^{lxxi} Due to this rural bias, it is not possible to include variables concerning community endowment when analyzing poverty in urban areas. Nevertheless, using the community level data allows an analysis of rural poverty related to access levels, such as access to land or off-farm employment. This information will be taken from levels of community endowment and mobility of households. Few empirical studies have made full use of this community level information.

Commune surveys can also provide information for cross-checking purposes. For example, in the case of payment by instalment, especially relevant for taxes, this information is easier to estimate since the interviewers have access

lxxi. Quoted from the introductory notes for the VLSS Statistical Abstract 1997/1998, prepared by GSO, 1997, p.2



to commune-level data. Should the head of household forget the amount of taxes paid, the interviewer may refer to the books from the local authority, which are widely used to collect the commune data.

2.3 Census data

It is recommended to make further use of the Census data in order to link it up with VLSS. See for example the excellent work done by Baulch and Minot using this methodology. If possible, adding anthropometric data such as the Body Mass Index (BMI) could be used as a proxy indicator of human development since it has very little measurement error.

3. Areas for future research related to inequality

3.1. Qualitative data collection

In recognition of the multi-dimensions of poverty, it is suggested that longitudinal qualitative surveys be undertaken for targeted groups, as opposed to geographical targeting in various provinces. Such information would be complementary to the six consultations sites done to gather community views on the poverty reduction strategy in 2002 and the 'voices of the poor' reports by various NGOs in 1999. Based on the experience from "Voices of the Poor", to inform policy makers on areas of safety nets development, voices from various segments of the population who are particularly vulnerable could be presented in the form of case studies.

The methodology could follow that used for the Voices of the Poor in Vietnam (1999) using a participatory approach combining interview, focus group discussions, associations, ranking and scoring, charts drawing, causal flows and institutional diagrams. The primary objective of these studies would be to understand the causes and impacts of inequality and draw up policy responses to tackle these problems. The studies would aim at determining poor people's perceptions of inequality, understanding the root causes and exploring possible solutions. It would allow a better understanding of the issues of migration, indebtedness, land alienation, coping mechanisms in relation to disasters.

- *Voices of the Rich*: This study would look into who they are, how they succeed, and how to tax them.
- *Voices of the 50+*: Focusing on people aged 50 and over (pre-retirement age and beyond), this study would address future needs for the establishment of safety nets for the elderly. The focus should be on how to extend coverage of existing schemes if our concern is inequality, and how to extend any sort risk-reducing help to poor households.

- *Voices of migrants*: This study would explicitly address the concerns of safety nets for migrants (males and females) so as to move policy to encourage rural-urban migrants, as in China.
- *Voices of the ethnic minorities*: Some surveys have been done on health issues, but more information is required on the traditional safety nets of ethnic minorities so as to find the best way to spend external funds to assist ethnic minorities. A specific focus should be on access to education by female minorities.

3.2. Labour market survey

Most of the recent studies related to the labour market rely on the VLSS instead of surveys specifically focusing on labour. MoLISA currently implements a labour survey but it has limited value for policy purposes. Its objectives are to collect information on employment by region, sector, type of employment and employer, as well as estimating labour use time rates. Information on income, benefits, etc is not considered as part of this survey.

However, an increasingly important area for policy makers is how to increase access to a *regular* flow of income. Another is on understanding the impact of the formalization of the informal sector, in the development process - see for example studies by H. De Soto. Up to date, surveys on the informal sector have been sporadic and geographically targeted due to lack of resources. The labour market survey should be designed so as to increase our understanding on the types of policies that could to reduce inequalities. For this purpose, the survey should systematically address the major sections of the labour code (salaries, benefits, conditions of employment, etc) and compare males with females.

3.3. Land issues

To date, there is no national or provincial level survey that covers access to resources for rural households in order to have sufficient understanding on the characteristics and operation of the rural land-use rights market, the relative roles of the various credit sources, the rural labour market and the role of access to input/output markets for income generation. Key surveys and census such as the 2002 Vietnam Households Living Standards Surveys (VHLSS), which covers over 60,000 households nationwide, and the 2001 Rural, Agricultural and Fishery Census, conducted by the General Statistical Office, provide valuable information on the wellbeing and development of rural households. These surveys though extensive in topics and area of coverage, treated the four resources that affect households' production ability only briefly.



3.4. Impacts of migration

At the time of writing this report, there exists no reliable and longitudinal data on migration. Although various types of surveys have been done, many by independent researchers, none of the datasets are at the national level. This current study pointed out the many important implications of migration for a balanced regional development in Vietnam. This information will be increasingly important for policy makers.

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PANELLISTS' PERSPECTIVES

Dr. Do Minh Cuong

Thank you Dr. Frtizen, we just listened to the excellent presentation of an issue, which I myself and many other are very interested in. I would like to point out that this issue was paid much attention when the Vietnamese delegation took part in the Copenhagen International Conference 20/20 in 2000. Vietnam is resolutely committed to social development along with social progress and equality. Now I would like to present my comment.

I believe this report has addressed one of the issues of most concern in Vietnam now, that is, the inequality in Vietnam during the *doi moi* period. This report is well written by a team of domestic and foreign scholars who throughout the preparation must have searched a large body of literature by both Vietnamese and international authors for the references, indicators and data. This ensured a firm ground for a comprehensive analysis. The purpose of this report as clearly expressed is to propose policy options in order to curb the widening inequality. From my point of view, it is a well chosen topic and it has been approached and analyzed in an objective manner. The authors said that on a global scale, inequality does not closely correlate with economic growth and GDP per capita; they also pointed out that many nations have been able to ensure equality throughout the process of economic development. This argument contrasts with some views that market led economic development inevitably results in inequality. The point here is how to deal with the situation.

In the paper, 20 years of *doi moi* are reviewed with reference to key indicators such as economic growth, poverty reduction, the Human Development Index, and the Gini index. Though the inequality in Vietnam in terms of the Gini index is not really alarming, it is receiving much attention in terms of its dimensions and root causes. I strongly agree with some points here. After briefly describing the causes, the authors presented some policy options, particularly the appropriate role of the State in dealing with inequality related issues which stem from the market economy. The question is to what extent the state should intervene in order to ensure equality without having undesirable side effects on economic growth incentives. This is an issue for careful consideration and handling and the authors asserted that economic reform should be carried out in such a way so as not to negate the impacts of development policies whilst maintaining equality in development. Policies should be designed in order to improve equality and facilitate the fast growing economy of Vietnam as a



driving force for modernization and poverty reduction in the decade to come. Then the causes of inequality are presented in 7 groups: bias towards state-owned sector, bias towards urban areas, blockage in primary education, access to social security, gender issues, ethnic minority issues, and corruption. The solutions presented for these problems, for me, are basically acceptable. However, I wonder how they can be realized and at what pace. It would seem in the analysis of the issues, that the authors recognized that Vietnam's Party and State are consistent in harmonizing economic development and social equality. One point I want to make here is about the bias towards the state-owned sector. It is noted that in recent years, especially in preparation for joining the WTO, the Vietnamese government during the last 2 years has issued a series of legislations. This fact seems to have been omitted in the report. The development of small and medium enterprises and equitization of state-owned firms are strongly promoted at the present time. It seems that the authors wish this would be achieved more rapidly but I am afraid that in the specific context of Vietnam where the market economy is not fully developed and the capacity and mechanisms for evaluation are not well built, quicker equitization may lead to new inequality. Experience from Russia and East Europe showed that privatization and equitization of state-owned companies made a small privileged group much richer. The question raised here is how the process can be carried out using proper measures in order to protect social security and welfare. Concerning this point, the analysis made by the author is accurate and profound but I would like the author to take this analysis further in the context of Vietnam. Firstly, Vietnam is still a poor country and the employment relationship within it have not been institutionalized, i.e., many hidden workers are not recognized as employees. While there are limitations to the existing social insurance and social assistance programs, the poverty reduction program led by the Government is quite successful. Apart from the conventional insurance system, there is a system supporting those people who made considerable contributions during the wars. This may be both politically and morally justified but they are also socially correct because these people, perhaps millions of people, are disadvantaged in some way and in need of external support for their livelihoods.

Regarding the causes of inequality, I want to add two more causes: the incomplete system of policies and lack of information and capacity of the poor. These factors distort the market and deliberately benefit a small interest group which has access to the information. Take land issues as an example. Those people who know the planning of land use in advance are much likely to get rich through speculative activities. This is due to the fact that there is a lack of transparency in disclosing information. Other problems have occurred in this process because of the shortcomings in the existing system rather than in the State's direction. The second point is the capacity of the poor in accessing resources. Let's me take as an example, as many of you may know, credit provision to the poor in mountainous areas. When the bank gives a preferential loan to poor ethnic people, they expect them to use it for the purpose of production enhancement. However, in actual fact, after some time when the loan matures, the borrower takes it out from the smoking-shelf in the kitchen



where it has been stored since they borrowed it and gives it back to the bank. These poor people do not know what to do with the money and think that holding it is the safest way to preserve the capital. By taking this example, I want to add another cause, namely the lack of management skills needed to improve people's living standards. I assume this will be of great importance and added to further discussions.

