

**The London School of Economics and Political Science**

**A Political Economy Approach to the Impact of  
the WTO's Accession Process on Vietnam's  
Economic Reform: A Case of Compliance?**

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London School of Economics for the degree of Doctor of Philosophy,  
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## **DECLARATION**

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## **ABSTRACT**

This research examines the impact of the WTO accession process on the economic reform process of Vietnam. The WTO accession provided a decisive external force to accelerate and lock-in domestic reforms. Accession acted as a template to inform and structure the reform process. The process was utilised by reformers help rescue Vietnam from economic crisis. With the extensive reform of economic institutions, the opening up to the market economy and the input of foreign capital, the Vietnamese economy showed rapid growth, moving from being the poorest country in the world to a middle ranking economy by 2013.

In the first and second chapters the objectives of the thesis are explained and the contextual framework and research design are presented, with the focus being on the economic reform of Vietnam. A literature review is followed by a comparative analysis of China's accession to the WTO.

In the third and fourth chapters, both the Vietnam political and economic systems and processes are presented in the context of Vietnam's transition from a centrally commanded economy to a market economy. A full examination is made done of the Communist Party and its governance mechanisms. Chapters five, six and seven concentrate on three case studies that evaluate the impact of the WTO on three Vietnam economic sectors; Agriculture, Banking and Textiles.

The conclusion demonstrates that the thesis research provides a unique new contribution to the literature as it revealed limits to the reach of WTO accession in accelerating domestic reforms. It identified the structural impediments to the full-fledged transformation of what was an insulated command economy into a globally integrated market economy. Endemic corruption, a growing debt burden and the influence of a powerful and wealthy elite interest group now threaten the Vietnam economy with a severe financial crisis. The reforms have failed to provide the necessary tools to avert the impending crisis. How and why this is the case is explained in the thesis.

# TABLES OF CONTENTS

DECLARATION.....	i
ABSTRACT .....	ii
TABLES OF CONTENTS .....	iii
LIST OF TABLES .....	viii
LIST OF FIGURES .....	ix
LIST OF ACRONYMS AND ABBREVIATIONS .....	x
ACKNOWLEDGEMENTS.....	xiii
<b>CHAPTER 1 INTRODUCTION .....</b>	<b>1</b>
<b>1.1 Introduction to the research.....</b>	<b>1</b>
<b>1.2 The political economy of reform .....</b>	<b>9</b>
<b>1.3 Vietnam as a case study .....</b>	<b>12</b>
<b>1.4 Research question.....</b>	<b>20</b>
<b>1.5 Research methodology .....</b>	<b>21</b>
1.5.1 Research design.....	21
1.5.2 Case study approach.....	21
1.5.3 Soviet and Chinese Influence on Vietnam reform .....	<b>Error! Bookmark</b>
<b>not defined.</b>	
1.5.4 China as a shadow case study.....	24
1.5.5 Horizontal policy areas .....	27
1.5.6 Delimitation and time period .....	28
1.5.7 Research conceptual framework.....	28
1.5.8 Data collection.....	30
<b>1.6 Thesis outline .....</b>	<b>31</b>
<b>CHAPTER 2 LITERATURE REVIEW: ECONOMIC REFORM AND THE</b>	
<b>WTO ACCESSION PROCESS .....</b>	<b>34</b>
<b>2.1 Political economy of reforms.....</b>	<b>34</b>
2.1.1 Components of Reforms .....	41
2.1.2 Determinants of the policy reforms.....	45

<b>2.2</b>	<b>World Trade Organisation (WTO) and its accession process .....</b>	<b>54</b>
2.2.1	WTO and its functions .....	54
2.2.2	Roles of the WTO in economic reform.....	55
2.2.3	WTO Accession Process .....	57
<b>2.3</b>	<b>China's WTO Accession .....</b>	<b>59</b>
2.3.1	China's WTO accession and commitments .....	61
2.3.2	China economic reforms .....	65
<b>2.4</b>	<b>China's implementation of the WTO's commitments and economic reform post- WTO accession.....</b>	<b>73</b>
<b>2.5</b>	<b>Conclusion.....</b>	<b>76</b>

<b>CHAPTER 3</b>	<b>VIETNAM'S POLITICS AND INTERNATIONAL INTEGRATION PROCESS .....</b>	<b>79</b>
<b>3.1</b>	<b>Overview of the Vietnam Economy .....</b>	<b>79</b>
<b>3.2</b>	<b>Political System of Vietnam.....</b>	<b>85</b>
3.2.1	The Communist Party of Vietnam.....	85
3.2.2	Formal structure of the Vietnam Government.....	89
3.2.3	Vietnam's National Assembly .....	90
3.2.4	Policy making process .....	91
3.2.5	Relationship between the Party and the State.....	93
3.2.6	Relationship between Central and Local Governments.....	95
3.2.7	Relationship between state and society .....	97
<b>3.3</b>	<b>VIETNAM'S ECONOMIC INTEGRATION AND WTO ACCESSION</b>	<b>112</b>
3.3.1	Vietnam's economic integration process .....	112
3.3.2	WTO's accession process and the commitments of Vietnam.....	117
<b>3.4</b>	<b>Conclusion.....</b>	<b>126</b>

<b>CHAPTER 4</b>	<b>IMPACT OF THE WTO ACCESSION PROCESS ON VIETNAM'S ECONOMIC REFORM PROCESS.....</b>	<b>129</b>
<b>4.1</b>	<b>Pre-reform period (before 1986).....</b>	<b>130</b>
<b>4.2</b>	<b>Economic reform process in Vietnam since 1986 to 2006 .....</b>	<b>133</b>
4.2.1	First stage of reform (1986-1995) .....	135
4.2.2	Slow reform (1996-2001).....	141

4.2.3	Accelerated reforms under the WTO accession process (2002-2006) ....	148
<b>4.3</b>	<b>Impacts of WTO accession on the accelerated reform process of Vietnam....</b>	<b>159</b>
4.3.1	WTO accession process has provided pressure for reforms .....	159
4.3.2	WTO accession process has influenced the political balance of interested groups for reforms .....	163
4.3.3	WTO accession process has guided the institution reform .....	176
4.3.4	WTO accession process has influenced the ideology for economic reforms .....	177
<b>4.4</b>	<b>Economic reforms after the WTO accession .....</b>	<b>179</b>
<b>4.5</b>	<b>Conclusion.....</b>	<b>190</b>

**CHAPTER 5 CASE STUDY: THE AGRICULTURAL SECTOR’S REFORMS ..**  
..... **194**

<b>5.1</b>	<b>Overview of the Agricultural sector and policies .....</b>	<b>195</b>
<b>5.2</b>	<b>Agricultural Sector Reform .....</b>	<b>197</b>
5.2.1	Agricultural shift to an export-oriented economy from 1986-1998 .....	197
5.2.2	Reform problems and slowdown: 1996-2002 .....	200
5.2.3	Reforms during the accelerated WTO accession process (2002-2006) ..	204
<b>5.3</b>	<b>Impact of the WTO’s accession process on the reform of agricultural sector .....</b>	<b>208</b>
5.3.1	Vietnam’s agricultural commitments to WTO membership .....	208
5.3.2	WTO’s accession process has provided pressure on economic reform in agriculture .....	209
5.3.3	WTO accession process has influenced the balance of politics to support the agricultural sector .....	212
5.3.4	WTO accession process has guided the institutional reforms in agricultural sector.....	216
5.3.5	WTO accession process has influenced the economic development ideology of the agricultural sector.....	218
<b>5.4</b>	<b>Reforms after the WTO accession .....</b>	<b>220</b>
<b>5.5</b>	<b>Conclusion.....</b>	<b>224</b>

<b>CHAPTER 6 CASE STUDY: THE BANKING SECTOR’S REFORMS .....</b>	<b>230</b>
<b>6.1 Overview of the Banking Sector .....</b>	<b>231</b>
<b>6.2 Banking reform process since 1986 .....</b>	<b>234</b>
6.2.1 Banking industry before Doi Moi.....	234
6.2.2 Establishment of market-oriented banking system from 1988-1997 .....	234
6.2.3 Limitations and slowdown of the reforms in the initial stages .....	239
6.2.4 Reforms restarted from 2000-2004 .....	242
<b>6.3 Impacts of WTO accession process on banking reform .....</b>	<b>246</b>
6.3.1 The WTO’s commitments on banking sector.....	246
6.3.2 WTO’s accession process has provided pressure for reforms .....	247
6.3.3 WTO’s accession process has influenced the balance of politics to support reforms in banking sector.....	249
6.3.4 WTO’s accession has guided institutional reforms in the banking sector .....	255
6.3.5 WTO’s accession process has influenced the economic development ideology of the banking sector .....	261
<b>6.4 Reforms after the WTO accession .....</b>	<b>263</b>
<b>6.5 Conclusion.....</b>	<b>274</b>
<b>CHAPTER 7 CASE STUDY: THE TEXTILE AND GARMENT INDUSTRY’S REFORM .....</b>	<b>279</b>
<b>7.1 Overview of the textile and garment sector .....</b>	<b>280</b>
<b>7.2 Reform of the textile and garment industry. ....</b>	<b>281</b>
7.2.1 Textile and garment industry before Doi Moi .....	281
7.2.2 Reforms from 1986-1997 .....	283
7.2.3 Reform’s shortcomings in the industry.....	288
7.2.4 Reforms since 2000 .....	293
<b>7.3 Impacts of WTO accession on the textile and garment industry.....</b>	<b>295</b>
7.3.1 Vietnam’s Commitments to WTO related to textile and garment industry .....	295
7.3.2 WTO’s accession process has provided pressure for reform .....	298
7.3.3 WTO’s accession process has influenced the balance of politics to support reforms in T&G .....	303
7.3.4 WTO’s accession process has guided the institutional reforms .....	313

7.3.5	Reforms after the WTO.....	318
<b>7.4</b>	<b>Conclusion.....</b>	<b>321</b>
<b>CHAPTER 8</b>	<b>CONCLUSION .....</b>	<b>324</b>
<b>8.1</b>	<b>Introduction .....</b>	<b>324</b>
8.1.1	Vietnam and Compliance with International Agreements .....	329
8.1.2	Vietnam Crisis: The Rich Get Richer and the Poor Get Poorer.....	330
<b>8.2</b>	<b>WTO influence on economic reform .....</b>	<b>332</b>
8.2.1	Comparisons with China.....	336
8.2.2	Vietnam’s ‘East Asian Miracle’ and the role of special interest groups.... .....	340
<b>8.3</b>	<b>Political and Economic update: Dangers and problems.....</b>	<b>343</b>
<b>8.4</b>	<b>Limits on WTO influence on domestic reforms .....</b>	<b>346</b>
8.4.1	Reasons for the ineffectiveness of WTO’s led reforms .....	349
8.4.2	Non-Market Economy Membership: A ‘Half-Way’ House .....	353
<b>8.5</b>	<b>Solutions for the Future.....</b>	<b>354</b>
8.5.1	IMF Loan: Easy Solution? .....	356
8.5.2	Following China again: A future rescue or another failed strategy ...	358
<b>8.6</b>	<b>Conclusion.....</b>	<b>359</b>
<b>BIBLIOGRAPHY .....</b>		<b>364</b>
<b>APPENDIX .....</b>		<b>425</b>



## LIST OF TABLES

TABLE 3.1: DISTRIBUTION OF FDI IN DIFFERENT SECTORS IN VIETNAM.....	83
TABLE 3.2: AVERAGE TARIFF REDUCTION UNDER CEPT IMPLEMENTATION OF VIETNAM .....	114
TABLE 3.3: SUMMARY OF THE WTO'S COMMITMENTS OF VIETNAM AND CHINA .....	120
TABLE 4.2: PROCESS OF EQUITISED SOES IN VIETNAM FROM 1999 TO 2005 .....	155
TABLE 4.3: NOMINAL AND EFFECTIVE RATE OF PROTECTION UNDER THE WTO COMMITMENTS (%) .....	160
TABLE 4.4: FDI, EXPORT AND IMPORT VALUE AFTER THE WTO ACCESSION (BILLION USD) .....	183
TABLE 5.1: NRP AND ERP ESTIMATE OF VIETNAM TARIFF FROM 1997-2003 .....	201
TABLE 5.2: TOTAL INVESTMENT AND ITS GROWTH ON EXTENDED AGRICULTURE PRODUCTS OVER THE YEAR.....	221
TABLE 5.3: FDI IN AGRICULTURAL AND AQUATIC PRODUCTS SINCE WTO ACCESSION ..	221
TABLE 6.1: NUMBER OF COMMERCIAL BANKS ESTABLISHED FROM 1991 TO 1999 .....	235
TABLE 6.2: PERCENTAGE OF CIRCULATED MONEY IN GDP OF VIETNAM AND OTHER COUNTRIES .....	240
TABLE 7.10: ANTI-DUMPING CASE AGAINST VIETNAM'S EXPORT PRODUCTS FROM 1994- 2004 (SEE APPENDIX 14 FOR MORE UPDATED INFORMATION) .....	301