In summary, I want to say that this report is written in a comprehensive and objective manner with a clear purpose: to describe the real situation of inequality, analyze the root causes and propose solutions to curb widening inequality. This can be a great reference for policy makers and I recommend that further research on this issue be carried out in order to find out feasible solutions taking into consideration the current level of economic development and the implementation capacity.

Thank you for your attention.

Prof. Brian van Arkadie

Hello, I would like to start by thanking the Vietnamese Academy of Social Sciences for inviting me and giving me another chance to come to Vietnam. I also would like to thank UNDP for inviting me to these meetings. And secondly I'd like to thank SIDA for inviting me to participate in the meeting.

I don't think I discovered until the mid-1990s, that I was the most difficult to interpret. So now I will just read my research and comments. The paper by Scott is comprehensive with a large amount of data and covers a number of points. There are a lot of analyses and policy discussions that I agree with. My comments are not about the technical analyses, but some reflections in some areas that are identified as the drivers of rising inequality. Before that, however, I would like to repeat that although it's quite difficult at this time to examine why the inequality is rising, I think it is a very important topic. It is also recognised that under *doi moi* the Vietnamese performance in reducing inequality has been an example. And even the public policy changes should continue to concentrate on the number of the poor. If Vietnam has become more unequal, if it was more equal twenty years ago, it should be remembered that was equality in sharing poverty.

Now I want to touch on some of the issues raised. The issue the paper identified as important, were straightforward policy changes that can be introduced in relation to access to secondary education. The paper shows that educational access is becoming a more important cause of inequality of opportunities. But having made that case effectively, I thought Scott was pessimistic in his policy conclusions.



Besides the simple fiscal arguments, in the case of fees for higher education it is simply based on the argument that the benefits of higher education are with the better-off. However, if fees are going to be introduced and the resources not used to expand supply and provide effective scholarships, the result must be that educational benefits are even more steeply towards the better-off. At the margin, it would be the poor students, who would drop out.

If historically in the US and in most European countries, development is based on free education, showing a degree of equality of opportunities in otherwise unequal societies, why should Vietnam attempt to do otherwise? In other words, I am saying maybe the best thing to do about school fees is just to avoid it. If they are to be maintained for this reason, however, there should be basic principle commitments, policy commitments that no child should be charged for education at any level because their parents lack means. So I think this is a clear conclusion, I would argue.

Reading along this paper however I found the case regarding urban bias to be much less persuasive. To some degree, development always involves urban bias, as it involves the shifts in economic activity and population from the countryside to the cities. And also increases in incomes that rise faster in the cities than in the countryside. Average productivity of capital is always higher in agriculture, at the margin many rural investments are in fact capital intensive. Also the critical point is beyond investments in casual infrastructure and water, the critical needs in rural centres are in fact knowledge, improved skill and improved practices.

An additional important rural-urban issue which is hinted at in the paper and was developed in the discussion, is the need to address equality. It is the bias against the rural relatives who wish to move to the cities. Such migrants will be anyway at the bottom of Vietnam's underclass. But current policy on resident status lacks support for this group and has created a large urban underclass with few rights and unnecessary low income. Policy should pay much more attention to equality improvement and the economic assistance of migrants to the cities.

Turning to corruption I would make some robust pessimistic comments. I was a bit surprised by Scott's observation about corruption. It may be the case about big corruption and a new sort of corruption may now be taking place. But more common forms of corruption such as the famous envelope system, payment for public services, payment for access to jobs etc., my early observation is this system is well known and well understood.

Indeed the corruption system in Vietnam can be described and fully spelled out by any Vietnamese here, they can tell us how much you are expected to pay for a teacher's job in each province; and how much you have to pay back if you are given permission to have temporary jobs in international organisations. Those are stable, well-known and can easily be discovered. In fact the problem is the system is very well established, very well understood and it is the normal ways that still exist in the country side as far I can see.



So I urge the system should be changed by political exertion or even by the change of surcharges by corrupt officials. One necessary condition will be a following reform of public administration. Salary scales must be improved so that it creates a modern public administration which is not in place yet.

Likewise, the arguments about state bias being a source of inequality will have to be handled with some care. The main case which I think is of some credibility is that of private sector use of capital and modern factories to effectively generate employment. So the shift in capital and other resources from state to non-state enterprises will increase employment and generate benefits for the poor is a plausible case.

So there are powerful arguments along side these arguments that are creating a levelled playing field. However, there is little evidence that non-state sector generates more equal income than the state sector. Incomes within the private sector are likely to become more unequal, both within and between enterprises. Level playing fields do not result in draws. I mean the level playing field is very misleading and the playing may be level but one side may win by a very large margin.

In Western capitalist economies the most striking inequalities are not in earned income but of assets. In my own country there are very small groups of extremely wealthy in a way that is not justified in any right argument on the incentives as seen in many capitalist societies. Such inequality to pick up the chairman's point creates urban privatisation, privatisation in Russia resulted in fact in one Russia oligarch buying the Chelsea Football team. I think many Vietnamese would like the Vietnamese should buy Manchester United, but I don't think it necessarily a case related to inequality.

Now such patterns of ownership may and may not be justified but they are certainly unequal. And such a great inequality has been important in principle cases. In the West, for example, there is no level playing field in access to the media. The issue of what sort of pattern and what distribution of assets ownership should be adjusted when you take long term view in the future of the economy.

Is emerging extreme property ownership an inevitable outcome of the market economy? Now in earlier social literatures, there was powerful theoretical argument that you could have a model of market socialism with high degree of access equality. But what this does suggest is that there is an alternative long term vision for the future of market economy which needs to be explored and have not been explored yet in any other discussions on Vietnam.

Gender we haven't discussed as it's discussed in the paper but I think the paper demonstrates that Vietnam does pretty well on economic criteria compared with many other countries in relation to gender gaps. But I should argue that the critical issue faced on the gender form relates to changes in attitude which



determines gender relations, for example within the households. This particular area involves enormous economic policies.

In relation to safety nets, there is no place in this country to aggregate substantial resources to help the government in mobile. However, with very limited resources I would also join the Chairman's scepticism about large programs of social security, particularly as he pointed out there is a minority in the urban formal sector. So I suppose that the social safety net in that sense, there is a strong case to be made to use what resources are available to generate employment. So these people can not help themselves particularly the old and the disabled. And it seems to me there is some social responsibility.

Finally, I appreciate that in the paper the issue of ethnic minorities is addressed as a matter of choice. Dealing with ethnic minorities is not just a matter of pumping resources to these areas, again the Chairman made these reasonable points. I would add something different. One thing about rapid economic growth, while ethnic minorities might not yet be prepared to compete economically they can effectively go for migration. I think in some ways this is what happened in the Central Highland. Also one has to know that if it is a targeted area for one reason without more economic opportunities, then pumping resources to these areas is simply wasted. For decades in Italy, the state pumped resources into the South, the main function of this was to ease the outward migration of the people. The migrants would move to Milan. Of course, Scott's paper did not claim all the policy options, but it does focus on a number of these subjects which I already discussed. So I congratulate Scott, thanks.

Dr. Mary McDonnell

Thank you Dr. Fritzen and his team for such a thoughtful, sensitive, sophisticated and innately intelligent piece of work; a close match with the reality I have observed in Vietnam since the mid 1980s.

First of all want to make a general comment about this workshop. In 1990, my organization held a workshop with VASS, evaluating progress on *doi moi* to that point. I cannot tell you how different that was in tone and character. Despite good will and willingness to take risks, so much could not be discussed which is now raised openly. Though twice postponed, the boldness of VASS leadership and those who supported it from Premier Do Muoi on down enabled the workshop to take place. We should not forget just how far we have come in engaging in these difficult topics raised in Dr. Fritzen's paper.

This paper highlights Vietnam's enormous economic success, moderate but rising inequality, and continued progress on human development indicators. Clearly economic gains are more modest for the poorest and more dramatic for



the rich. Though modest, rising inequality is of great concern to ordinary citizens and to policy makers in part because concern for social fairness has been at the core of Vietnam's political life since the end of the colonial period.

From the initial years of *doi moi*, concern has been to grow in ways that benefited most people and to retain and even enhance the social safety net for those least able to benefit. Not to throw the baby out with the bath water as transition progressed – probably the biggest concern in the early 90s. Because this is state initiated and led economic and social reform and because there is the expectation that the state will take care of the people, there is enormous potential for the Vietnamese government to be successful in adopting the kinds of measures that Dr. Fritzen suggests which will assist in diminishing growing inequalities.

So while continued growth is good news and only a moderate rise in inequality is also good news, since for historical reasons citizens are likely to have low tolerance for increased differentiation and high expectations that the government can and will do something about it. This will be especially true as differentiation becomes more visible in the form of new elites. Dr. Fritzen's emphasis on the importance of developing a serious personal income tax system is exactly right. This must be a priority - sons and daughters of the wealthy flaunt their wealth. Being able to tax personal wealth must be preceded by the ability to collect accurate data on income. Dr. Fritzen's distinction between the former system's stress on equality of outcomes and current stress on equality of opportunity seems a useful distinction.

Vietnam's socialist system stressed collective values and social good while the reforms strengthened private and especially household values while promoting individual choice. Household reforms may inherently exacerbate regional, class and sectoral inequalities at least initially. We saw regions with larger capital resources and more private land quickly take advantage of the emerging markets. Rural households near urban areas are easily able to benefit more quickly than remote areas critical to promote rural sidelines and industry. As Dr. Fritzen points out in his discussion of minorities, it may be more a matter of remoteness than being a minority. I would suggest that isolation drives the other pieces of the poverty trap. If I look at the situation of Malaysia, with which I have been involved since the early 1970s, we see that despite enormous efforts to enfranchise, as the economic pie has grown, minorities still lag behind.

As I read Dr. Fritzen's paper, I was struck by how much our 1990 look at *doi moi* and the recent work we've done on poverty and migration in HCMC, supports his analysis. There are many resonances between his work and ours; I feel it is less useful to go through the whole paper than to highlight a few areas where I can add nuance, flesh out or probe behind some of the issues based on our work – but fundamentally, this is a very sound analysis based on significant cooperation between international agencies, scholars and the Vietnamese government.



Our project

Let me say a few words about the project we have been doing at the interface of poverty, migration and urbanization as I will refer to it often in my remarks. It is a joint project between SSRC and SISS which began in 1997 and continues today. It is a training, institution building and network creation project examining the social consequences of economic transition in Southern Vietnam through longitudinal, multidisciplinary research in three urban wards and 4 rural communities. We had 3 rounds of data collection 1998-2001 using range of methods including:

- Household and individual surveys
- Household budget surveys
- In depth interviewing

Focus on urban bias

Dr. Fritzen states that urban bias is a serious problem and I agree. In part this is a common problem in rapidly developing countries but may be more intractable here for historical reasons. One of the results of the socialist revolution was levelling the playing field between rural and urban areas. My early visits in the mid 1980s found significant rural-urban equality in poverty, in many ways people I dealt with in government, education and research were disadvantaged in comparison to rural counterparts, while our urban colleagues went hungry subsisting on green tea and tobacco, often ill or too tired to sustain concentration for long periods. To many, an urban bias seems but a correction to an earlier rural bias. This thinking may present a psychological obstacle to some of the policy measures suggested in the paper.

More importantly though, our research on migrants and the families they leave behind, shows that a focus on rural poverty may miss important new pockets of urban poverty, such as internal migrants from rural to urban areas and their children. Our study shows that internal migration provides significant positive contributions to development – in both the urban area and through remittances, to rural areas. As migrants are typically from land owning households and make clear decisions to take the risks involved in migration, they are neither the poorest, nor least skilled, nor least educated. Remittances increase disparities that already exist making some rural households better off and linking them through social networks to urban based social and economic processes.

We need to understand migration better in order to insure stronger positive impact on sending and receiving communities but we already know quite a bit. In depth interviews suggest that the push and pull factors involved in the decision to migrate are complex: Yes, lack of opportunity at home; yes, HCMC is full of opportunity. But, social capital, household composition and structure significantly impact on the decision to migrate. Level of debt is also critical. Many migrants are landowning, but indebted. In the absence of alternatives, sending a migrant is seen as a quicker way out of debt.



While the rural household benefits considerably, the migrant him or her self often chooses to lower their standard of living in order to send remittances. Thus formal income is relatively high but lifestyle is poor. As with other poor people, migrants must borrow money, creating debt, for unusual expenses such as illness. Migrants are not usually eligible for government assistance due to their KT4 residence status; or may not be anyway as they make a decent wage in the formal economy.

Dr. Fritzen discusses the importance of education to upward mobility. Migrant's children rarely attend school. This seems to relate to both school fees and to residence status. Migrants are KT3 and 4 and this status prevents access to social services, loans and education. I agree strongly with Dr. Fritzen's conclusion that this is an arena ripe for urgent reform and one which can be readily accomplished.

Economic and social mobility

I want to stress something mentioned above in passing. While Dr. Fritzen notes old age related illness and expenses as a prime contributor to preventing mobility – and I agree – our data indicates for those who routinely fall in and out of poverty the issue is really debt. Debt incurred for any reason; illness, funeral, marriage, will cause a household to return to below the poverty line.

A final point relates to globalization. Vietnam recognized from the beginning of the *doi moi* process that integration with the world economy was the only plausible option. The pace and scope and success of reforms have come to depend on an expanding economic pie itself dependent on foreign capital, technology and of course markets. Greater engagement with markets creates risks for individuals as commodity prices fluctuate. This was the hardest piece for our researchers to investigate as we conceptualized the project. It was easy to see ways the household was impacted by local, regional and national decisions. It was much harder to recognize how decisions made in Europe, US, Japan, at Nike or at The World Bank can impact an individual's ability to be upwardly mobile.

I recognize the intended emphasis in this paper was to demonstrate what the Vietnamese government can do – what is amenable to government intervention and what sorts of interventions might make sense. But perhaps two points are worth making:

This government cannot directly control all the variables and what happens in Vietnam will be subject to what happens internationally – in firms, in regional and international bodies and in foreign governments. Thus making internal policy in Vietnam for Vietnamese people is only part of the answer; Vietnam must also carefully craft external policies. Take the Asian economic crisis – how grateful people here were that integration with ASEAN had not proceeded as quickly as originally hoped. New research shows liberalization of trade barriers in agriculture and textiles may harm developing countries. Vietnamese internal policies must be developed within the context of the broader environment.

PANEL III: INTEGRATION AND RAPID POLITICAL AND ECONOMIC CHANGE IN EAST AND SOUTHEAST ASIA

Keynote Presenter: Prof. Carlyle A. Thayer, Prof. of Politics, Australian Defence Force Academy¹

Panellists: Mr. Hong Ha, former Secretary of the Party Central Committee in charge of external relations, former Chairman of the Party Commission for External Relations and current General Secretary of the Party Theoretical Council

Mr. Bradley O Babson, World Bank Country Director in Vietnam, 1994-97

Mr. John Shrimpton, Director, Dragon Capital

THE CHANGING REGIONAL GEOPOLITICAL LANDSCAPE: IMPLICATIONS FOR VIETNAM

Prof. Carlyle A. Thayer

This paper discusses three main questions: (1) how has the regional geopolitical landscape changed for Vietnam since the initiation of *doi moi* in 1986, (2) what are the implications of the rise of China for Vietnam's economic and political integration, and (3) what are the implications for the future of reform in Vietnam?

1. The changing regional geopolitical landscape

In late 1986, when Vietnam initiated *doi moi*, the global geopolitical landscape reflected the Cold War rivalry between the United States (U.S.) and the Soviet

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Union. The international states system was essentially bipolar with China generally supporting the U.S. against the Soviet Union. The dominant feature of the global geopolitical landscape was military confrontation between two blocks: the Warsaw Pact led by the Soviet Union and the North Atlantic Treaty Organization led by the United States. The influence of the Third World or Non-Aligned Movement was negligible due to economic and political differences among its members.

The regional geopolitical landscape in Southeast Asia reflected the global system to a large extent and was largely shaped by the Cambodian conflict and the intervention by external states (1978-91). Southeast Asia was divided into two groupings: (1) the three states of Indochina backed by the Soviet Union and (2) the members of the Association of South East Asian Nations (ASEAN) backed by China, the United States, Japan and other Western countries. Military conflict in Cambodia was the dominant feature of this period. The role of China was more noticeable at the regional than global level. China opposed Vietnam's dominance of Indochina and provided military support for the Khmer Rouge through Thailand.

Vietnam was in an isolated position in Southeast Asia because of its intervention in Cambodia. The ASEAN states, Japan, Australia and others implemented various forms of economic boycotts and sanctions. The United States continued its economic embargo that it first applied against North Vietnam in 1964.

What factors account for the dramatic changes in the international and regional geopolitical landscapes since 1986? Some observers stress the importance of external factors. At the international level the United States pursued a policy of containment against the Soviet Union. In this view, socialism collapsed because of unrelenting pressure for change – or “peaceful evolution” – applied by the West.

In 1986, when Vietnam adopted *doi moi*, Mikhail Gorbachev, the General Secretary of the Communist Party of the Soviet Union (CPSU), already had initiated a number of political and economic reforms designed to restructure the failing Soviet model of central planning. These policies led to domestic political instability. The collapse of socialism in Eastern Europe (by late 1989) and the Soviet Union (late 1991) resulted in the abrupt reduction if not termination of support for Vietnam in all spheres.

The end of Cold War confrontation led to unprecedented cooperation between East and West and between China and the Soviet Union. In brief, the global political landscape was transformed from bipolar military confrontation to a unipolar system dominated by the U.S. The U.S. was called a “hyper-power” because its national power dominated in all spheres: military, science and technology, political, economic, and cultural.

Changes in the global geopolitical landscape led to equally significant changes in Southeast Asia. At the regional level Vietnam succumbed to a combination



of military and political-diplomatic pressure exerted by the coalition of states that opposed its intervention in Cambodia. In September 1989 Vietnam withdrew all its military forces from Cambodia (following the precedent of the Soviet Union's withdrawal from Afghanistan). In October 1991, the Cambodian conflict was formally brought to an end by a comprehensive political settlement. The following year, at the request of the Philippines, the U.S. withdrew from its military bases in that country.