## LIST OF FIGURES

FIGURE 1.1: THE ANALYTICAL FRAMEWORK.....	29
FIGURE 3.1: NUMBER OF PROJECTS AND VOLUMES OF FDI TO VIETNAM .....	83
FIGURE 4.1: SOEs EFFICIENCY OF USING RESOURCES COMPARED WITH INDUSTRY AVERAGE.....	162
FIGURE 4.2: FDI INFLOW IN VIETNAM FROM 1988-2008 .....	181
FIGURE 5.1: EXPORT SHARE OF THE MAJOR AGRICULTURAL PRODUCTS .....	196
FIGURE 5.2: IMPORT AND EXPORT OF AGRICULTURAL PRODUCTS OF VIETNAM.....	216
FIGURE 6.1: CREDIT RATION TO GDP.....	239

## LIST OF ACRONYMS AND ABBREVIATIONS

<b>ADB</b>	Asian Development Bank
<b>AFF</b>	Agriculture, Forestry and Fisheries
<b>AFTA</b>	ASEAN Free Trade Area
<b>AOA</b>	Agreement on Agriculture
<b>ATC</b>	Agreement on Textiles and Clothing
<b>BASEL</b>	Basel Accords
<b>BTA</b>	Bilateral Trade Agreement
<b>CAR</b>	Capital safety ratio
<b>CCP</b>	Chinese Communist Party
<b>CEPT</b>	Common Effective Preferential Tariff
<b>CIEM</b>	Central Institute for Economic Management
<b>CMT</b>	Cut-Trim-Make
<b>CPV</b>	Communist Party of Vietnam
<b>CSR</b>	Corporate Social Responsibility
<b>EPR</b>	Effective Rate of Protection
<b>EVN</b>	Vietnam Electricity Group
<b>FDI</b>	Foreign Direct Investment
<b>FEI</b>	Foreign Economic Information Joint Stock Company
<b>FOREX</b>	Foreign Exchange
<b>FRB</b>	Federal Reserve Bank
<b>FTA</b>	Free Trade Agreement
<b>GATS</b>	General Agreement on Trade in Services
<b>GATT</b>	General Agreement on Tariffs and Trade
<b>GOV</b>	Government of Vietnam
<b>GSO</b>	General Statistic Office
<b>IFI</b>	International Financial Institution
<b>IMF</b>	International Monetary Fund
<b>IOTG</b>	Institute of Textile and Garment
<b>JSB</b>	Joint Stock Bank
<b>MFN</b>	Most Favoured Nation
<b>MHB</b>	Mekong Housing Bank

<b>MIS</b>	Information System Management
<b>MOARD</b>	Ministry of Agriculture and Rural Development
<b>MOET</b>	Ministry of Education and Training
<b>MOF</b>	Ministry of Finance
<b>MOLISA</b>	Ministry of Labour, Invalid, and Social Affairs
<b>MOT</b>	The Ministry of Trade
<b>MPI</b>	Ministry of Planning and Investment
<b>NA</b>	The National Assembly
<b>NCIEC</b>	National Committee on International and Economic Cooperation
<b>NME</b>	Non-Market Economy
<b>NPL</b>	Non Performing Loan
<b>NTB</b>	Non-Tariff Barrier
<b>PWC</b>	PricewaterhouseCoopers
<b>SASAC</b>	State-Owned Assets Supervision and Administration Commission
<b>SBV</b>	State Bank of Vietnam
<b>SME</b>	Small and Medium Enterprise
<b>SOCB</b>	State Owned Commercial Banks
<b>SOE</b>	State Owned Enterprise
<b>SOEG</b>	State Owned Economic Group
<b>SPS</b>	Sanitary and Phytosanitary Standards
<b>T&amp;G</b>	Textile and Garment
<b>TBT</b>	Technical Barriers to Trade
<b>TPP</b>	Tran-Pacific Partnership
<b>TRIP</b>	Agreement on Trade-Related Aspects of Intellectual Property Rights
<b>TVE</b>	Town and Village Enterprises
<b>UNCTAD</b>	United Nation Commission on Trade and Development
<b>UNDP</b>	United Nations Development Programme
<b>US Aid</b>	United States Agency for International Development
<b>US BTA</b>	US-Vietnam Bilateral Trade Agreement
<b>USTR</b>	United States Trade Representative
<b>VBSP</b>	Vietnam Bank for Social Policies
<b>VCCI</b>	Vietnam Chamber of Commerce and Industry
<b>VDR</b>	Vietnam Development Report
<b>VFF</b>	Vietnam Father Front

<b>VFF</b>	Vietnam's Fatherland Front
<b>VINAFOOD 1</b>	Northern Vietnam Food Corporation
<b>VINAFOOD 2</b>	Southern Vietnam Food Corporation
<b>VINALINES</b>	Vietnam National Shipping Lines
<b>VINASHIN</b>	Vietnam Shipbuilding Group
<b>VINATEX</b>	Vietnam Textile and Garment Group
<b>VPA</b>	Vietnam People Army
<b>VITAS</b>	Vietnam Textile and Apparel Association
<b>VNA</b>	Vietnam News Agency
<b>VND</b>	Vietnam Dong
<b>WB</b>	World Bank
<b>WTO</b>	World Trade Organisation

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# CHAPTER 1 INTRODUCTION

## 1.1 Introduction to the research

This thesis examines the impact and role of WTO accession and membership upon Vietnam, and the subsequent affect it has had upon the reform process, with the economy converting from a centrally controlled system to a free market economy. However, its findings have drawn the thesis away from a constructive examination of the impact upon reforms of compliance to the WTO commitments and turned it towards an examination of a case of non-compliance, in which WTO accession and membership has illustrated how a developing country can, and has, resisted the reforms necessary for a true movement towards a market economy. Subsequently, the case studies and research focuses on domestic reforms in the context of commitments to the WTO and the reason why the credibility of even the most observable changes, such as in regulatory reform and establishment of new institutions, has to be questioned. The primary findings become not the type, degree and application of WTO commitments and the negotiations in formulating them, but rather the shape and form of internal, domestic resistance that negates many of the changes appearing to take place in the Vietnam economy. So deep is the resistance that the WTO becomes merely another player in a political and economic strategy of survival of the Vietnam Communist Party. Domestic reform is predicated on the grounds of political survival and not on economic growth or sustainable development, resulting in a thesis that has no choice but to assign the Vietnam case as a clear demonstration of the levels of non-compliance possible in a process formulated on supposed 'commitments' to an international organisation. The outcomes of such a strategy are now just becoming clear, and although the 'eye' of this hurricane of economic disaster is still to appear, the signs all point to an impending crisis of the gravest nature. The thesis examines the evidence for this hypothesis and presents the impact of the WTO as a force to bring transparency to an otherwise opaque economic situation, uncovering a variety of domestic issues where faults are far more apparent in the light of WTO commitments to reform. The actual reform process began in earnest with the advent of Doi Moi.



Doi Moi<sup>1</sup>, in 1986, began a movement from the centrally controlled system to a free market based upon ‘openness’ and ‘renovation’. This was a gradual process as the country retained many of the supports, relationships and politics of communism. Doi Moi was the country’s first major domestic reform in transformation of the economy and eventually progressed towards WTO accession. That accession was only made possible by the initial changes that occurred through Doi Moi and its subsequent packages of reforms, and when the global market judged reform to have sufficiently moved towards free market principles. That reform process, although successful, saw many difficulties remain and the challenges presented required a new acceleration of reforms that arrived with the onset of WTO accession.

WTO accession provided another means to reform the economy and in the process facilitated resistance against the conservatives and anti-reformist in the government and business world. WTO accession in Vietnam is not only an economic tool for reform, but in Vietnam, has played a part in promoting liberal democracy, challenging the sustainability of a communist regime and bringing into question the viability of the communist’s leadership role in a market economy. The political impacts upon reform have often resulted in serious flaws in the Vietnam economy remaining, such as the continued power and dominance of State Owned Enterprises and central control through them of the economy by the Communist Party. Reform through conversion to a market economy and the strengthening of that through WTO membership, are powerful influences upon political transformation, first being used by Vietnamese reformists to counter the resistance against economic and political reform of Vietnam, but also by the major actors in the global markets to impact upon Vietnam and bring about social, economic and political change. The main actors in the WTO (ex. USA), also see it as a way to promote liberal democracy. On the one hand it opens up new markets, and access to resources- such as cheap labour, while also providing political gateways for change.

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<sup>1</sup> Doi Moi is the economic reforms process initiated in Vietnam in 1986 with the goal of creating a "socialist-oriented market economy”.

Vietnam is a similar case to China, where economic reform is also taking place against the background of continued dominance of the Communist ideology. But, China is much larger than Vietnam and very different in many ways, such as the size of population, types of economic activity, etc. The two systems are very different types of communism. Added to this is the particular aspects of Vietnam that make it a unique study- coming out of many years of war and the subsequent destruction of those wars, being culturally very different, etc.

The thesis presents a comparison with China, but focuses chiefly on how reform, Communist political dominance and the impact of the WTO affected three main areas of the Vietnamese economy: The Textile and Garment industry, Banking and the Agriculture industry. Originally envisaged as a study of the positive reforms from WTO accession and the changing nature of the economy, the hypothesis of this thesis was dramatically changed by the research itself, with clear evidence uncovered that, rather than eventually leading to economic success, the WTO accession is beginning to reveal the structural problems that threaten economic collapse and crisis. It also showed that rather than reasoned and planned strategies for reform brought about by choices made through economic logic, the Vietnamese political and economic system is more often only changed by impending and disastrous crisis that threatens total collapse if adjustments are not made. When faced with virtually no choices but disaster or reform, the Vietnam Communist Party has only then welcomed the onset of reform on any effective level. WTO accession was originally seen by the author as primary evidence of an open arms welcome to the impacts and demands of free markets economics, but instead, the research showed that WTO accession forced changes only where the Party believed it could control the effects and the Party changing many 'appearances' of the economic system but retaining the basic elements of a centrally controlled system that ensured political dominance over all major areas of the economy. Equally disturbing has been the realisation that rather than providing access to global markets and the subsequent necessity for transparency, efficiency and competitiveness, WTO accession and membership has not prevented an increase in corruption in business and Government and left the economy on the verge of collapse, brought about by a refusal to actually change the basic underlying structures of the economy. To clarify such a statement, it should be made clear that the WTO accession process has not been the cause of such a situation, but rather the victim of an embedded Vietnam political and

business culture that continues to avoid embracing the competitive forces of the market economy, and instead remains in the control of ‘relationships’, cronyism and political and economic corruption on a scale that the forces of the market and the domestic ‘systems’ developed for WTO membership have failed to alter or deter.

The WTO accession and membership has been successful in providing the right impetus for reforms and in structuring those reforms in a more knowledgeable and professional way, such as the wholesale reform of the law and the introduction of new processes and systems for government administration and management of the business world. This success has provided the major challenge and in many ways the Vietnam economy has failed to meet those challenges. For example, the law on foreign direct investment has been aligned with WTO principles and for the first years, FDI improved at dramatic rates, but is now in the worst decline in South East Asia. The reasons for this include the Government failure to fully open up the economy to foreign businesses, the lack of any significant overspill of capital, technology and efficient management skills into the domestic Vietnam businesses, the numerous cases of corruption on a scale involving billions of USD and the unwillingness of Vietnam companies to actually change the way they do business in order to ‘fit’ into the international model. In Banking, the WTO accession brought international capital, skills and knowledge into the Banking sector, with economic growth providing ideal conditions for profitable and long-standing improvement of the Vietnamese Banks. Yet, in less than a decade, the benefits of WTO developments of the banking sector have been virtually wiped away as Banks find themselves billions in debt from the Government directed forced lending to State Owned Enterprises. Vietnamnet News (2012) recently reported that:

“In other countries, the ratio of outstanding loans on the capital mobilized from businesses and individuals is less than 100 percent, while the safety line is 80 percent. Indonesia and the Philippines, which are considered as having similar conditions with Vietnam, have the very low ratios, while Vietnam’s is 104.2 percent. The bad debt ratio of the banking system, according to the State Bank, is about 3 percent. However, international credit rating firms believe that the actual figure is higher. Fitch Ratings

believes that Vietnam's bad debt is 3-4 times higher than the official figure released by the State Bank, if calculating bad debts in accordance with the international standards".<sup>2</sup>

This aversion to actually carrying out reforms that totally move away from central control of the economy has brought the whole question of WTO benefits and costs to the forefront of the economy, not only showing the failures to significantly change the way the economy is run, but also a continuous process of trying to hide the fact with false reporting of statistics and the creation of dual systems where companies continue a covert pattern of business through 'relationships' and cronyism, while the 'face' is presented as abiding by the changes required to meet the demands of the free market.

Throughout the thesis the research revealed alarming facts and was presented with two ways to view accession and membership of the WTO. The first was in line with the original hypothesis: namely that WTO accession was a vital step in carrying forward reforms, accelerating and deepening their impact while also acting as a template to inform and re-structure the reform process. With the extensive reform of economic institutions, the opening up to the free market and the input of foreign capital, the Vietnamese economy showed rapid growth, the control of inflation and a transformation from a controlled economy to a free market. However, research into the three case studies and the Vietnam economy in general, revealed a second face that required careful navigation through the propaganda and suspicious data of the Government. This revealed the flaws in the model presented, and could not avoid the conclusion that the movement from a central control to a free market system was not actually taken on in a thorough and deep way, but instead has involved a refusal to fully reform the system and now clearly shows that Central Government control covertly remains the dominant form of managing the economy. In addition it has shown that the chief flaw in the present system is the increase, and almost critical impact, of corruption, with the now almost totally embedded systems of corruption threatening the Banks and many of the major State Owned Enterprises with collapse under the growing burdens of debt. For example, the real estate market is in crisis as the value of land and

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<sup>2</sup> Vietnamnet News, 14<sup>th</sup> June 2012, "Bank sneezes, the national economy catches a chill"

property slumps and numerous investors find themselves searching for liquidity. Yet the depth of crisis and the true assessment of the situation is impossible to calculate, while investor are also unable to reveal the true debts, because almost all deals involve on-going hidden charges, such as ‘bribes’ to officials to gain possession of land or rights to actually build on it. Much of these ‘hidden charges’ are linked to the investors ‘borrowing’ money to pay them. Because of the ‘unofficial’ means that the finances are often sourced from, the debtor is often left with loans from ‘unconventional’ providers that involves incurring excessive interest rates and even dangerous terms for non-repayment. These practical problems are aggravated by systemic faults in the Vietnam governance model.

The Party and the Government have retained a central control of the economy through the SOEs and continue to use the system of administration as a means to provide vast fortunes to individuals who have used the Political and economic systems for personal gain only. In a recent meeting of the Politburo, the Communist Party Chief, Nguyen Phu Trong, declared that the ‘immoral lifestyles of some Party members’ and their families was the main cause of Vietnam’s present economic problems (An Diem, 2012).

The thesis fully examines this hybrid system of WTO accession providing support for market economy reform, while also secretly retaining the old system of central control. Its path shows that in less than a decade of reform through openness and an often covert conservative refusal to reform, the Vietnam economy has reached a cross-roads, where there are signs that Vietnam’s growth is on a reverse track and economic crisis is one of the strongest possibilities for the future.

The WTO and its impact on the Vietnamese economy are the central targets of this study. The WTO administers trade agreements negotiated among its members and is the international institution that deals with international trade, ensuring smooth, fair and predictable global trade flows. The main contingent of those seeking membership are developing and transitional economies. WTO membership provides countries with:

1. Opportunities for access to new markets,

2. Protection for transitional economies against the trade blocking measures of the more dominant ones,
3. The strengthening of the domestic institution-policy establishment,
4. Helps prevent an erosion of past reforms and guards against pressures from interest groups by locking-in such reforms through binding international commitments (Michalopoulos, 2002; Drabek and Laird, 1998).<sup>3</sup>

WTO membership is essential in reform of developing countries, as they require greater market access and protection against any arbitrary actions by bigger players. The reform success often generates the need for further reform, such as further liberalisation in trade and investment<sup>4</sup>, the development of a new regulatory regime for SOEs and the private sector in order to encourage competitiveness and integration into the world economy. Further reform is often technically and administratively more difficult than the initial stages and often encounters political resistance (Krueger, 2000). Under such circumstances, developing countries are rushing to become WTO members with the hope that the WTO will help support and accelerate reform processes.

Despite the success of the WTO, there remain a number of contentious issues, such as claims from developing countries about the lack of fairness and asymmetrical gains. After the Uruguay Round, international trade practices on the part of developed countries focused on the benefits they could gain from membership, although many developed countries continued to provide protection and subsidies and engage in 'dumping'. WTO members have negotiated several agreements covering both border and non-border issues. The trade-related issues often burden developing countries with administrative and economic costs (Katrak and Strange, 2004; Finger, 2001).

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<sup>3</sup> Krueger, 1998; Sally, 1999; Langhammer and Lucke, 1998

<sup>4</sup> Further trade liberalisation often entails greater reduction of tariffs in goods, service sector market access, and trade related processes or behind the border issues such as custom valuation, trade facilitation, etc.

Under the principle of ‘single undertaking’, all WTO members have to sign and implement all WTO agreements. Apart from Special and Differential Treatment provisions, developing countries are obliged to make trade related policies fully compatible with their WTO commitments (Hoekman and Kostecki, 2001). However, efforts to liberalise global trade through the WTO have achieved limited progress since the Doha Round in 2001. The large and unwieldy agenda, coupled with a chaotic UN-style decision-making process and a vastly expanded membership, has raised concerns about the organisations future. The failure of the Doha Round (Geneva 2008) was a vivid illustration of these controversies and concerns. Negotiations resulted in a disappointing stalemate and major differences remain between members over trade policy priorities. Mr.Lamy<sup>5</sup> said “members have simply not been able to bridge their differences”, while an US Trade Representative declared “it may be that this grand-scale agreements format that we have been operating under since 1947 needs to be reviewed” (Beattie, 2008, pp.1-2).

WTO membership still plays an important role in the economic development of developing countries, as its rules help to strengthen domestic institutions and policy systems and prevent the retreat of previous reforms by a lock-in through binding international commitments. WTO rules can become guidelines for determining which trade restrictions to impose or retain and which to avoid, providing a basis for government resistance to domestic pressures for protection, and allowing use of WTO rules as a mould for unilateral policy choices. Accession is a powerful and effective measure to counteract protectionists groups and to mobilise support for the reform stages, where political resistance against further reform is growing and entrenched. Countries seeking WTO membership use the accession process to overhaul their economic management institutions. WTO membership requires the policies of acceding countries to be in line with the provisions of the main international agreements. The policies help adapt laws and redesign institutions to make the market operate free from government controls (Drabek and Laird, 1998). WTO membership is regarded as a means to accelerate domestic reform and prevent the retreat in reforms, while also gaining credibility from the international business community. It indicates a willingness

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<sup>5</sup> Mr. Pascal Lamy is the General Secretary of the WTO

on the part of acceding countries to implement far-reaching changes in domestic policies and institutions.

Economic liberalisation sees developing countries liberalise their economies via three major tracks (Sally, 2006). They can undertake unilateral reform, reciprocal liberalisation such as bilateral, regional or multilateral liberalisation and finally, via agreements with donors (reform under conditions set by IMF or World Bank in order to receive financial and technical aids). Literature also points out that unilateral economic liberalisation should be given first priority and that multilateral tracks can serve as a helpful auxiliary to unilateral liberalisation. Multilateralism provides a springboard for further and deeper unilateral reforms (Sally, 1999). Accession is a multilateral process for liberalising the economies of developing countries and is an auxiliary to unilateral liberalisation.

## **1.2 The political economy of reform**

The last two decades have witnessed an unprecedented effort on the part of developing countries to reform their economies. Integration of developing countries into the world economy is an enabler for their economic successes (Winter and Finger, 1998). In the second half of the last century there were many success stories where developing countries opened their economies and became new economic powers. These have acted as examples for other countries that are struggling to find appropriate development policies. Reform is not always smooth and there are internal and external factors that discourage, retard and even reverse the process. Countries intent on a successful economic liberalisation have to utilise different methods to overcome these difficulties.

Most developing countries adopted a very similar set of ‘import substitution industrialisation’ policies, with the aim of catching up to the level of development of industrialised countries. This strategy for achieving fast economic growth often relied on state intervention in international trade and investment, especially through trade barriers, government planning and investment policy. Since the 1970s these policies often failed to achieve their purpose, and the economic imbalance of the trade and



budget deficits was the result, accompanied by inefficient government investment practices and the adverse control of international trade that forced countries into debt. The situation worsened with the impacts of the oil price crisis and the world recession in the 1970s.

Facing threats from the internal and external environments, developing countries had few options but to adjust their policies in a market friendly direction. Many recognised the problem and started unilateral reform, while others liberalised their economies with the assistance of the International Monetary Fund or World Bank under Structural Adjustment Loan Schemes. The 1980s witnessed the demise of ‘import substitution industrialisation’ policies in developing countries, and this was accelerated with the collapse of the Soviet Union. By the late 1990s, most developing countries had attempted liberal and market oriented policy reform (Krueger, 2000).

The economic reforms aim to limit the role of government and encourage a stable macroeconomic environment, liberalise trade, privatise State Owned Enterprises and promote the private sector. Reform focuses on macroeconomic stabilisation and structural adjustment, with programmes varying in scope, content, commitments, political support and results. Such variation in reform effort and its results suggest that the economic reform process is not an easy and natural process, but is complex and influenced by many natural, economic and political factors. The pace at which governments adopt economic reform is determined by domestic political factors. Economic reform imposes short-term economic and political costs on decision-makers and on many powerful groups with vested interests in the status quo (Krueger, 1993). Changes in income distribution generate conflict between interest groups affecting the balance between support and opposition during the policymaking process. The interest groups that gained most from import substitution stand to lose the most from stabilisation and structural adjustment. Import competing firms benefiting from credit subsidies are hardest hit as government payments are substitutions for operating inefficiencies. Vietnam workers in the urbanised non-traded goods sector who had benefited from subsidies for basic service such as utilities, transportation, and essential food items are also hit hard by budget cuts. Public sector employment suffers as budget cuts bring an end to wage increases and forces large reductions in government employees.

Structural adjustment programmes brings more political tension between groups as it is aimed at budget reductions and the efficient allocation of resources. Adjustment redistributes income from industry and urban non-traded goods sectors to agriculture and other export-oriented industries. This increases conflict between entrenched interest groups. Structural adjustment benefits, and negatively affects, the reform process. Interest groups that lose in the reform process exert strong influences on the government and their incentives to block reform often outweigh the benefits to groups in favour of reform, making forward movement difficult.

The enthusiasm for greater liberalisation and associated structural reform in developing countries has been low compared with the climax of the Washington Consensus in the 1980s and 1990s (Sally, 2008). Governments are more sceptical and defensive about further liberalisation and complex reform. After two decades of reform, reform-minded countries encountered more complex tasks and political resistance to pushing forward the reform agenda. Second generation reform involves complex domestic regulation and competition. These reforms are technically and administratively difficult, requiring time to be implemented and challenge the legislature (Krueger, 2000). These reforms often face severe political pressure and resistance. The hesitation in implementing further reform involves globalisation and a change in attitude towards liberalisation and structural adjustment. Increasingly there has been a trend to link any mishap in the world, be it from economic crisis or natural disaster, to rapid globalisation. Macroeconomic crises often provided windows of opportunity for economic reform in the 1980s and 1990s. But, the Asian Financial Crisis created doubts about economic reform under the 'Washington Consensus' model (Sally, 2008).

The promising economic reform model prescribed by the IMF and World Bank was not seen as delivering sufficient economic growth, employment generation, and poverty reduction in the developing world. Many governments slowed the process of reform as conditions constantly challenged them (Biersteker, 1995; Thomas, 2005; Sally, 2006; Stiglitz, 1998). This was the case in Africa and leading developing countries such as Brazil, Mexico, South Africa, and India.

China was still able to pursue its own liberalisation and reform before and after WTO accession, and is the most significant case of a developing country carrying out wholesale reforms (Sally, 2008). Vietnam has appeared to follow the Chinese path for liberalising its economy; ensuring the continued benefits of reform is a top priority in the Government's economic agenda, making decisive use of unilateral reforms, while also combining other tracks of reform to facilitate and lock-in current reforms. Vietnam has used multilateral liberalisation to assist domestic unilateral reform.

### **1.3 Vietnam as a case study**

Vietnam is currently undertaking market-friendly economic reforms with an impressive record of economic liberalisation. The reform process in Vietnam has not been a smooth and even process. There were periods when reform was slow or even at a standstill with periods of strong political resistance. Reform has slowed down when interest groups organised against the reform. Economic reform was slow from 1995 to 2002, and was only overcome when the Government publicly announced its accelerated efforts to become a WTO member. The Government appeared to leverage the advantages of WTO accession to push for an overhauling of the economic system and to overcome political resistance toward market reform.