In the early 1990s, the regional geopolitical landscape was transformed from military confrontation to unprecedented cooperation between ASEAN and Vietnam, and the normalization of relations between Vietnam and China. These changes set the scene for the growth of regionalism. ASEAN set itself the objectives of creating a free trade area and enlarging its membership to include all ten states in Southeast Asia. Nonetheless, Southeast Asian states became concerned by Chinese assertiveness in the South China Sea in 1992 and especially in 1995 (when China occupied Mischief Reef).

It would be a mistake to view changes in the regional geopolitical landscape as originating solely from external pressures. For example, in the 1980s, Vietnam adopted a number of long-range policies to extricate itself from a serious socio-economic domestic crisis. Vietnam's policy of *doi moi* was a recognition that the Soviet model of central planning was no longer appropriate. Vietnam's "open door" policy of encouraging foreign investment was a recognition that Vietnam had to reorient its foreign policies to take advantage of globalization. Politburo resolutions no. 2 (1987) and no. 13 (1988) set the stage for the withdrawal of Vietnamese "volunteer forces" from Laos and Cambodia, the downsizing of the Vietnam People's Army, and a new foreign policy orientation of "multilateralization and diversification of relations". In mid-1991, the 7th National Party Congress adopted the expression "making friends with all countries" to capture Vietnam's new foreign policy direction.

Vietnam achieved great success in adapting to changes in the global and regional geopolitical landscape. As mentioned, in 1991 Vietnam and China normalized diplomatic relations. Japan resumed Overseas Development Assistance. The year 1995 was pivotal. Vietnam normalized relations with the United States, became ASEAN's seventh member, and signed a memorandum of understanding with European Union (EU).

Since the mid-1990s, four main forces have shaped the international geopolitical landscape: globalization, demographic trends, international terrorism, and U.S. dominance.

Globalization refers to the scope and speed of growing world interdependence in capital, goods and services, labour, information and technology. Over the next fifteen to twenty years, globalization will push world economic growth to new levels, raise living standards and deepen interdependence among states. Many regions of the world will enjoy heightened prosperity. A large middle class will emerge for the first time in countries currently classified as



poor or developing. Hundreds of millions of working-age persons will migrate and become part of an integrated world labour market. The greatest benefits of globalization will fall to those countries and groups that can access and adopt new technologies to their own development. The East Asia region will be the centre of world growth.

Demographic trends in the future will see the emergence of youth bulges in many parts of the developing world. This will be accompanied by a fall in population growth rates in developed countries and an aging of their populations. This will pose constraints on economic growth. Japan and Russia will be severely affected in this regard.

The end of the Soviet occupation of Afghanistan and U.S.-led military intervention in Iraq (firstly to repulse Iraqi aggression against Kuwait and secondly to overthrow the Saddam Hussein regime) unleashed the forces of global jihadism. The factors that have helped create international terrorism are unlikely to lessen over the next fifteen to twenty years (see discussion of the “politics of identity” below).

In twenty years’ time the U. S. will still remain the most powerful global state in all dimensions of national power. However, the relative power of the U. S. will decline over the next two decades due to the rise of China and India and the likely proliferation of weapons of mass destruction to states that do not now possess them. How the U. S. responds to and attempts to manage globalization, demographic trends and international terrorism will play a large part in the maintenance of global and regional order.

The forces of globalization will also pose severe challenges to the capacity of both international institutions and states to successfully manage this process of rapid transformation. Newly created democracies may find it difficult to consolidate political reform. The “politics of identity” (separatism and political extremism) will challenge the legitimacy of the state. In particular, the spread of global information technology will contribute to the creation of a “virtual identity” among scattered minority groups around the world. It is likely that international terrorism will become highly decentralized among differing groups, cells and individuals. Terrorist groups and individual terrorists, with no apparent common interests, are likely to forge alliances of convenience to advance their political goals.

At the regional level, the geopolitical landscape is being shaped by a number of factors: the impact of globalization, the rise of China, the emergence of India, potential rivalry among the major powers (Japan-China and the United States-China), and growing East Asian regionalism. Over the next twenty years, all of these developments will pose challenges to ASEAN unity and cohesion, and Vietnam’s economic and political integration.

The impact of globalization on the regional geopolitical landscape was demonstrated by the Asian Financial Crisis of 1997-98 that impacted on



Southeast Asia at the same time as political instability in Cambodia, the Indonesian “haze” problem, and the subsequent collapse of the New Order regime in Indonesia. ASEAN unity and cohesion was severely shaken. ASEAN enlargement has led to several fault lines: between old and new members, between the economic “have” and economic “have not” members, and between the “politically open” (democratic) and “politically closed” (non-democratic) states. ASEAN’s disarray has slowed the pace of Vietnam’s regional political and economic integration.

The other factors shaping the regional geopolitical landscape are discussed below.

2. China’s “Peaceful Rise”

There can be no doubt that the most significant development that will reshape the regional geopolitical landscape over the next two decades is the rise of China and Chinese influence in all spheres: economic, political-diplomatic, social-cultural and military. China’s strategic goals may be summarized as follows:

- Maintain domestic security; prevent separatism in Tibet and Xinjiang; and then recover control over Taiwan;
- Promote a stable regional security environment, especially along China’s periphery, as the prerequisite for economic growth;
- Maintain high levels of economic growth to provide employment, raise income levels and prevent domestic disorder;
- Restore and expand China’s traditional political and diplomatic influence; and
- Promote a multi-polar international order to prevent encirclement or containment by the United States.

Southeast Asia is viewed by Beijing as China’s sphere of influence. China seeks to bolster a stable and secure region in order to gain access to regional energy resources and raw materials, protect maritime trade routes across the region, and develop wide-ranging relations for economic and political purposes (including isolating Taiwan and countering U.S. influence).

Southeast Asia’s future geopolitical landscape will be shaped not only by the emergence of China but of India as well. The rise of these two major powers will be based on high rates of economic growth, large populations, the active promotion of high technologies, and increased military capability. Measured in purchasing power parity (PPP), China’s economy is already the second largest in the world after the U.S. At market exchange rates, the Chinese



economy ranks sixth, after the U.S., Japan, Germany, the United Kingdom and France. By 2020, the dollar value of China's Gross National Product (GNP) is likely to become the second largest after the United States. At the same time, India's GNP likely will be the equivalent of a large European state. China and India will likely achieve higher economic growth rates than Japan and Europe. The growth of Chinese manufacturers and Indian high-technology services will pose a competitive challenge across the entire spectrum of industries and technologies and greatly complicate the successful development of other regional economies.

China's economic growth will spur increased demand for energy resources and other raw materials; this will drive an expansion of Chinese interests from the regional to the global stage. China's reliance on imported energy resources will result in an interest in maintaining political stability in those regions where these resources are found. In addition, China will also have an interest in maintaining the security of maritime lines of communications, especially through Southeast Asia. China, India and other growing economies could become competitors for energy resources to fuel their economic growth. Both China and India are seeking oil from Iran. This factor already may be driving naval force modernization in these two countries. The rise of China and India will trigger a new set of international and regional alignments.

China's economic rise will impact on Southeast Asia and the wider Asia-Pacific region. China's economic success will create competitive pressures in other states to reform and open their markets to foreign investment. China's "peaceful rise" will stimulate trade and investment from its neighbours. For example, China's economic success has contributed to lifting Japan out of recession and keeping the Philippines from falling into recession. China's energy needs have been a boon to Indonesia's oil, gas and mining sectors. In short, China's growing economy will be a catalyst for growth in Southeast Asia.

China's economic growth will also provide a firm foundation for its defence modernization. It is commonly assumed that real Chinese defence expenditures range between U.S. \$31-\$38 billion in 2003, well above the official Chinese figure of U.S. \$22.3 billion.² By 2020, China will overtake Russia as the second largest spender on defence after the United States. China's projected economic growth indicates that it will be able to spend between 2.3% and 5% of Gross Domestic Product on defence. By 2025, these figures would

2. According to a Chinese Foreign Ministry spokesperson, Liu Jianchao, China's defense expenditure in 2004 was U.S. \$24 billion. Liu noted that "In recent years, in pace with China's economic development, Chinese defence spending has indeed increased a little. But the bulk of the increase is for the improvement of living conditions of the officers and soldiers. China has not the intention nor the capability to drastically increase its military build-up." Quoted by Agence France-Presse (Beijing), "Rumsfeld's claims groundless: China," The Straits Times, June 8, 2005.



result in expenditures in the range of U.S. \$185 billion (or 60% of the U.S. defence budget in 2003) and \$403 billion (or one-third greater than the U.S. defence budget in 2003).

There are two main drivers of China's military procurement program (1) the perceived intermediate and long-term challenge posed by the United States and (2) the desire to project power. Specifically, China's objective of reasserting control over Taiwan must take into account the possibility of U.S. military intervention should a crisis occurs. The People's Liberation Army has devoted extraordinary efforts to purchase and develop weapons systems to deter the United States from intervening in a Taiwan contingency. Not only is the PLA building up the capacity for a preemptive strike on Taiwan, it is expanding its stocks of Inter-Continental Ballistic Missiles (ICBMs) to strike the U.S. mainland (and other parts of the globe as well).