This thesis shows that the appearance belies the truth and to a great extent the Government has used the process to maintain a central control over the economy. During this difficult time of economic reform, Vietnam's WTO accession process offers an interesting opportunity to examine the link between this process and domestic reform, and this reflects contemporary debate on the role of multilateral pressures as an auxiliary to unilateral reform. The most serious problem in analysing Vietnam's economic reform is the actual lack of real reform. In the case of WTO impacts upon the process, there is far more evidence of resistance to reform than real incidences of positive changes

A further problem for the thesis is that it has attempted to situate the assessment of the WTO reforms in the context of a 'communist' regime. But closer examination of Vietnam's political system would find that communism in Vietnam has strayed far from

its ideological roots and display very little evidence of what could be called 'communist' besides a complete commitment to centralised single Party rule. Party 'rule' is itself questionable, as the thesis uncovered strong evidence that Vietnam is strongly influenced by an elite interest group, consisting of individuals who hold omnipotent levels of power through positions in both the Party and the business economy, but actually operate almost entirely on individualistic reasons, rather than the 'Party' or 'National' ideals. Increasing evidence is appearing to justify this view as Communist Party chief, Nguyen Phu Trong recently observed "Some Party members have gotten richer so quickly leading a lavish lifestyle that is miles away from that of the workers" and that their actions are firmly embedded in a selfish exploitation of their own power and wealth (Dien, 2013, p.4). Leading economist, Le Dang Doanh identifies the influence as a 'group interest', which has diverted billions in government finances into their own pockets, and concentrated this mainly through the system of financing State Owned Enterprises (Hang, 2013, p.15). Anh (2013, p.10) finds that this involves such examples as US\$28.4 million being diverted by EVN (Vietnam Electricity Economic Groups) into buying 'houses, villas, tennis courts, swimming pools, etc' for staff and disguising it under 'creative accounting methods'. The present outcomes are far different from those originally envisaged when the dramatic reforms of Doi Moi began twenty-seven year ago.

Vietnam began its domestic economic reform programme in 1986 after the sixth Communist Party of Vietnam (CPV) National Congress. Against a background of critical economic imbalances, shortages produced by the command economy, the drying up of foreign aid and the loss of its traditional export market to the Soviet Union, economic reform initially aimed at reducing macroeconomic instability in order to provide accelerated economic growth (Harvie and Tran, 1997). Partial reforms began and were accelerated in 1988 when economic instability reached a critical level due to hyper-inflation and severe state budget deficits. Reforms included a series of market-oriented shock therapies to stabilise the economy - 'IMF style structural adjustment' (Masina, 2006). Major reform measures included internal trade and price liberalisation, exchange rate adjustment, interest rate reform, fiscal and monetary reform, gradual trade liberalisation, and restructuring of the SOEs sector (Arkadie and Mallon, 2003; Masina, 2006).

Encouraging results of the reform included controlling inflation, macroeconomic stabilisation and the creation of the pre-requisite conditions for economic growth. Macroeconomic stabilisation and fast economic growth were achieved (Arkadie and Mallon, 2003). Hyperinflation was contained and gradually reduced to single digits after 1993 (Masina, 2006).<sup>6</sup> Macroeconomic stabilisation and growth were achieved through liberalisation of international trade through flexible exchange rates pegged close to market prices, substantial reductions in the average tariff rates and reductions in quantitative restriction on imports and export (Masina, 2006). This transformation achieved early success, which made the external sector the engine of growth.<sup>7</sup> Imports for investment in export production grew significantly. Openness to trade was accompanied by openness to foreign investment. The new foreign investment law (1988) triggered a strong inflow of foreign investment. FDI became an important stimulus to growth, accounting for 28% of the total investment expenditure in the country in 1996 (Masina, 2006). By 1994, the first stage of economic reform was completed with success and had achieved the dual goals of macroeconomic stabilisation and high economic growth. Reform appeared to transform the closed economy into an economy with a significant degree of openness and gradually integrated it into the regional and world economy.

From 1996 to 2000, the Vietnamese economy slowed down with a lower GDP growth rate, deflation and a sharp reduction in both domestic and foreign investments (Pham, 1999). This was partly due to the regional financial crisis, which hit most economies in Asia. As the Vietnamese economy depended on exports and FDI, the economic crises in most FDI providing countries and the major export markets of Vietnam significantly affected the growth rate of Vietnam. Sharp currency devaluations from neighbouring countries exposed Vietnam to the increased competition in domestic and export markets, which led to a surge in its trade deficit. This crisis was also a result of its own internal weaknesses (WB, 1997; Pham and Le, 2003). Vietnam entered a period of slower economic growth and was losing the confidence of foreign investors

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<sup>6</sup> In the decade from 1987-1996, GDP growth was on average 7.3%, increasing to 9.5% in 1995 and 1996

<sup>7</sup> Exports grew far more rapidly than GDP (23% in 6 years to 1994), and as a result the proportion of total output exported went from 46% of GDP in 1989 to 97% in 1996 (Masina, 2006).

before the Asian Financial Crisis and this was a result of the internal resistance to reform and its lack of real intention to actually re-shape the economy.

The slowdown in the economy and the shrinkage of FDI commitments and disbursements was the result of inappropriate Government policies (WB, 1997; Arkadie and Mallon, 2003; Masina, 2006; Pham and Tran, 2002). The Government had been actively implementing an inward-oriented development strategy since 1995 with biased trade protection and government investments (Athukorala, 2006). Reforms in trade liberalisation and support of export industries were used to promote rapid industrialisation (Martin, 2001). Trade policy was focused on the import–substitution manufacturing sector and embedded in a long–standing protectionist state–led model (Pham, 1999; Pham and Tran, 2002; Auffret, 2003; Athukorala, 2006).

Government investment in SOEs was significant, indicating their important role in the economy and in the government’s development ideology. The SOEs, through their continued relationships at the high levels of Government and the Party retained a monopoly on the economy with explicit forms of state support and unofficial protection that was channelled through connections with political and administrative officers (Masina, 2006). Improvements in FDI helped accelerate the industrialisation process and to enable the country to enter into new strategic sectors. SOEs prioritised foreign investment in areas that were capital intensive and labour saving. The Vietnamese government was attempting to use industrial and trade policy to replicate the lessons of ‘developmental states’ and promote selected strategic industries in order to diversify its export composition (Masina, 2006).

The privatisation of small and medium SOEs was not successful and fell well behind the targets of the national authorities (WB, 2000; 2002). Large SOEs still remained intact and the government protected this sector, causing severe financial restraints on the banking system and restricted opportunities for the development of the private sector. The private sector was focused on high priced goods of low quality, which were less competitive in both domestic and international markets.

Banking sector reform made little actual progress and was kept afloat by strong government patronage and dominated by the largest SOE banks. An inconsequential supervisory framework, with unclear regulatory standards and imprudent lending forced the banks to function under severe stress, especially in regards to the high rate of Non-Performing Loans. Negative political and administrative pressures, corruption in the business community and weak management skills aggravated problems, with lending mainly due to political pressure forcing Banks to loan to inefficient, unproductive and failing SOEs. Lending to the private sector was subject to stringent procedures and high collaterals, which discouraged them from using the system and stifled their development.

The private sector was neglected and not promoted adequately as a key to employment generation and economic growth. Although economic reform changed the attitudes toward the private sector, the regulations and restrictions inherited from the previous era made growth of the private sector difficult. They suffered from an unfair competition with SOEs in regards to credit lending and government support. The CPV greatly fears any independent development of the private sector, identifying this as direct threat to their continued control of the economy, and forcing them to divert resources away from their own privileged SOEs.

Vietnam development was severely handicapped by inefficient and outdated economic management institutions. The whole economic system retained the old-fashioned central command economy style, with Government intervention still the dominant form of control in all economic activities. This was coupled with inadequate laws and regulations in almost every sector. Enforcement was also weak as a result of political interventions, lack of adequate laws and corruption. A major problem was the lack of capacities in the whole government system and especially in the enforcement of law and regulations. Many highly placed leaders and their middle management lacked even adequate levels of skills in their areas of responsibilities. Coupled with the very low level of salaries (thus enticing very few highly educated and capable candidates and depriving the system of any incentive to improve), the lack of capacities made reform and development difficult, if not impossible, in almost every area of administration and governance. Moreover, the administrative organisations and their procedures were often overlapping, cumbersome, bureaucratic and distorted by corruption. The real underlying

concern for the Vietnam economy post WTO accession is that the same faults beset the economy today and although the superficial appearance is one of dramatic change, the reality is the same problems not only exist but are in many cases worse.

The uneven pace of reform decreased enthusiasm for more change, and instead of being encouraged by increased FDI flows and development assistance funds from donors the leadership's sense of urgency in implementing sensitive reform measures was reduced. It is difficult for foreigners to understand this particular psyche of Vietnam leaders and people, where a cultural dominance for caution in decision-making, accompanied by very short term thinking in regards to the consequences, lead to irrational outcomes, such as meeting the success of reform with an aversion to more reform. While the official declarations encouraged a rapid liberalisation of trade, the resistance to reform in the political leadership remained strong (Masina, 2006).

Implementation of the reforms was slow, especially in trade liberalisation, SOE privatisation and legal and administration reform. This was reflected in the last minute postponing of the signing of the Bilateral Trade Agreement with the US, an agreement to set a course toward great openness, receding government control over the economy, and ultimately greater freedoms for individuals in Vietnam to find jobs and determine their own future (Irvine, 1999; Masina, 2006). The second stage of reform often involves difficult and complex domestic issues such as tax reform, privatisation and trade liberalisation. Implementation and the realisation of benefits take more time than in the first stage of reform (Haggard and Webb, 1994). As reform progressed it also generated resistance as the reforms are politically sensitive and affect entrenched interests that are extremely difficult to dislodge (Sally, 2006). Many were ideologically bound to communism and viewed the reforms as politically generated and feared more the overthrow of their oligarchic control, than they worried about economic decline.

The pace of reform was not quickened until the government actively engaged in the US-BTA (2001), which set the framework and momentum for further trade and trade-related liberalisation. This agreement was regarded as a WTO agreement mimic, which regulated almost all areas covered by a normal WTO agreement. In 2002 the government publicly announced its desire to join the WTO and intentionally accelerated



the negotiation process. Comprehensive reform now proceeded progressively and institutional reform accelerated with legal and regulatory revisions and more attention paid to law enforcement. Yet, all reform in Vietnam has to be assessed against what appears to have happened and the reality behind it. There is often little evidence of resistance to many reforms, and the introduction of new laws, regulations, and institutions regularly takes place without effective opposition. Its opponents are aware that Vietnam's greatest challenge is actually enforcing the reforms/changes and they are quite rightly correct in thinking that the practice will be as before. Lacks in capacities, low incentives such as low salaries and little chance of promotion without relationships, fear of change and the generally very conservative nature found at all levels means numerous reforms are often merely cosmetic changes.

Vietnam completed negotiations to join the WTO in 2006 and became the 150<sup>th</sup> WTO member state in 2007. Vietnam's accession to the WTO was very lengthy and demanding as reformers constantly met opposition from conservatives, communist dogmatic and interest groups affected negatively by reforms. What is clear now is that elements within these 'anti-WTO' groups have been far more successful at undermining the WTO reforms, and disguising that successful resistance under a blanket of commitment to the market economy. The WTO accession involved multilateral negotiations with member nations to help adjust Vietnam's trade regime to conform to WTO rules, while bilateral negotiations related to market access concessions in goods and commitments in the services sector (Michalopoulos, 1998). The process is lengthy as the acceding country enacts the laws, develops the institutions, and applies the policies that enable it to conform to fundamental rules and disciplines of the WTO (Drabek and Laird, 1998). Greater stability in commercial policy is required, and must adhere to WTO rules and legally binding agreements. The accession process is complete when all members are satisfied with the progress and assurance of policy and institutional reform from the acceding country (Michalopoulos, 2002).

WTO rules consist of the General Agreement on Tariffs and Trade (GATT), twelve issue-specific agreements (e.g. on agriculture), the General Agreement on Trade in Services (GATS) and the Agreement on Trade- Related Aspects of Intellectual Property Rights (TRIPs). A multilateral working party is established to review each accession case. In these working parties, WTO members investigate whether any part of

the acceding country's trade regime is inconsistent with WTO rules. Two main areas of scrutiny are the economic policies affecting imports and exports, and the institutional framework (legal and judicial factors) that exists to formulate and enforce such policies. Therefore, the process encouraged Vietnam to overhaul its economic institutions and policies in order to be in conformity with the market economy.

WTO accession was undertaken in parallel with the difficult process of structural adjustment and played an important role in pushing ahead reform progress. The process was an impetus for domestic reform and served as a lock-in. Success in WTO accession is the result of the dynamic interaction between the state and other actors in the economy, leading to a broad-based consensus on the need to open up and further integrate into the world economy. All these deductive conclusions lead us to many insightful questions about this event, such as the mechanism, development and interaction between multilateral agreements and domestic economic reforms.

However, the evidence gathered here in this study shows that much of these reforms are countered by a systemic aversion to 'real' change, and that for every reform there is disturbing levels of 'resistance' that continues to negate many of the benefits accrued from strategies such as entering the WTO. The outcome is that WTO accession, entry and reform remains secondary to a domestic determination to 'carry on business as usual'. Subsequently, this has appeared in previous studies as a commitment of the Communist Party' to survive' such global changes as the end of Communism in the Soviet Union and the turn to market economics by the Chinese Communist Party. Such studies would entail deeper analysis of the WTO negotiations and the substance of the impacts of the commitments made and their enactment. But, so deep is the actual levels of non-compliance to WTO commitments and the 'conservative' practices that continue to be the systemic formats of 'doing business' and 'ruling' the country, the thesis instead concentrates more on how the WTO impacts are merely a public screen for what one could more accurately call an elite dictatorship, rather than communist rule.

## 1.4 Research question

This thesis will examine how the WTO accession process contributed to the economic reform of Vietnam and concentrate the case studies on Agriculture, the Textile and Garment industry (T&G) and the Banking sector.

The main rationale for choosing these industries is because these industries are the most representative of the Vietnamese economy and have been directly affected by the WTO accession process. WTO accession process began during a stagnant period of economic reform and suddenly accelerated after five years of almost no progress.

The success of the first wave of reform had reduced the government's sense of urgency toward the economic crisis, which consequently left room for interest groups to revive and influence government policy. The dynamics of interaction between interest groups for and against economic liberalisation was further amplified by the politically sensitive and difficult nature of structural adjustment. The political regime inherited the ideology of a communist central command economy where elements in the Party and Government provided a favourable environment for the interest groups against reform. This led to delays in reform, but some degree of lock-in of reforms protected the achievements of past reform and prevented the Government from succumbing to the pressures of interest groups opposing reform. The efforts made by the Government to join the WTO were understood as a signal, which acted to push forward sluggish policy reform efforts.

In political terms, the accession process was an externally enforced multilateral agreement, making any domestic policy reversal costly. The added value of the WTO accession process, apart from the lock-in effects for domestic reform, is that in the absence of a pre-determined model of a social market economy, the economic and institutional framework of the WTO facilitates the acceding country's efforts at building full-fledged market institutions. The WTO accession process of Vietnam was presented as a conscious effort made by the Government to accelerate economic and institutional reform. The clear lack of enforcement of those reforms or even the establishment of mechanisms to truly apply the commitments made, show that WTO accession and

membership has failed to overcome the domestic business structures that are dominated by a relationship culture and the unbreakable hold of cronyism and corruption as a ‘way to do business’ in Vietnam.

## **1.5 Research methodology**

### **1.5.1 Research design**

This research will adopt a qualitative case study approach involving an analysis of a sequence of events and processes in order to identify the historical events. It will build an account of the WTO accession process in Vietnam and how it influenced the progress of domestic economic reform. Accession was undertaken in tandem with the implementation of the second generation reforms in Vietnam and was one of the levers that helped to accelerate current reforms. This approach enables us to explain in detail how and why the WTO accession process supported and accelerated reform.

### **1.5.2 Case study approach**

A multiple case study approach is taken here and in order to narrow the scope of the research, three traditional industries (textile and garment, agricultural, and banking industries) are selected for the purpose of examining the proposed research hypotheses and questions. These industries have different characteristics and roles in the economy and the reform process. They were selected based on four criteria: (1) representation for important industries in the economy, (2) representation for different levels of government protection and intervention, (3) representation for different actors in the economy, (4) representation for different levels of reform references.

#### ***Textile and garment industry:***

The textile and garment industry is key in the Vietnamese economy and its export-led growth policy. The impressive performance of Vietnam's T&G industries

over the past fifteen years was mainly attributed to the liberalisation of domestic and foreign policies initiated in 1986 and to the changes in WTO regulation on textiles and garments industry in 1995. The Agreement on Textiles and Clothing succeeded the Multi-Fibre Agreement under the umbrella of the WTO Establishment Agreement in 1995, whereby it was agreed that all quota restrictions would be eliminated by January 1, 2005. The elimination of quotas was expected to unleash the potential of developing countries and to provide tremendous opportunities for export expansion. Joining the WTO helped the industry to gain more access to export markets and it benefited from trade liberalisation and deregulation.

However, as the case study chapter shows, the industry should be judged more by the progress it should have made, rather than the impressive data it presents. Investment has been dominated by a Government's support of the T&G SOEs, which has retarded their levels of improvements in efficiency and denied much of the domestic private textile companies the funds they need for development; and a private sector reliant on FDI investors and private companies for any real economic progress. In addition, SOE power means many FDI companies can only optimise their profits by building relationships with SOEs and the officials that are closely linked to them. For example, one major foreign textile owner declared that bribes for acquiring land, good relationships with customs (nearly all FDI companies rely on importation of raw materials and overseas customers) and almost every aspect of production and management adds a cost that is increasingly being seen as an 'unsustainable' overhead in the present global market conditions (Confidential interview<sup>8</sup>, 2012).

### *Agricultural sector*

Agriculture is a vital industry in the Vietnamese economy and in its export-led growth policy.<sup>9</sup> It is the dominant employer in rural areas, accounting for more than

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<sup>8</sup>Director of a European textile company focused solely on supplying its 85 different European customers.

<sup>9</sup> Agriculture accounts for 22% of GDP with an average growth rate of 4.3% and employs more than 60% of the Vietnamese population (WB, 2006).

30% of the country's total exports and rice, coffee, cashew nuts, pepper, etc. have occupied an important role in world markets (Nguyen and Grote, 2004). Before economic reform, Vietnam imported rice and other food products. Presently, Vietnam is the world's largest rice exporter and the country's exports of agricultural, forestry and fishery products reached 4.19 billion USD in 2000, and soared to more than 12 billion USD in 2007 (UNDP, 2004). The export growth rate of agricultural commodities has been 20% on average during the last 10 years. Agricultural success is due to government reforms in this sector and the process of international economic integration. The agricultural sector was the first target of structural adjustment reform, with measures directly promoting agricultural production such as land-use rights and tax reforms, investment, credit provisions and market liberalisation (UNDP, 2004). The WTO provided market access through MFN and new protections against powerful trading nations. Nonetheless, there was a declining contribution of this sector relative to the contribution of the industrial and services sectors. The proportion of agriculture to total GDP fell from 42.1% in 1989 to 22% in 2007 (Nguyen and Grote, 2004). Agriculture highlights the impact of the WTO accession process on economic reform and will allow us to see how the WTO accession process affects the formation of pro-trade interest groups and its interaction with other actors in the economy.

Again, the progress and development of agriculture in Vietnam disguises an inherent fault in the sector's business. Almost all producers (the farmers, etc) are dependent on the SOEs, which act more as 'middle managers' than producers. The SOEs dominate the agricultural sector by acting as the only connection between the global economy and the industry. They deny the producers direct access and carry out both overt and covert means to control the prices that producers receive. The outcome is that much of the benefits of WTO entry, including larger and new markets, improved profits, etc are channelled almost entirely to the SOEs and many producers remain on only subsistence levels, denied credit, limited to only small land holdings and barred from any real opportunities to modernise and mechanise. Subsequently, farmers still remain one of the poorest sectors in the economy, and are the main source of protest against the Government and the WTO 'reforms'. However, their poverty, social conditions and lack of coordinated and powerful representation means much of their protests are ineffective.

## ***Banking and finance industry***

Vietnam's banking and finance industry can be traced back to 1988 when four state-owned banks were separated from the State Bank of Vietnam (Le, 2000). The banking sector has been at the forefront of the economic transition and liberalisation in Vietnam and is dominated by four State-Owned Commercial Banks, which together account for 72% of total banking assets.<sup>10</sup> During the reform, the banking industry was criticised for its inefficiency and loss-making operation since the banks operated as covert government agencies, with restricted access given to foreign investors (Masina, 2006; WB, 2007).

Yet, the role of banking as merely the gateway through which the Party subsidised the SOEs is now undeniable. Banks remain solvent and defended themselves from foreign competition by concentrating their profitable business on transferring government money to the SOEs. The profits from this sustained all the major banks, and this 'false' economy was further embedded into the system by allowing 'owners' of the main SOEs purchase controlling shares in the banks and using this to ensure on-going preference in loans and debt. This 'cross-shareholding' scandal is discussed further in the case study chapter.

In the next section we examine the Chinese case and its relationship to Vietnam.

### **1.5.3 China as a shadow case study**

In this research, a parallel is drawn between Vietnam and China's WTO-related economic reform, providing theoretical and empirical support for the study. China made the same transition from central command to a free market while retaining its communist political system.

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<sup>10</sup> There are 36 joint-stock commercial banks (10.5%), 4 joint venture banks, 25 foreign bank branches (16%), and some 40 foreign bank representative offices as well as a network of credit cooperatives (Le, 2000).

Economic reform in China is a textbook case of strong unilateral economic liberalisation (Sally, 2006). Chinese economic reforms can be traced back to 1978, but reform accelerated after 1994, transforming the Chinese economy into a market-oriented economy. A series of structural adjustment measures<sup>11</sup> were undertaken unilaterally in order to restructure the economy. GDP growth rates exceeded 9.5% during the 1991-2005 reform period (Naughton, 2007). Inflation was controlled in 1996, producing a stable macroeconomic situation in the following years, and domestic market prices gradually converged toward international levels (Lardy, 2002). The most impressive economic reforms have been in the trade and foreign investment sector. China unilaterally moved from extremely protectionist trade policies to relatively liberal ones (Sally, 2004).<sup>12</sup> The liberalisation of the Chinese economy led to a surge of imports and exports, rapid expansion of international trade and the liberalisation of foreign direct investment (FDI), with FDI inflows surpassing 40 billion dollars since 1996 (Naughton, 2007).

By 1999, China faced an urgent need for further reform (Qian and Wu, 2000). China's economic growth slowed down in 1998 and 1999. Although this deceleration of the economy can be partially accounted for by the pervasive impact of the Asian Financial Crisis, the sluggishness of the reform in key areas also negatively affected Chinese economic performance (Qian and Wu, 2000; Lardy, 2002). Several issues were still left unaddressed by the previous reform thrust: the weak financial system, which was dominated by SOEs, was subject to government and well-connected insider group intervention; weak legal accountability; an absence of regulatory agencies independent from governmental influence; and the limited progress in developing a transparent and publicly accountable regulatory apparatus (Qian and Wu, 2000). The standards of

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<sup>11</sup> They included the unification and convertibility of the exchange rate, SOEs privatisation, formal recognition of private property rights, tax and fiscal system reform, banking restructuring and a host of other market-based reforms.

<sup>12</sup> Extensive trade reforms were undertaken unilaterally during this period, which resulted in a significant drop of tariff rates and non-trade barriers. Simple statutory tariffs were reduced to only 16.5% in 2001 from 17.5% in 1998 and 43% in 1992.



corporate governance were still low (Naughton, 2007). WTO accession made it urgent for China to push through its domestic reform more rapidly (Qian and Wu, 2000).

Reforms were initiated in 1999 with a whirlwind of economic liberalisation (Naughton, 2007; Kynge and Jonquieres, 1999; Lardy, 2002). Premier Zhu Rongji made clear during his visit to the United States, that reform was highly dependent on the possibility of using WTO accession as a lever to overcome domestic opposition (Lardy, 2002).

In 2001, China was officially admitted to the WTO as its 143<sup>rd</sup> member after 15 years of negotiation. China's WTO commitments are very strong and they exceed those of other developing countries by a wide margin (Sally, 2004). These comparisons hold not only for tariff ceilings on goods but also for border and behind-the-border non-tariff barriers in goods and services. Although a few implementation shortcomings still remain, notably in the creation of independent regulatory schemes and judiciary, research shows that China complied in a satisfactory manner with the large majority of WTO commitments that it undertook (Zhang 2005). Zhang (2005, p.332) commented that "there is no ground to allege China's compliance with the WTO agreements as 'uneven and incomplete' in a wide range of areas".

The reform-oriented Chinese government intentionally used the WTO accession process and commitments as a lever to accelerate and complete the transition to a market oriented economy. Vietnam and China share similar starting conditions and characteristics at the outset of the reform process. Both countries are ruled by communist parties that have adopted a similar reform model favouring economic reform without political reform. The two countries have also demonstrated the same enthusiasm for unilateral reform and the use of international commitments as lock-in devices for internal reform. The pattern and ideology of reform in Vietnam are very much based on China's experiences.

#### 1.5.4 Horizontal policy areas

This research focuses on how Vietnam's WTO accession process influenced the course of domestic economic reform. Four major horizontal policy-areas have been chosen: (1) trade and investment liberalisation; (2) SOE restructuring and (3) private sector promotion; and (4) institutional reform.