Projections of China's economic and military development over the next two decades must also take into account various factors that could constrain the most optimistic estimates. First, it is widely believed that the official annual Chinese growth rate of 8.7% over the last twenty-five years is exaggerated. Second, economists project that China's economy will grow at 7% per year through 2010 and then gradually decline to 3% per year until 2025. Constraints on Chinese economic growth include: stagnation and eventual decline in its labour force, a fall in domestic savings as the population ages, a slowdown in the growth of exports and industrial output because of market saturation, weaknesses in the financial sector and problems in agriculture in the rural area. The Chinese government also has a number of contingent liabilities such as unfounded commitments on pensions, the need to re-capitalize state-owned banks as they write off debt-ridden state-owned enterprises and interest payments on rising government debt. As the Chinese population ages the government will come under pressure to increase spending on pensions, health care, and education. Nevertheless, China's economy will continue to grow. China's GDP is projected to reach U.S. \$9.45 trillion in 2025 (in 2001 dollars) or about half the size of the projected U.S. economy at that time.

China's "peaceful rise" has been accompanied by a complete turn around in China's view of and participation in regional multilateral organizations. Initially, China was sceptical and suspicious that multilateral institutions would impinge on national sovereignty. Within the short space of a few years China has become a strong supporter of the multilateral process. In this respect, China's development of "soft power" has been most impressive.

Beginning in 1996, China began to actively participate in the work program of the ASEAN Regional Forum (ARF). In 1997, China attended the first ASEAN Plus Three Summit (APT), also involving Japan and South Korea. The following year China proposed a meeting of governors of central banks; this resulted in the Chiang Mai Initiative or currency exchange surveillance



mechanism. APT meetings have broadened in scope and now include finance, economics and trade, labour, agriculture, forestry, tourism and energy and environment ministers.

In 2000, China proposed the establishment of an ASEAN-China Free Trade Agreement (ACFTA) to expand trade and investment ties. As a first step, China and ASEAN negotiated a Framework Agreement on ASEAN-China Comprehensive Economic Cooperation in 2002. China has also agreed to an "early harvest scheme" that will give ASEAN members earlier access to Chinese markets than other WTO members, and China has granted special treatment to ASEAN's least developed members (Cambodia, Laos, Myanmar, and Vietnam) who are expected to comply with ACFTA implementation by 2015. The ASEAN Six (the original five members plus Brunei) are expected to meet the implementation deadline by 2010.

The APT process with its emphasis on East Asian regionalism is a counter-reaction to globalization, the rise of regional trading blocks (EU and the North America FTA), and ASEAN dependency on the U.S. dollar. ASEAN hopes to enmesh China through the APT process, while China hopes to allay regional fears about the negative impact of its ascendant economy. ASEAN members hope that the ACFTA and access to the Chinese market will assist them in regaining competitiveness and thus their attractiveness to foreign investors. China, for its part, hopes that the ACFTA will give it access to Southeast Asia's markets, especially energy and minerals. China also hopes to contain Japanese and U.S. influence in the region. According to economic projections, the ASEAN-China FTA will result in a 48 percent increase in ASEAN exports to China and raise ASEAN's total GDP by 0.9 percent. China's exports to ASEAN are expected to increase by 55.1 percent or 0.3 percent of China's GDP.

By any measure, China's use of "soft power" has been successful. China is now widely perceived as sympathetic to regional concerns and respectful of "the ASEAN Way". The APT process offers China an opportunity to expand its political influence and its ability to reshape regional order. At the 7th China-ASEAN Summit in 2003, for example, China acceded to the ASEAN Treaty of Amity and Cooperation. At the same time, China and ASEAN signed the Joint Declaration of Strategic Partnership for Peace and Prosperity. In late 2004, China hosted the first ARF Security Policy Conference as an alternative to the U.S.-dominated Shangri-La Dialogue. China has also played a major role in initiating the Network of East Asia Think Tanks (NEAT). In sum, Southeast Asian regionalism, as embodied in the ASEAN Plus framework, is now evolving into a more explicit East Asia economic, political and security community led by China. The First East Asian Summit is scheduled for Malaysia in December 2005; China has offered to host the Second East Asian Summit in Beijing in 2006.

East Asia's new regional security architecture has not taken firm shape. There are a number of possible obstacles. The biggest obstacle is Sino-Japanese



strategic rivalry. Another obstacle is the exclusion of the United States from membership thereby constraining U.S. influence in the region. This would be a worrisome development for those ASEAN members who advocate a continued U.S. presence as a counter balance to China. The emerging East Asian Community poses challenges to ASEAN and its declared goal of creating an ASEAN [Economic, Socio-Cultural and Security] Community by 2020. It is unclear whether ASEAN members would join the East Asian Community as a single entity or as ten individual states.

In summary, China is now actively promoting multilateral initiatives as the main channel for cooperation among the states of East Asia not only in the economic sphere but in the political and security spheres as well. China's successful use of "soft power" has alleviated the "China threat theory" of the early to mid-1990s, constrained Taiwan's economic diplomacy in Southeast Asia, and relegated other major powers to reactive on-lookers. It is noticeable, for example, that China's ACFTA initiative provoked counter-responses by Japan, India, South Korea and the United States.

3. Implications for reform in Vietnam

Vietnam has set itself the goal of becoming a modern and industrialized country by 2020 or "a prosperous country, a powerful nation and an equitable and civilized society". In order to accomplish this goal Vietnam relies on domestic economic reforms (market forces with socialist orientations) and an open door foreign policy of "making friends with all countries". Over the next twenty years Vietnam will face serious challenges arising from fast changing global and regional geopolitical landscapes.

At the start of *doi moi* Vietnam looked to many countries as possible models for its development such as Taiwan, Singapore, South Korea, Malaysia and China. Some observers argue that China has become the principal model and main reference point for Vietnamese domestic reforms. In this view, Vietnam was inspired by high Chinese economic growth rates and shared concerns: of how to maintain one-party rule, socialist ideology, and political stability while carrying out potentially destabilizing economic reforms. Both countries seemingly faced the "threat of peaceful evolution". Vietnam inevitably looks to China before drawing up its domestic and foreign policies. As one former Vietnamese party secretary general proclaimed, "If China succeeds in its reform then we'll succeed, if China fails, we fail".

On the external front, Vietnam's policy of "multilateralization and diversification of relations" is more of a hollow slogan than a reality. In actual practice, Vietnam tends to take no action inconsistent with Chinese foreign policy. The very existence of China also acts as a constraint on Vietnam's military relations with other major powers and Vietnam's freedom of action in the Eastern Sea (South China Sea). In sum, Vietnam has achieved breadth but not depth in its foreign relationships.



4. What are the lessons for reform in Vietnam?

4.1 International

1. The key drivers of global change identified above - globalization, demographic trends, international terrorism and U.S dominance - will result in a future marked by new levels of strategic uncertainty and fluidity among the major powers. Vietnam will have to develop new analytic tools to understand how to cope with these changes. This should include a re-evaluation of the role of socialist ideology as an appropriate framework for analyzing changes in the international and regional geopolitical landscapes.³
 2. It is critically important for ASEAN to emerge as a unified and cohesive organization to better deal with the magnetic pull of China's "peaceful rise", East Asian regionalism and the influence of major powers. A weak ASEAN risks becoming a "new colony" providing raw materials to China in exchange for manufactured goods. A weak ASEAN also risks being subsumed in a larger East Asian Community. A strong ASEAN will provide a firm base for Vietnam's political and economic integration in the region. Vietnam can no longer afford to play a mendicant role in ASEAN but should contribute to strengthening its organizational capacity. Vietnam can help strengthen ASEAN by carrying out economic and political reforms (see points 5-7 below) and by encouraging similar changes in Laos and Myanmar.
 3. Vietnam should add depth to its critically important bilateral relations. "Making friends with all countries" is not an effective framework for the development of long-term strategic relations. For too long, for example, Vietnam has imposed self-restraints (including ideological constraints) on developing a fully rounded relationship with the United States. In a future likely to be marked by continued U.S. dominance, Vietnam must learn to leverage its relations with the U.S. to support its own comprehensive development.
 4. International terrorism will continue to threaten the stability of regional states with Muslim populations. These include several of Vietnam's neighbours. Vietnam is not likely to be directly affected by these developments but it needs to develop a clear national counter-terrorism strategy that includes meaningful cooperation with regional and external states as well as international institutions.
 5. China's military rise poses a challenge to Vietnam and its ability to exert sovereignty over its Exclusive Economic Zone and resources in maritime
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3. Are such formulations as doi tac (to cooperate), doi tuong (to struggle against), "making friends with all countries" and "peaceful evolution" useful in understanding the nature of change in the contemporary international system?



areas of the South China Sea that it claims. The Vietnam People's Army should not be kept isolated from global developments in defence technologies. Vietnam's military needs to develop a deterrent capacity through selective modernization of its naval and air forces (already underway) and by improving their capacity to act in a joint or coordinated capacity. In order to acquire this capacity Vietnam will have to develop appropriate forms of military cooperation with relevant major powers. Secondly, Vietnam must give serious consideration to the external role of the Vietnam People's Army in cooperation with the international community in such areas as peacekeeping and natural disaster relief.