Trade and investment policies are present in all economic activities. They are a central aspect of economic reform, especially in structural adjustment programmes. Economists define trade and investment liberalisation as the transition from an interventionist government towards 'neutrality' between tradable and non-tradable sectors of the economy (Sally, 2008). This process often involves the reduction of quotas (import and export) and tariffs, and the dismantling of licensing agreements, state trading policies, and other non-tariff barriers. Foreign currency exchange control and currency convertibility is reformed as FDI liberalisation entails fair and non-discriminatory conditions for foreign companies investing in the host economy. This involves removing market entry and ownership restrictions, and opening up protected markets such as the service and agricultural sectors. The changes are to ensure efficient resource allocation and development of a comparative advantage through international competition (Biersterker, 1995).

The second and third policy areas placed under the microscope are the process of SOE privatisation and restructuring, and of private sector promotion. In many developing countries, a large set of economic activities is undertaken by the State. SOEs have become monopolies in almost all of the important industries. These inefficient state investments divert resources from other competitive industries leading to a sub-optimal economic equilibrium. The privatisation of SOEs is an efficient way of reducing government intervention in the economy and fostering greater competition, bringing a more efficient private sector to lead in economic development (Oatley, 2006).

The fourth policy area to be scrutinised in this research is the development of efficient economic management institutions. Since the market operating mechanism

shifted sharply from government planning and intervention to free market forces, the role, functions and competence of economic management institutions has to be adjusted to match the development of a market-based economy. Government institutions abdicate their powers of direct intervention and adopt the role of market monitors and guides. This process entails redefining the mandates and competencies of economic management institutions as well as providing them with technical support in the early stages of their mission. This institutional reform also involves the provision of adequate laws and regulations, not only to manage the economy on a fair and intervention-free basis, but also to guide economic activities and prevent conflicts between interested parties. This often involves the revision or enactment of laws and regulations as well as their fair and unbiased enforcement.

### **1.5.5 Delimitation and time period**

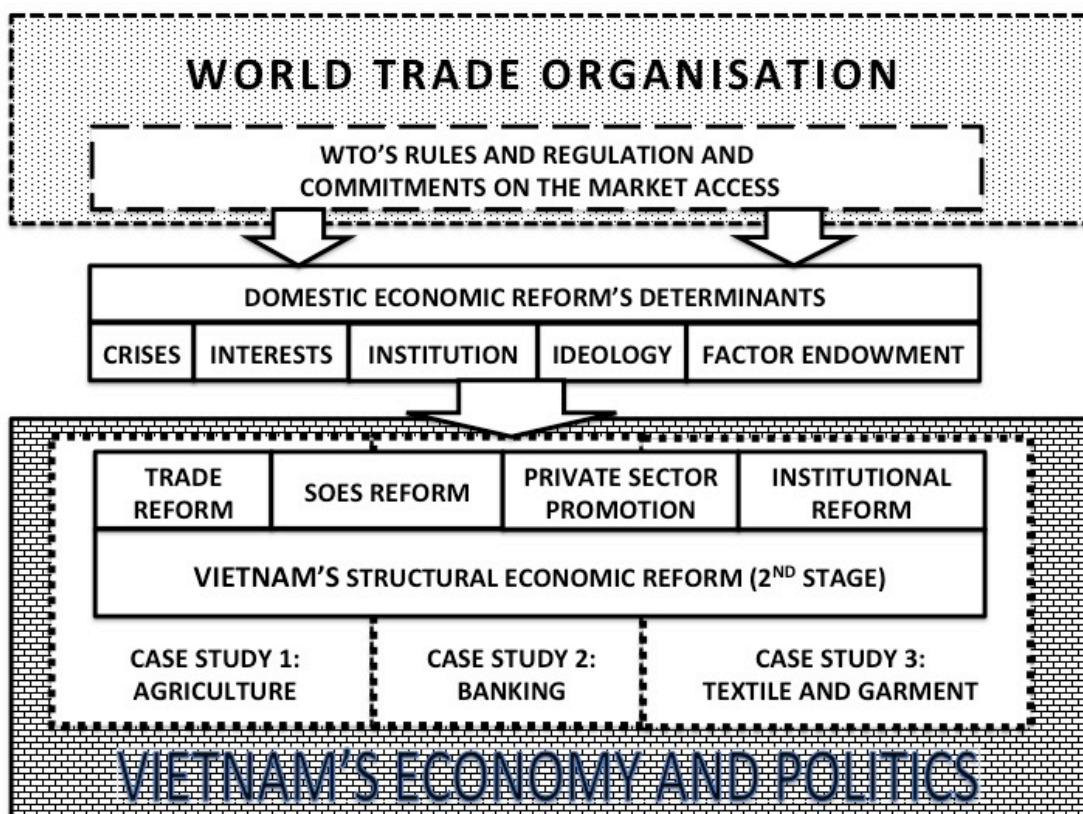
Vietnam accession took twelve years (1995-2007) and the rate of reform implementation was markedly uneven: a relative standstill from 1995-2000, slow progress from 2000-2003, and a very rapid pace from 2003-2006 when the reform process ran in parallel to Vietnam's final efforts to accede to the WTO. From 2007 to 2012, Vietnam membership of WTO has revealed a number of political and economic challenges, which are examined in the later parts of the thesis chapters.

### **1.5.6 Research conceptual framework**

The process of adjustment of Vietnam's domestic trade and investment policies to comply with WTO rules and regulations and the effects of these changes on the progress of economic reform is examined in the thesis. Two important blocks of literature are reviewed.

First is the literature on the WTO accession process, which provides an understanding of the rules, regulations, and mechanisms through which the WTO accession process affects a country's policy reform. The WTO accession process requires an adjustment of the applicant's trade regime and economic policies in order to

conform to WTO rules. Adjustments are reviewed by a multilateral working party in each accession case to investigate whether any part of the acceding country's trade regime is inconsistent with WTO rules. Two of the main areas that often have strong impacts on economic reform are (1) the economic policy measures affecting imports and exports, and (2) the institutional framework (of legal and judicial factors) that exists to formulate and enforce such policies.



**Figure 1.1: The analytical framework**

Second is on the politics of economic reform. This highlights the components, processes, difficulties and politics of economic reform, especially of a structural adjustment programme and the determinants through which external factors can influence the economic process. The five determinants used as points of analysis, are economic crisis, interest groups, ideology, institutions and factor endowments. These determinants help to explain how changes in economic policy meet the requirements of accession and influence the reform process.

The reform process consisted of structural reform, with four major components: trade liberalisation, SOE privatisation, private sector promotion and the building of institutions for a market-oriented economy. The WTO accession process requires an applicant country to adjust its domestic policies to conform to WTO rules and regulations. The impact on determinants is assessed as to whether they are positive and helpful to the reform.

### **1.5.7 Data collection**

Data for this thesis was collected by documentary research and in-depth elite interviews. The sources for documentary research were mainly from domestic governmental agencies, with both English and Vietnamese versions accessed. WTO, international and Vietnamese economic policies were extensively reviewed. Reports on economic reform, multilateral trade agreements and economic integration were consulted for conceptual frameworks, empirical information, and additional insight into the economic reform of Vietnam. Newspapers and magazines were cross-referenced with media material from different international sources to minimise the possibilities of biased information.

In-depth elite interviews were conducted between November 2008 and January 2013. There were in total 36 interviews with 16 elite individuals and 3 other anonymous persons. Interviewees were selected from different policy-making influencing groups, who were decision-makers; famous research intellectuals and policy consultants; businessmen and foreign experts on economic reforms and WTO accession. Many of them were engaged in two or three interviews during the research to gather or clarify more details on the researching subjects. Instead of a rigid questionnaire, an aide-memoire was used and referred to during the interviews. Further clarifications from interviews were obtained through e-mail or telephone and personal communications.

Most interviewees were senior policy makers, such as ministers and their deputies, heads of departments, trade negotiators and key members in trade delegations. Interviews with middle-level officials, general directors and managers of SOEs and in the private sector were taken to access feedback about government policies. Interviews

with researchers and consultant from government and independent think-tanks provided more truthful and balanced views on the process of economic reforms and impacts of the WTO accession on reforms, as well as clarifying the information provided by the government officials. Foreign experts were approached to see the standard views from an outsider's position on WTO led reforms in Vietnam.

## **1.6 Thesis outline**

Chapter 2 begins with an examination of the literature used in building the research framework and briefly explores the parallel case of China. China's reforms is explored to generate some understanding and lessons about the relationship between the WTO accession and the progress of domestic reform in the similar condition countries, and helps further understand and explain Vietnam's economic reform process.

Chapter 3 focuses on the background information on Vietnam's economy and politics. It provides a summary on Vietnam's international economic integration process, including the WTO negotiation process and its commitments, while also identifying the interest groups in the process of economic reform.

Chapter 4 is dedicated to the process of economic reform in Vietnam since 1986 and the impacts of the WTO on the reform process. It describes the process of domestic policy reform and summarises all the difficult areas and unfinished reforms of the previous era. An analysis of how the WTO's accession of Vietnam helped to accelerate structural reform is given and examines the political economic impacts.

Chapters 5-7 analyse the impact of the WTO accession process on three sectors and each assesses the adjustment of domestic policy to WTO rules. The development and interactions of different interest groups over time are compared across specific industries and different periods of reform in order to understand the evolution of economic reform.

The last chapter draws conclusions about the impact of WTO accession on domestic economic reform in Vietnam and provides some lessons for other developing countries that undertake similar tracks of reform and liberalisation. However, the final chapter will conclusively show that a new understanding of how WTO accessions affects a developing countries reform process needs to be re-evaluated by economists, as the Vietnam case shows an alarming level of misappropriation and misunderstandings of its impacts and the very process itself. The continued levels of involvement by the Party and Government in the economy remains a problem, as it means the basic aims and processes of reform through the WTO membership are limited by the lack of real separation between the political system and the economy. The acceptance as a fully market economy may only come if there is dramatic political reform that clearly shows less control of the economy by the Party and Government and less active participation by the Government in many major economic sectors.

The conclusion compares the appearances of reform with the actual reality, where to all intents and purposes the Vietnam economy remains almost solely under central command control, and where those with political power are able to subvert the reform process for individual gain on a scale that now threatens the very core of the economy's sustainability. Whilst the market economy membership is the basic tenet and flagship achievement of the WTO, the continuation of central control of the Vietnam economy by the Government and SOEs, alongside unsustainable levels of corruption, belies the WTO's very purpose as a progressive tool of reform.

The case studies show different levels of negative outcomes to reform of the economic system. This is in some cases due to powerful (financially and politically) individuals misusing the process and benefits of reform, such as diverting governmental financial support into their own 'pockets' or to an ideological bounded resistance that makes it difficult for them to agree to reducing political control and Party involvement in the economy. WTO membership requires valid separation of political power from active participation in the monopoly control of the economy, and a development of greater separation between the government and the economic institutions that govern the economy. In the case of Vietnam, the failure to fully move to a WTO market system has resulted in crippling levels of corruption, a failure to achieve economic

competitiveness and efficiency, a banking system on the brink of total collapse due to unsustainable burdens of debt and the possible beginning of a financial crisis that could overflow into the whole Asian economy.



## **CHAPTER 2      LITERATURE REVIEW: ECONOMIC REFORM AND THE WTO ACCESSION PROCESS**

Unilateral economic reform in developing countries is often a difficult and challenging undertaking. Impediments to unilateral reform arise from both internal and external factors. The internal factors reflect the political resistance of vested interests and the technical problems inherent in the reform process. External factors stem from the overall scepticism towards globalisation and economic liberalisation after the Asian Financial Crisis (Bates and Krueger 1993; Stallings, 1995; Sally, 2006; Rajapatirana, 2001). The World Trade Organisation has a role in facilitating difficult unilateral domestic reforms, providing governments with both the mechanism to overhaul policies and institutions and a lock-in device for market-friendly reforms (Rajapatirana, 2001).

This chapter outlines the theoretical literature and discussions on the economic reform process and WTO accession of a developing country. It establishes the conceptual framework and gives an understanding of the political economic reforms in developing countries. It focuses on:

1. The concepts and process of economic reform, and
2. The determinants of a successful reform.

The functions and procedures of the WTO accession process are analysed and the thesis explores how the accession process influences a developing country's economic reform. The final section examines China's WTO accession and its relativity to the Vietnam case.

### **2.1 Political economy of reforms**

After WWII, many developing countries gained their independence and started to reconstruct their economy. Developing countries adopted similar economic policies,

in which rapid industrialisation through state intervention in trade and investment was put at a higher priority in their development programmes (Bates and Krueger, 1993; Oatley, 2006; Krueger, 1993). Developing countries strongly believed that industrialisation through government controls and leadership of the economy would bring about greater economy growth (Bates and Krueger, 1993). State-led development policy relied heavily on three policy instruments: trade barriers, government planning and investment policies (Oatley, 2006; Krueger, 1993). The strategy is dubbed as the 'import substitution industrialisation' (Krueger, 1993; Bates and Krueger, 1994; Nelson, 1990). They adopted highly restrictive trade regimes to protect domestic manufacturing industries with the aim of producing their own goods in substitution for imported goods. In any relatively closed economy, the government exerts strict control of foreign trade to ensure that the foreign exchange is allocated correctly in line with the governments' development objectives (Bhagwati, 1978; Oatley, 2006, p.126). Tariffs and quotas are used extensively to protect the domestic industries from foreign competition. Import licensing is applied extensively and granted for small numbers of monopoly agencies to control imports (Krueger, 1993). The exchange rate is undervalued to ensure cheaper import inputs for the industrialisation process (Krueger, 1993). Governments also strictly control investment in the industry sectors via development plans. These plans serve as the coordination device for investment to promote targeted industries for development rather than according to their role in the market (Little, 1982; Oatley, 2006). In order to assist these plans, the state controls the financial sector to enable easier management of capital and direct it to targeted sectors. Government investments are channelled through the State Owned Enterprises to support implementation of growth in the industrialisation process.

A general consensus is that these policies fail to achieve their purpose (Williamson, 1994; Krueger, 1993; Bates and Krueger, 1993). The strategy first brought economic growth to the applied economies in 60s and 70s, but increasing economic imbalances created by persistent deficits in trade and budgets proved this state control and centralisation of economic power impeded, rather than supported, economic growth (Krueger, 1993; Nelson, 1990). Heavy government intervention in the economy in the forms of SOEs and state investments tended to generate budget deficits for governments (Bates and Krueger, 1993). Many SOEs never became profitable and were kept solvent through funds from the governments' budgets (Waterbury, 1992). Current accounts

suffered persistent deficits due to trade deficits and the industrialisation process generated considerable demand for imported capital and inputs. The restricted trade regime for domestic market protection increasingly undermined the export capacity of the countries. Overvalued exchange rates helped to support cheaper intermediate imported goods and inputs, but equally made the export goods more expensive in the world market. Restrictive trade regimes in new industries prevented economies of scale needed in order to compete in the world market (Little et al, 1970).

Industrialisation shifted resources out of agricultural sectors, weakening the capacity of this sector at domestic and international levels. Problems with budget and trade deficits created macroeconomic instability and increases in money supply were used to cover deficits, resulting in aggravation of difficulties with inflation (Krueger, 1993). Many countries, especially in Latin America, borrowed heavily through external loans to finance their deficits and industrialisation processes (Oatley, 2006).

In the 1980s, the imbalances in these economies were increased by a number of external shocks (Nelson, 1990; Krueger, 1993; Easterly, 2001; Rajapatirana, 2001; Stallings, 1992). Dramatic increases in oil prices in 1979 posed significant challenges to global growth and developing countries in particular, widening their current account deficit and forcing them into debt (Nelson, 1990). The US government changed its monetary policy, focusing it on controlling inflation and believing that interest rates were too high. Many developing economies were brought to the brink of insolvency (Harvey, 2005). The global economic recession saw demand for developing countries export goods reduced and debt-servicing was tightened and widened (Cline, 1984; Oatley, 2006; Stalling, 1992). These negative international shocks increased the domestic problems of the majority of developing countries, except for those that were oil exporters (Rajapatirana, 2001). Latin American countries defaulted in their debts and showed that the domestic policies used by these countries were not compatible with continuing economic growth plans and were a major contribution to crises (Bate and Krueger, 1993; Krueger, 1993; Rajapatirana, 2001; Nelson 1990; Stalling 1995). The debt crisis forced these countries to revise their development policies, with many forced to make policy changes by their international creditors and a sea change in policies in developing countries (Haggard and Kaufman, 1992).

Some developing countries in East Asia adopted a different set of development strategies. Although sharing the same background with other developing countries, these countries were able to develop rapidly in a short time. The rate of average income growth was twice as fast as the rate in Latin America and 26 times the rate in Africa. As a result, the average income in East Asia countries soared and manufacturing output demonstrated sustained growth rates (Oatley, 2006). Exports grew rapidly with an annual rate of 8.5% from 1965 to 1990, which completely contrasted with little or no growth in other developing countries (WB, 1991). A common agreement was reached on the development of the East Asia with them pursuing market friendly and outward development strategies. These countries focused on producing manufacturing goods for export rather than producing them for domestic markets, as in the import substitution industrialisation model (Krueger, 1993; Rodrik, 1994; Haggard and Kaufman, 1992; Nelson, 1990; Haggard, 1990).

The debt crisis in Latin America and other developing countries indicated that their policies were not appropriate for economic development and there was a need for policy changes. Most debtor countries turned to the International Financial Institutions for financial assistance to rescue their economies. IFIs were explicitly linked to policy reform packages, aimed at medium term structural adjustment programmes (Nelson, 1990). Countries were encouraged to maintain macroeconomic stability, trade liberalisation with export promotions, rationalisation of public sector investment, and reduction in the role of the state with SOE privatisation programmes (Kahler, 1990; Nelson, 1990; Williamson, 1990; 1994; Oatley, 2006). These measures were inspired by a neo-orthodoxy approach under the guidance of the IMF and the World Bank. There were pressures from international lenders to take adaptive measures (Nelson, 1990). Developing countries accepted that an economic reform agenda was unavoidable.

There was no standard reform programme, with reform packages often entailing some common adjustment measures to alter previous policies including the rate of government spending; the financing of the government expenditures; the foreign trade and payment regime; policies affecting conditions of operation of private firms and the SOEs (Bate and Kruger, 1993; Williamson, 1990; Beirsteker, 1995). These reforms

were considered as a process rather than instant measures, thus often taking time and commitment (Bate and Kruger, 1993). Reform packages aimed to reduce the macroeconomic instability of the early 1980s (Stalling, 1992). ‘Structural adjustment’ reforms encouraged movement away from inward oriented development and focused on medium and long-term economic development (Stalling, 1992). Structural adjustment reforms became increasingly popular and were adopted in developing countries around the world in the late 1980s (Stalling, 1992). Economic reform was composed of two major groups of policies: (1) macroeconomic stabilisation and (2) the so-called ‘structural adjustment’ (Bates and Krueger, 1993; Haggard and Kaufman, 1992; Nelson, 1990).

Stalling (1992) argued that the changes in the development policies of the developing countries were the result of not only the economic situation but also of the political and ideological changes made in the international environment. The UK and US governments were headed by liberalist leaders (Reagan and Thatcher), who strongly supported the ‘magic of the market’ (Biersteker, 2005). These governments supported the IFIs in terms of financial and political resources for researching and advancing the idea of neo-liberalisation (Biersteker, 2005; Stalling, 1992). IMF and the World Bank were centres for propagation and enforcement of ‘free market fundamentalism’ and ‘neo-liberal orthodoxy’ (Harvey, 2005). Creditors were increasingly united with the IMF and World Banks in facilitating the idea of neo-orthodox reform packages offered by the IFIs (Stalling, 1992; Biersteker, 2005; Nelson, 1990). They acted as the external pressure for the reforms in debtor’s countries.

The IMF and the World Bank offered debt re-scheduling on condition of structural adjustment for economic reforms in debtor countries (Stalling, 1992; Nelson, 1990; Kahler, 1990). Policy reforms were also the result of the ideological changes that moved economic policies based on Keynesian to neo-orthodox, then neo-liberalisation influences (Nelson, 1990; Kahler, 1990; Harvey, 2005). In a decade of slow growth and economic instability, the Keynesian approach was believed to have failed and was responsible for the failures in development (Harvey, 2005; Bierkester, 1995). This gave rise to the search for an alternative policy approach, in which correction of the previous policies were taking into account.

Support for the neo-orthodox approach stemmed largely from the success of East Asian countries when compared to the struggling Latin American, African and South Asian economies (Stallings, 1995). In contrast to structuralism and neo-Keynesianism's distrust of market mechanisms and faith in the state, neo-liberalism is highly sceptical of the state's ability to efficiently allocate resources and as such, places greater faith in the market's ability to do so. Neo-liberalism advocates limits to government intervention in the economy and the phasing out of protectionist measures (Harvey, 2005; Biersteker, 1995; Stalling, 1992; Nelson, 1990; Krueger, 1993).

The new ideology was shared by the leaders of developing countries, as many of them were classified as technocrats who had been trained as economists in neo-liberalisation. The convergence of beliefs in neo-liberalisation among the economists and many countries' leaders had created a general consensus on 'a recommended policy for developing country development', known as the 'Washington Consensus' (Stalling, 1992; Biersteker, 1995). Structural and trade reforms were further supported by the creation of new endogenous growth models that analysed the link between policy reforms and economic growth (Romer, 1986; Lucas, 1988). Empirical works were also conducted to support the new ideology.<sup>13</sup> These strengthened the belief in the new ideology of development policy (Rajapatirana, 2001). The 1980s and 1990s were considered as the decades of major policy changes, with developing countries turning away, partly or fully, from previous policies.

Policy reform under the neo-liberalisation ideology was not free of challenges, and was criticised on theoretical and empirical grounds. Researchers believed that East Asia development was wrongly interpreted as evidence of the superiority of the market-oriented mechanism and for the potential to turn away from the import substitution policies.<sup>14</sup> They argued for the active role of government in guiding and promoting some selective sectors, in order to have better industrial performance and economic

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<sup>13</sup> Dollar 1992; Sachs and Warner 1995; Edward 1997

<sup>14</sup> Bierkester, 1995; Amsden, 1989; Haggard, 1990; Wade, 1992; Amsden, 1989; Wade, 1990; and Lal, 1996

success, rather than leave them to free market influences. Taiwan and Korea advocated the role of government in designing policies and organisation to promote the transition from one level of industrialisation to another (Wade, 1994; Amsden, 1989). Wade (1990; 2003) promoted Governed Market theories in which the developmental state model combined with an international market orientation as the main contribution of the success of the East Asian model. Rodrik (1992) was sceptical about the across-the-board trade liberalisations, although he did support the selective promotion of a specific industry. World Bank adjusted their criticism on the roles of state and government policy failures, with more importance given to other factors for structural reforms. In the study 'The East Asian Miracle', the World Bank suggested that effective institutional development, human capital investment and some types of sector policies were needed to accompany the reforms (WB, 1993; Bierkester, 1995). The tone for reforms had shifted from a total laissez faire approach towards more 'market-friendly' policies (Berger and Beeson, 1998; Masina, 2006).

The theoretical challenges to the traditional argument of free trade came from the direct relationship between trade liberalisation, welfare and growth. Stiglitz and Charlton (2005) suggest that the benefits of trade liberalisation may not be taken for granted. The traditional arguments for free trade are often built in perfect conditions, but developing countries operate in less than perfect conditions. A perfect market entails full employment, full resource utilisation and perfect risk management (Stiglitz and Charlton, 2005; Dasgupta and Stiglitz, 1977). Newbery and Stiglitz (1984) showed that under certain conditions free trade is Pareto-inferior to autarky, in which welfare is reduced and leads to increased unemployment. Anand and Johsi (1979) suggested that there was a trade-off between efficiency and inequality in trade liberalisation. Rodrik and Rodriguez (2001) found that there is a gap between the results that economists have actually achieved and the policy conclusions they have typically drawn. Rodrik and others suggests that in order to achieve the effect of trade liberalisation on long-term growth, the market may not be sufficient for encouraging restructuring, diversification, and technological dynamism. Thus, developing countries need to develop 'a framework of public action' for private initiatives to change the competitive advantages. Countries with poor institutions suffered a strong negative impact in terms of trade losses, and trade liberalisation diverts the needed resources away from development priorities such as education, public health, industrial capacity and social cohesion (Rodrik, 2001).

Rodrik (2001) declared that global integration rested on shaky empirical grounds and negative results have fuelled increasing criticism and challenges to the economic reforms advocated under the neo-liberalisation banner in the last two decades. The IMF and World Bank frequently expressed their pessimism on the extent to which policy agreements would eventually be implemented accordingly (Haggard, 1985). Reform implementation is often politically constrained (Nelson, 1990). These reform failures are not the only reason for the poor performance of many African and Latin American countries in implementing economic stabilisation and structural adjustment (Bierkester, 1995; Nelson, 1990). The implementation of trade liberalisation has often come at a high cost. Finger (2001) estimated that developing countries must spend 150 billion USD to implement requirements under just three WTO agreements, which may exceed the capability of many low-income nations. The evidence on the benefits of liberalising capital flows is even weaker after the Asian Financial Crisis, as financial markets are inherently unstable, subject to ‘bubbles’, panic and short-sightedness (Rodrik, 2001).

Although the mood for reform was lowered since the Asian Financial Crisis, intellectuals and policy makers still believe the harshest elements of each development policy should be avoided (Stiglitz and Charlton, 2005). Instead the worries for the roles of market or of the state in efficient allocation of resources, has caused many researchers to have serious reservations about the ability of the officials in developing countries to manage the development policies (Krueger, 1997; Stiglitz and Charlton, 2005). Winter (2003) clearly expressed his sceptical view on the ability of officials to implement the state intervention policies effectively, thus rejecting the possibility to use these interventions against the market failure. Krueger (1997) doubted the ‘degree of sophistication of officials’ to interpret policy reform research results correctly. In addition, the simple orthodoxy policy is more transparent and less prone to corruption and rent seeking activities (Stiglitz and Charlton, 2005).