4.2 Domestic

1. The Chinese model of socialist economic development may have reached the end of its shelf life and needs to be re-evaluated. After a quarter-century of reforms, the Chinese model has been unable to solve such pressing problems as weak banking and financial structures, heavily indebted state-owned enterprises, and rampant corruption. China's internal problems have contributed to political instability, especially in urban areas. Vietnam faces many similar problems and emulating the Chinese model has not helped to solve them. It is critical for Vietnam to speed up its economic reforms and develop niche industries that are competitive in the global market place. Vietnam should now look elsewhere to find a solution to its problems – Taiwan, South Korea and the United States.
2. The heightened pace and scope of global change over the next twenty years will result in major challenges to Vietnam's ability to manage change or capacity for governance. Vietnam needs to reform the decision-making process and structure of one-party rule to draw in larger sections of its population. Vietnam can no longer afford to delay political reforms. In the long-run Vietnam's failure to shift the legitimacy of its regime from economic performance to popular sovereignty may well contribute to domestic instability as a rising entrepreneurial class, larger numbers of individuals with work experience overseas, ethnic minorities, and urban youth all demand a greater say in the domestic political decision-making process.
3. The forces of globalization will reward countries that access and apply new technologies. Vietnam will be left behind if it does not harness new technologies to speed its economic development. Vietnam's tight political controls over Internet usage must be eased if it is to take advantage of the free flow of ideas and information so essential to the development of a market economy.



PANELLISTS' PERSPECTIVES

Mr. Hong Ha

I would like to thank Prof. Thayer for presenting a lively picture of the changing regional geopolitics and proposals for the *doi moi* process in Vietnam. His arguments and judgments on the world and regional affairs are profound and remarkable. I have the following comments:

When proposing the *doi moi* process in 1986, facing bipolar military confrontation in the world and the ongoing war in Vietnam, we had new thoughts in seeing the world and foreign affairs. From mainly seeing the world as a fierce fighting arena, a life-and-death struggle between the two opposing blocks, we switched to see the world as an environment in which Vietnam needed to survive and develop; the trends for globalization, cooperation and coexistence in peace among countries with different social structures were developing more and more; Vietnam was part of the world and needed to integrate with the region and the world. Since then, repeatedly in the years 1987, 1988, 1991, 1992 and 1995, Vietnam took initiative in very important foreign policies, marking the strategic change and renewal in foreign policies and guidelines.

We have solved the Cambodian issue, normalized relations with China, the United States, become a member of ASEAN, signed a cooperation framework with EU, had cooperative relations with international financial and monetary organizations, become a member of APEC, etc. Our country has broken away from the blockade and isolation, integrated with the region and the world, and created a foundation for a comprehensive and extensive renewal of foreign policies.

The reform of Vietnam's foreign policies and guidelines themselves have contributed positively to changing the regional geo-political picture, changing Southeast Asia from a region with two opposing groups of countries to a region of peace, cooperation and development.

The *doi moi* process of Vietnam has been carried out with reference to the reform experience of foreign countries and ideas of international friends but it started entirely from the reality of Vietnam, from the demands and intelligence of the Vietnamese people. We did not dogmatically follow any foreign socio-economic development models. Dogmatism and mechanically copying any existing foreign model is bound to fail.



We also implemented a foreign policy of independence, self-control, openness, diversification and multilateralization of international relations. This does not simply mean opening up international relations. We developed international relations with focus and depth, intertwining interests and creating a long-term foundation for stability and sustainability. That foreign policy and approach is not a slogan but really has profound content and vitality in the *doi moi* process of Vietnam.

Prof. Thayer advanced predictions about regional and world affairs in the next 20 years. This is not an easy task at all. These predictions provide very noteworthy information. For example globalization will lift the world economy to a new height; the American influence will decrease with the rise of China and India; East Asia will become the centre of the world's growth; international terrorism will not diminish; hostile relations among some powers still exist implicitly, etc. All these factors will challenge ASEAN, including Vietnam.

Thus, I would like to request Prof.'s opinion about two issues: Firstly, compared to the situation of the world and Asia Pacific region during the last five years, will the situation of the world and region in the next twenty years be better or worse? Secondly, can local wars occur in this region in the next twenty years?

Prof. Thayer stressed main factors determining the world's geopolitical face such as the trends for globalization and demography, international terrorism, the superpower of America and the rise of China. What does Prof. Thayer think about other factors that some researchers also believe to be very important and influencing the world's geopolitical face such as:

- Scientific and technological revolution will make great advances and breakthrough and significantly impact on all countries.
- International economic, financial and monetary institutions.
- Multinational and transnational corporations.
- National and international non-governmental organizations (NGO).

Global issues such as the polluted ecosystem, exhausted resources, changing world's climate, natural catastrophes, population explosion, large flows of migrants, transnational drug trafficking, deadly epidemic diseases, transnational crimes, etc.

Prof. Thayer's suggestions on eight lessons for the *doi moi* process in Vietnam are also very noteworthy. There are points that we can refer to during our *doi moi* process. Other points need to be further contemplated. There are also points that we have already implemented.



In the following years, with experience from nearly 20 years of *doi moi* and assistance from international friends including UNDP and SIDA, we will renew more strongly, harmoniously and comprehensively with a greater economic growth. That cause must be based on the mobilization of our internal strength to a high degree and at the same time, taking advantage of external resources through further extensive promotion of multilateral and diversified international cooperation.

For this reason, I would like to thank Prof. Thayer, UNDP, SIDA and international friends for valuable ideas that have helped us to further step up the *doi moi* process in Vietnam.

Thank you.

Mr. Bradley O. Babson

Carlyle Thayer has provided us with an excellent analysis of the geopolitical dynamics of change in Asia and has drawn important lessons for the future reform agenda for Vietnam. I would like to associate myself with all of his recommendations.

What I would like to do during the timeframe for me is first to discuss two aspects of regional integration in Asia that are not fully developed in the paper and their implications for Vietnam in the future. One is the Mekong sub-region cooperation through the Greater Mekong Sub-Region (GMS) and Mekong River Commission (MRC) frameworks. And the second is the Northeast Asia sub-regionalism that is being shaped by both economic and security factors, including the Six Party Talks process with the participation of North Korea. Then, I would like to comment on Vietnam's relationship with the U.S. in the context of increasing regionalism in East and Southeast Asia. Finally, I would like to say a few words about Vietnam's future strategy for trade, private investment and ODA in light of these regional perspectives and to end with some comments about the continued relevance of the *doi moi* concept itself.

Sub-regional dynamics

The MRC and GMS are important because they integrate political and economic interests and provide operational frameworks for conflict management and long-term mutual benefit. Vietnam has strategic long-term interests in maintaining good relations in natural resource use with the other five countries in GMS, especially China, Cambodia, Laos, and Thailand. The integrated water resources management of the Mekong River Basin poses challenges for balancing development and environmental values and for



managing trade-off choices of the countries and competing demands among countries for water in the sub-region. The same issues apply to bilateral relationship with China about the Red River Basin. Similarly, power trade among the GMS countries offers potential win-win solutions to meeting energy needs among the countries. In both water and energy security, Vietnam will face increasing pressures and difficult choices in the coming years that will require more sophisticated policy coordination and resource management. This will require not only political will but also further development of systems supporting knowledge-based decision making and the strengthening of institutions and of linkages between regional, national and sub-basin management. Vietnam's new demands will require a coherent political and economic response to protect Vietnam's interests and nurture Vietnam's long-term cooperation dynamics in the sub-region. Vietnam should make proactive efforts to develop the MRC and GMS further so that they become useful institutions for long-term cooperation and shared management of the Mekong sub-region's natural resources.

In Northeast Asia, such powerful economies as China, South Korea and Japan are becoming increasingly integrated although they had historical acrimonious relationships which has inhibited the development of sub-regional cooperation institutions. It is noteworthy, for example, that South Korea now has a larger trade relationship with China than with the U.S. With shared energy security interests in an increasingly volatile world, the integration of Russian natural resources with these economies is also likely to move forward in the coming decades. This will create a new set of dynamics in which ASEAN and especially Vietnam will be largely excluded, or treated differently, as we can recognise from the several 10 plus 1 ACFTA proposals with the NE Asian countries and ASEAN, while they are discussing a tripartite ACFTA. Ironically it was the formation of ASEAN Plus Three that gave impetus to more structured cooperation among the Plus Three countries and this cooperation is now developing. The potential solution of the North Korean issue will only bind these countries closer together in a block to supervise any negotiable agreements and gradually integrate North Korea into the regional and international economic system. This will divert attention away from ASEAN and stimulate institutionalization of the security cooperation that is emerging through the 6PT process. I don't see how Vietnam or other ASEAN countries will become a significant part of this new equation, although security dialogue through the ARF will continue and can evolve into a cooperation dialogue between the two sub-regional blocks. Because the U.S. plays the central role in the North Korean equation, it is impossible to imagine the emergence of new security architecture in Northeast Asia without the U.S.'s presence, although all people are talking about the emerging Asian Community.

U.S.- Vietnam relationship

This leads to my comments on the U.S.-Vietnam relationship in the changing regional context. This relationship is an unusual and special one for both



countries. Strong bilateral ties are in the long-term interest of both countries for the reasons spelled out in Carlyle's paper. One aspect of this is the role of the American Vietnamese, who both serve as a valuable channel for Vietnamese exports to enter the U.S. market and as a source of foreign exchange through remittances. It is in Vietnam's interest to deepen its relationship with the U.S. on multiple aspects in the coming years, which will be built upon the Prime Minister Phan Van Khai's successful visit. This process will be accelerated and enriched if and when Vietnam moves towards adopting more formal democratic power sharing mechanisms domestically.

It is also worth noting, as pointed out in Edward Lincoln's recent book on Asian economic regionalism, that the tendencies towards growing regional economic collaboration that exclude the U.S. will be moderated by the reality that trade and investment relations between the U.S. and all the large economies of Asia as well as the middle income group will remain substantial, even with growing intra-regional trade and investment. This will remain a primary driver of transpacific cooperation in security as well as economic areas. Vietnam can thus be confident that it can exploit its special relationship with the U.S. not only to maximize its opportunity for long-term market penetration and economic benefits from remittances, but also as a stabilizing factor politically in a somewhat more complicated and competitive regional integration environment that has risks as well as potential rewards.

Implications for financing Vietnam's future development

One implication that I draw from the discussions of global and regional dynamics is that Vietnam should not assume that it is going to be the "Darling of Development" forever. The first 20 years of doi moi has not only been a story about Vietnamese policy and institutional development. Vietnam received large inflows of foreign capital in the form of ODA, FDI and remittances from overseas Vietnamese at the same time. This is highly unusual in the general experience of developing countries and Vietnam should not assume such a combination will continue indefinitely. While donors have been highly supportive of Vietnam's doi moi policy, and this can be expected to continue, Vietnam should not assume that ODA will continue at such high levels and with such soft terms in the coming years. There are a number of reasons for this. First, Japan as the largest ODA donor has been reducing its global ODA steadily and this can be expected to continue with some further adjustments influenced by the regional geopolitical and economic dynamics. A second reason is the renewed focus on Africa by the international community that is leading to the G-8 decision next week to forgive \$40 billion in multilateral debt. This will affect ODA re-flows and future priorities for IDA allocations. Third, there are likely to be future competing ODA claimants in Asia, whether due to disasters like the Tsunami or the emergence of new clients such as North Korea and Myanmar. On ODA, my advice to Vietnam is to have an exit strategy that would guide the

country in working its way deliberately out of being a large ODA recipient, first by managing a staged process of graduating from IDA/ADF funding from the World Bank and ADB and shifting to IBRD/OCR financing. Also, ODA policy should be geared to using donor resources and expertise on catalytic needs linked to the country's long-term development strategy that is now being reconsidered. Vietnam needs to look ahead to what it will mean to mainstream financing of its future development out of its own resources and well-managed commercial borrowings and look to the experiences of South Korea and the more advanced countries of ASEAN for models of future development financing. Vietnam should be leading this process and not find itself in a position to have to react and adjust without forethought to pressures from outside to wean itself from the soft money.

Similarly, on FDI, the issue for the future will be increasingly on the quality of investment and what it means for helping Vietnam develop long-term export markets in the regional and global environment we have been discussing, and to be able to increase the productivity and competitiveness of the economy for sustainable growth. The attention will need to be on "smart investment" not just the amount of investment that Vietnam is able to attract in competition with China and other ASEAN countries. Smart investment will require attention to sustainability, especially of the natural resource base; deepening value-added and productivity in export processing industries; investing in comparative advantages, identifying niches that work such as in eco-tourism and cultural exports; and exploiting the geopolitical tensions between China and Japan.

Priority in the future will need to be given to improving the mobilization of domestic private savings for investment, removing constraints on efficiency of investment, and tapping the growing regional bond markets for financing of public infrastructure in addition to traditional ODA sources of infrastructure finance. This means that continued development of the financial system as an efficient intermediary in the allocation of resources will be extremely important as Vietnam adapts to the realities of regional and global competition and opportunity, and the changing climate for ODA.

Priority on people

Fundamental to Vietnam's future success in responding to the dynamics of regional political and economic change and in mobilizing the financing for smart investment decisions, is to pursue a policy of trusting and empowering the Vietnamese people to use their ingenuity and ambition to seek out opportunities and exploit them. This requires not only to continue to strengthen the legal and financial frameworks that enable private initiative, but also to upgrade and internationalize the education system and stimulate knowledge transfers. Vietnamese creativity combined with a knowledge-based development strategy that seeks to understand the larger world and how it works in a time of dynamic change, can underpin Vietnam realizing its dream



of being a strong and vibrant society. By being confident in its people, culture and vision, Vietnam can contribute to the process of regional cooperation and integration for the larger good of Asia above and beyond pursuing its own nation-building aspirations.

Is it time to move beyond *doi moi*?

In conclusion, I want to underscore the main point made by Carlyle Thayer in his paper, which is that Vietnam should re-assess the socialist ideology it has been using as an analytic framework to set policy goals and legitimize its strategy for achieving them. I would go even further and suggest that the doi moi concept itself is now outdated and leads to an inadequate conceptualization of the challenges that Vietnam must address in the future. The main reason I say this is that the primary orientation of the socialist ideology and the doi moi strategy have been inward-focused and directed towards guiding changes within Vietnam itself to build a stronger society and economy that are integrated in the regional and international system. These have been necessary tasks and Vietnam has been rightly praised for all the progress made in the last 20 years and with WTO membership now in sight. While I would agree that there is unfinished business in this internal agenda, I would also argue that the tasks ahead require Vietnam to recognize the dynamics of change in its external environment and prepare to act decisively in its political and economic relations with other countries and regional organizations to advance its own strategic interests. It must now pursue a coordinated dual track strategy of reform and of increasing Vietnamese influence over the course of future developments in a proactive not reactive way. It might be a good idea to give this next phase a new label that reflects these new challenges and tasks, not just the continuation of meeting the old ones.

Mr. John Shrimpton

Thank you very much indeed, Mr. Chairman, distinguished guests , ladies gentleman This is the final panel, so I would like to add my thanks also to Johnson Thimb and UNDP for very kindly inviting me to be able to be at the conference. I think professor Thayer is humbled by the company of the scholars in social science that we have here. I would like to focus on some of the comments that have been made today, particularly on domestic reforms. I hope also to add complimentary comments, to the Mr. Babson's remarks especially with regards on how the flow of funds from the donors to Vietnam might be affected later in the future. In that regard, I would like to provide some comments on another aspect of the review of doi moi which have not yet been mentioned which refer to capital markets in Vietnam.



First, perhaps a couple of comments, from the professor Thayer paper especially with regard to what has been categorized as China's peaceful rise.. I would then add some comments on some long term concerns for Vietnam.. Demography undoubtedly is a major source of concern while at the same time we assist at the paradox that in Southern China there is labour shortage. I would say that in the context of Vietnam we have already seen its affects. For example, last year one mainland Chinese investor established a factory down in the southern province of Dong Nai, designed to accommodate an investment of 20,000 workers. It suggested that we could be in the early stage of perhaps an exploded boom in foreign direct investment.

In his conclusion, with regard to the section on domestic reform in Vietnam professor Thayer quite rightly mentions that Vietnam does face similar problems in following the Chinese model in many respects. This is true by the logical trend but frankly from my perspective Vietnam has created its own model on the basis of its knowledge about some aspects. Among them, it has been successful to avoid a trap in which I would argue China has now fallen. From the investors' perspective, the most notable difference is the respective approach to privatization in China and equitization in Vietnam. The general model in China has been the one that the state generally retains 70% share in the state enterprises, but they are privatised. There is the issue of failing to intensify management changes. Also I think this model prohibits direct impacts on China's capital market.. Vietnam has its own approach to equitization and seems to be avoiding this paradox. The applied model has been that the Government retains only one third of total shares in state own enterprises when they are equitized. The shares are also sold to workers, and one third are set aside for outside investors which can include foreign investors.

The second example of Vietnam's successful approach is the emergence of private banks. In China today, even "Minsheng" banks, as the key model are still mainly under state ownership. They have not completely privately owned. But in Vietnam, 30 years ago the Government already allowed the establishment of completely privately owned banks.

Prof. Thayer stated that domestic reform has also posed the challenges to Vietnamese Government's capacity. The key advantage that Vietnam enjoys I think would be a different history. Here there is complete absence of the traditional power blocks that we would normally see in every other Asian country. Vietnam did not have family dynasties that controlled huge parts of the country like Thailand or the Philippines for example. There are no Chaebols as seen in South Korea. There is also no equivalence of Developer Clubs that effectively control majority of the economy in Hong Kong. And also I would say no equivalent of the Malaysian UMNO. The consequence of these is the historical absence of substantial amount of domestic private capital. Who is really the class of entrepreneurs here to pool the financial and other resources? Six years ago we started to offer and promote a couple of best international practices. It might be many of these companies have now



adopted best international practices in corporate Governance. So it has indeed spread rapidly.

This constitutes the achievement of 20 years of doi moi. I would like to add a few comments on the state of Vietnam's capital market on its potential for the future of the country. Speaking as an investor, as an investment manager, I hope I will be excused for the special interest that I have in this subject. Let's consider for a moment what hopefully building a capital market can deliver for Vietnam. First I think you can say an efficient bond market will provide long term funding for central government, for provincial government and for asset security, and debt security. In pool the equity would also assist in line with the overall cost of borrowing. And of course infrastructure development could be more readily funded. An effective equity market would have to facilitate the Government goals for equitizing further the state own enterprises including the larger general enterprises. We could also provide private sector companies with access to capital with which to fund their expansion, aiding the ability to create further job. And for foreign investors the capital market would provide the means to grow their long term saving and this in turn would eventually lessen their dependence on support from the state for income after retirement. I think in short, virtually all Vietnam's development goals projected can be linked in one way or another to the need for a properly functioning and large scale capital market.

So where are we now? and indeed how can we achieve this? After 5 years of operations of the capital market in Vietnam there are indeed very encouraging factors. The most positive point I think is the Government has built an extremely sound foundation for its capital market. And the best example of this is really that Vietnam is, in my own experience, the only country on the world in Asia which has had its stock market regulation in place before its stock market itself. It sounds a very basic point but the model that we see elsewhere around the region has been the model that established a stock market and after this the market crashes and then the market regulator is created. So I think we could say that Vietnam's unorthodox approach is certainly one which has instilled investor confidence. I also encourage the Government to take great confidence in forming the board of regulators for the framework which has been established.

Second, although the scale today is small, it very much resembles more of the developed OECD model than those of any others in the region including those of which I have seen along the history of the capital market. This is most encouraging for all of the market participants to learn how to make multiple planning to help make the capital market development another national priority. The key structure I see does require special attention to creating greater scale. Hopefully all of the elements required to do this are already in place. To give an example, which included almost 2 billion dollars of reachable stocks and a very significant reservoir of domestic liquidity. These elements now just need to be brought together. I think we should graduate from a market which in equity terms is 300 million dollars today to a market



approaching 2 billion dollars. And we will see one of the tiny miracles the stock market can offer is the phenomenon we refer to as 'flow attracts flow'. This means financial liquidity would flow into the markets where it can easily enter and also easily depart. Engaging in the phenomenon of flow attracts flows will start a virtual circle of capital market growth here which will enable Vietnam in turn to attain the broader developmental policies. It would do so as flow would be generated from domestic resources which would better encourage flow from portfolio resources. It will serve in the course of time to replace the donor flow that Mr. Babson has mentioned earlier and this will provide Vietnam exit strategy.

Finally I would like to draw similar attention to one facet of the equation which received frustratingly little attention. This is to me to develop individual cooperations in long term saving vehicles, for example, pension schemes managed independently from the state and the state's social security funds. I think that Vietnam's demographic transition makes it tempting to think that there is plenty of time to leave the development of pension funds for the future. I think it is simply not the case. Everyday that goes by without the operation of a social security system has a considerable opportunity cost for the country. I would take this opportunity perhaps in urging any donor looking for the area whether they can contribute to the broader development program here, to strongly consider helping to provide technical assistant in this area. And I think it certainly will have a key catalytic affect. Finally again I would like to do add my thanks to my program led by the UNDP and to the Vietnam social sciences Academy. Thank you very much indeed for the opportunity to share a few thought in this conference.



CLOSING REMARKS

Closing remarks by Mr. Jordan Ryan

Mr. Jordan Ryan thanked all participants for papers, comments, ideas and thoughtful discussions. Mr. Ryan also expressed his sincere thanks to VASS for the courage to foresee and hold discussions on such selected issues facing Vietnam now and in the future, to the UNDP staffs led by Senior Country Economist Dr. Jonathan Pincus, and the press and media for dynamic reflection on the High Level Roundtable Meeting series.

Mr. Ryan raised the question of what were the key elements of *doi moi*, how *doi moi* had helped individuals having more say and ability to be engaged in the life of Vietnam, in their own development in life. Such reforms that had unleashed the creativity and drive of the Vietnamese during the last 20 years needed to be emphasized even more in the next 20 years.

Mr. Ryan shared Prof. Nam's view on cultural identity but stressed that it also needed to be developed towards a pragmatic, persistent, compassionate and sensitive Vietnam, being the drivers of new reforms. Mr. Ryan was also cautious about a "New Doi Moi" and observed that all Vietnam needed was to do more, to urge deeper *doi moi* to be unleashed. One very great challenge to *doi moi* to be in the right direction was *to engage young Vietnamese people in new ways of thinking*, Mr. Ryan said.

Mr. Ryan re-emphasized the values of the Millennium Development Goals (MDGs) to be accomplished with the new stage of *doi moi*, which are the values of freedom, tolerance, equality, and legitimate rights. Mr. Ryan expressed his hope that in the new thinking of *doi moi* prominent international and local scholars today could challenge Vietnam in doing much more, as rights are not only to entitlements given by the state, but individual's inherent rights not to be hungry, to have education; to move from the fundamental rights, in which Vietnam has so far been doing so well, to *deeper rights; to think, engage, debate and ultimately decide*.

Closing remarks by Prof. Do Hoai Nam

Prof. Do Hoai Nam thanked international speakers for frank, subjective, provocative discussions and ideas, which are valuable for Vietnam in



preparing for the Xth VCP Congress and the next Five Year Socio-economic Development Strategy 2006-2010.

Prof. Do Hoai Nam also expressed his sincere thanks to the Ambassadors for giving their time, to Vietnamese policy-makers and scholars for open and active participation, to the two teams of UNDP and VASS for conference preparation and logistics.

On this occasion, Prof. Nam expressed his wish to see all participants again at the Third High Level Round Table Meeting by late 2005 and expected to inform the participants on key outlines of next development strategy of Vietnam then for peer-review, discussions and insightful inputs by international scholars to better prepare for the next stage of *doi moi*. Prof. Nam concluded by giving his best wishes for good health and happiness to all participants.



ANNEX

SECOND HIGH LEVEL ROUNDTABLE MEETING “ASSISTANCE TO THE 20 YEAR REVIEW OF DOI MOI IN VIETNAM” PROJECT 30TH JUNE - 1ST JULY 2005 MELIA HOTEL, 44B LY THUONG KIET

Thursday, 30th June

- | | |
|-------------|---|
| 8:00-8:30 | Registration |
| 8:30-8:40 | Opening remarks
Prof. Do Hoai Nam, President, Vietnam Academy of Social Sciences |
| 8:40-8:50 | Welcoming remarks
Mr. Jordan Ryan, UNDP Resident Representative |
| 8:50-9:00 | Welcoming remarks
Ms. Anna Lindstedt, Ambassador of Sweden to Vietnam |
| 9:00-10:00 | Keynote Address
<i>Chairperson:</i> Dr. Prof. Vo Dai Luoc
<i>Presentation:</i> ‘Governing the Market in a Globalizing World Economy’ Robert Hunter Wade, Prof. of Political Economy and Development, London School of Economics
<i>Panelist:</i> Dr. Prof. Vo Dai Luoc, Vietnam Association for Economic Science |
| 10:00-10:30 | Plenary discussion |
| 10:30-10:45 | Coffee break |
| 10:45-12:30 | Panel discussion: ‘Law Reform, State-Society Relations and Social Organizations in Asian Comparative Perspective’
<i>Chairperson:</i> Dr. Prof. Dao Tri Uc
<i>Presentation:</i> Prof. Mark Sidel, University of Iowa
<i>Panelists:</i> - Dr. Prof. Dao Tri Uc, Director, Institute of State and Law - Vietnam Academy of Sciences
- Dr. Neil Jamieson, author of Understanding Vietnam
- Dr. Borje Ljunggren, Ambassador of Sweden to China |



- 12:30-14:00 Lunch**
- 14:00-15:30 Panel discussion: The Political and Economic Causes of Rising Inequality**
Chairperson: Dr. Prof. Do Minh Cuong
Presentation: Dr. Scott Fritzen, National University of Singapore
Panelists: - Dr. Prof. Do Minh Cuong, Ministry of Labour, Invalids and Social Affairs
 - Prof. Brian Arkadie, co-author of Vietnam: Transition Tiger?
 - Dr. Mary McDonnell, Executive Director, U.S. Social Science Research Council
- 15:30-15:45 Coffee break**
- 15:45-17:00 Plenary discussion**
- Friday, 1 July**
- 8:00-8:30 Registration**
- 8:30-10:45 Panel discussion: Integration and Rapid Political and Economic Change in East and Southeast Asia**
Chairperson: Mr. Hong Ha
Presentation: Prof. Carlyle Thayer
Panelists: - Mr. Hong Ha, former Secretary of the Party Central Committee in charge of external relations, former Chairman of the Party Commission for External Relations and current General Secretary of the Party Theoretical Council
 - Mr. Bradley O. Babson, World Bank Country Director in Vietnam 1994 - 1997
 - Mr. John Shrimpton, Director, Dragon Capital
- 10:45-11:00 Coffee break**
- 11:00-12:00 Plenary discussion**
- 12:00 Closing remarks**
 - Prof. Do Hoai Nam, President, Vietnam Academy of Social Sciences
- 12:30 Lunch**

In 500 bản, khổ 21x29,7cm, Công ty TNHH sản xuất Thông minh Hải Nội.
 Giấy chấp nhận đăng ký kế hoạch xuất bản: 814-2007/CXB/3-213/ThG
 cấp ngày 8/10/2007. In xong và nộp lưu chiểu quy định năm 2008.