### **2.1.1 Components of Reforms**

The failure of the Keynesian model, combined with serious macro-economic instability with high inflation and budget and current account deficits, resulted in the



need for policy reform in the 1980s. Orthodox measures often required the re-establishment of a healthy economy by immediately controlling inflation; reducing the growth rate of government spending; reforming the tax structure, rationalising expenditures, reducing government subsidies, and improving the efficiency of public investments by scaling down and shifting their focus from production and towards infrastructure and the social sector (Biertesker 1995).<sup>15</sup>

The existing inefficient economic structures made sustainable growth difficult for the success of the first stages of reform, and in the second stages there was a need to improve incentives and efficiency for sustainable growth (Nelson, 1990). The new policies required the rationalisation of the allocation of resources and the strengthening of the export sector (Bates and Krueger, 1993). The specific measures may vary with individual country's circumstances (Nelson, 1990). Reform programmes often reallocated resources for more efficiency through promoting a greater reliance on market mechanisms, further reducing the roles of government, and bringing integration into the international economy (Bates and Krueger, 1993). Typical structural adjustment programmes often involved four main issues:

1. Trade and foreign direct investment liberalisation;
2. SOE privatisation and restructuring;
3. Promotion of economic competition and of private sector;
4. Efficient economic management institutions (Bates and Krueger, 1993).<sup>16</sup>

Trade and investment policies are often at the core of the structural adjustment processes. Welfare enhancement through free trade has been the one of the most fundamental doctrines in modern economics (Stiglitz and Charlon, 2005). Countries are required to liberalise their trade regime with several degrees of liberalisation. Free trade is “generally regarded as an incentive structure which does not discriminate between exportable and importable goods or between production for domestic market and export

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<sup>15</sup> Nelson 1990; Haggard and Webb 1994; Biertesker 1995; Stalling 1992; 1995; Harvey 2005; Krueger 1994

<sup>16</sup> Williamson, 1990; 1994; Haggard and Kaufman, 1993

sales” (Oyejide, 1998, p.343).<sup>17</sup> Liberalisation aimed to create a trade regime with minimum barriers for trade and investment, ensuring that countries establish and exploit their comparative advantages, therefore enhancing the efficiency of the domestic resource allocation.<sup>18</sup> From this process, technology and knowledge also flow and transfer between countries, which increase innovation development (Srinivasan and Bhagwati, 2001). Trade liberalisation is the process of balancing domestic and international prices (Masina, 2006; Nelson, 1990; Kruger, 1992; 1994). This involves the reduction of quotas and tariffs, dismantling of licensing agreements, state trading policies, and other non-tariff barriers (Oatley, 2006). Foreign exchange controls are also relaxed to create unifying exchange rates and greater currency convertibility. FDI liberalisation focuses on creating fair and non-discriminatory conditions for foreign companies investing in the host economy, and removing market entry and ownership restrictions (Stiglitz and Charlton, 2005). In Vietnam, the free trade approach thus entailed both internal and external reforms to liberalise the economy; but domestic reforms based upon opening up the economy to global competition lacked enforcement mechanisms and were open to distortion through opaque methods of non-compliance.

An essential challenge is SOE reform and private sector promotion, as developing countries governments tend to prefer state control of economic activities. The existence of the large SOEs is considered a major burden preventing a country from realising its economic potential (Masina, 2006). This sector benefits from the government policies and supports such as subsidies, trade protection and cheap credit. SOEs become monopolies in major industrial sectors and usually operate inefficiently. State investments and interventions are believed to draw resources from more competitive industries and to weaken the banking system through the state’s policy of lending. These supports and protections actually make the SOEs compete directly with the private sector for the country’s limited resources and limit the capacity of the private sector to compete and develop in the market. Regulations increase operating costs of the private sector and reduce output growth rates (Oatley, 2006). SOEs restructuring and privatisation process reduces this inefficiency. It fosters greater competition in the

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<sup>17</sup> Helleiner, 1995; Iqbal and Khan, 1998

<sup>18</sup> Srinivasan and Bhagwati, 2001; Nelson, 1990; Stiglitz and Charlton, 2005; Biersterker, 1995

private sector, which in turn helps to create a more efficient private sector and better resource allocation. In general, structural adjustment encourages scaling back of the role of state in the economy, while enhancing the role of the 'market' (Oatley, 2006; Biertesker, 1995).

Essential to reform is economic institutions. Since the market operating mechanism shifts sharply from government's planning and intervention to market forces, the role, functions and competence of economic management institutions has to be adjusted to match the development of a market-based economy. The advocates of the New Institutional Economics (Coase, 1992; North, 1997; Williamson, 1994; Rodrik, 2004) recognised that a good market economy requires not only 'getting prices right', but also 'getting property rights right' and 'getting institutions right' (Rodrik, 2004). Property rights and institutions in general, set the rules to affect the behaviour of economic agents in a fundamental way (Qian, 2002).

Institutional reforms are critical for growth including improving secured private property rights protected by the rule of law, impartial enforcement of contracts through an independent judiciary; appropriate government regulations to foster market competition effectiveness; public administration; corporate governance and a transparent financial system. They are needed for sustainable development because they determine the efficiency and existence of both markets and organisations, public and private (Rodrik, 2004). Institutions determine the level of investment in physical and human capital and the dynamics of innovation, determining the perceived risks by individuals and other economic agents of conducting investments and undertaking risks (Burki and Perry, 1998).

There is a strong consensus on the absence of a 'typical' or one fits-all reform package since the characteristics and circumstances of each economy, such as economic structures, reform priorities, initial conditions, and types of governments, differ widely (Nelson 1990; Haggard and Web, 1994; Bates and Krueger, 1993). The task of selecting a suitable reform package is often daunting and the implementation of the reform in a quantum leap is not easy, since reform is usually a lengthy process (Krueger 1993; Krueger and Bate, 1993; Haggard and Webb, 1994). There are numerous strategies for

economic reforms and the results vary greatly between countries (Krueger, 2000). Since the mid-1980s, there have been an increasing number of the developing countries altering their economic policies, as the previous policies had failed to serve their purpose in providing growth and rapid development (Krueger, 2000). This trend was further strengthened by the wave of Eastern-European countries undertaking reforms following the collapse of the Soviet Union.

The trend of economic reform in developing countries was still continuing and holding its general trend in the 1990s. However, the Asian financial crisis in 1997 had negative effects on the reforms process in developing countries. Due to the global economic instability, many countries, including both advanced and developing countries de-escalated their will to liberalise their economies. This dramatically slowed the process of the reforms in many countries in the next decades (Sally, 2008). Economic reform processes varied vastly from country to country. It was not an easy and natural process, but rather a complex process influenced by many factors.

### **2.1.2 Determinants of the policy reforms**

In the last three decades, enormous efforts and resources have been used to achieve appropriate reform programmes and the necessary conditions for the development of the developing countries. They were often concerned about the factors influencing nature, programme, speed, and results of the reform process. These factors are concentrated in five determinants:

1. Crisis/Pressure,
2. Interest,
3. Ideas,
4. Institutions, and
5. Factor endowments (Sally, 2008).<sup>19</sup>

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<sup>19</sup> Bates and Kruger, 1993, Krueger 1993; 2000; Haggard and Web, 1994; Nelson ,1990; Sally, 2008

**(1). Crisis/Pressure:**

Crisis often means that the policies in place have problems created by internal and external influences. Bates and Krueger (1993) found that crisis was the more frequent stimulus to reform. The reforms are often triggered by three major types of crisis: (1) balance of payments difficulties; (2) accelerating inflation and (3) the loss of economic control. The first two problems often leads to shortages of imported goods, services, debt-servicing difficulties or capital flight, which worsens the living conditions of the ordinary citizens (Bates and Kruger, 1993). The deterioration of public services, increased corruption, and the increased size of the informal sector, such as in frequent evasion of regulation, smuggling, etc. are often the symptoms of the loss of State control. When faced with these problems, governments often strive to restore their control and stabilise the situation (Bates and Krueger, 1993).

However, in the case of Vietnam a more sophisticated examination of the causes and impact of crisis needs to be taken. The Communist Party fixation on survival at all costs means that re-occurring crisis became an almost systemic inevitability, as the Party consistently decided strategy on the basis of political survival and the subsequent policies created economic crisis. An example is the SOE debt crisis, brought about by the enormous amounts of financial support loaned without risk controls, and predicated purely on a need to retain a government control of the economy and using SOEs as the Party's means to that end. The unforeseen ends was that large amounts of the financial support were illegally diverted into individuals hands, the SOEs failed to invest in restructuring and improving their competitiveness and the distortions in the economy, such as less investment for the private sector and distortions in the market sectors, meant that the governance ability of the Party was publically seen to be failing, The very strategies for avoiding crisis became the actual source of re-occurring economic and political crisis. A vicious circle of crisis became inevitable, as the 'creative' economic statistics, (constructed to 'hide' the consequences of Party decision-making) mean future policies were based on fictional economic realities and old problems deepened, while new challenges, such as debt, aggravated already critical faults in the economic system.

Crisis does have a positive ‘side’ as it helps to break the patterns of ‘normal politics’ and can lean towards an accumulation of power for reformers in government to implement positive reforms (Williamson, 1994; Bates and Kruger, 1993; Nelson, 1990). It not only re-shapes societal interests, but also shifts the domestic balance of power by “weakening some groups and strengthening others” (Haggard and Webb 1994, p.153). Crisis often worsens living standards, so it tends to increase the public’s intolerance in the short-term costs accompanying the reform process.

The role of crisis in initiating reforms has not yet been satisfactorily supported by empirical studies (Haggard and Webb, 1994, Sally, 2006). Nelson (1990, p.325-26) has argued that “the nature of the crisis itself – its sudden or gradual emergence, its largely exogenous or substantially internal causes, even its severity – has little clear relation to the timing of policy response in many of our cases”. Governments may respond differently to crises, and their response may even vary in the most common and circumscribed balance of payments difficulties.

There is still no consensus among researchers about the right timing with which to respond to a crisis (Haggard and Webb, 1994). While in countries such as Thailand, Colombia and Indonesia, governments have usually responded quickly to warning signals at the outset of an economic crisis, the average African government has waited until the worst has materialised (Haggard and Webb, 1994). Moreover, a crisis is not a sufficient condition to guarantee the sustainability and institutionalisation of a reform. Even though it can stimulate government willingness and tolerance of both the political opposition and public opinion, it does not eliminate the vested interests opposing reform. But, again, Vietnam has a particular problem here in reacting to crisis and the right-timing for decisions. Decision-making can often be instinctive and rushed, or conversely, extremely slow and cumbersome. An example here is the Minister of Transport’s decision to extend school hours to 7pm (from 5pm) in 2012, in order to lessen the traffic on roads in rush hour. The decision was taken without recourse to the Ministry of Education and chaos resulted in schools and on the road network. The pilot project was cancelled within a week. Traffic control has become a major problem to the economy, with severe impacts on transport logistics, but the strategy for dealing with it was poorly constructed, enacted without planning or forethought and created a bigger crisis than the one it was designed to deal with (VNS, 2012).

## **(2) Interests:**

Interest groups act together to promote and protect their interests by attempting to influence government decisions (Salisbury, 1975). These groups use various methods, such as the diffusion of information, expertise, publicity, campaigning or electoral assistance to influence the policy decisions of government (Olson, 1965). The effective influence of an interest group stems not only from their decisive role in mobilising electoral support, but also from their capability in spearheading collective action outside of the routine channels of politics, such as labour strikes, capital flight, demonstrations, riots and even insurrection. Thus, interest groups often play a central role in the decision-making process, especially in democratic societies.

Extensive literature on the political economy of policy reform during the 1980s supports the view that the politics of economic reform are driven by income-distribution dynamics between interest groups. Economic reform tends to redistribute income across groups in the short run, and achieve better resource allocation, faster growth and higher average income only in the long run. Consequently, reform-related income redistribution leads to a complicated political scenario, where groups losing from the reform attempt to block it, while groups benefiting from it promote it (Frieden and Rogowski, 1996; Nelson, 1990; Haggard and Kaufman, 1992). As the government needs the support of interest groups to be successful, it often has to serve as a mediator between them. This mediation process then influences the government's pace and attitude toward the reform process (Frieden and Rogowski, 1996).

The structural adjustment accentuates political tensions between interest groups through budget reductions and enhanced efficiency in resource allocation. In, agrarian, labour abundant countries like China and Vietnam, reforms often redistribute income from industry and urban non-tradable sectors to agriculture and export-oriented industries. Given that the benefits from structural adjustment are often only felt in the medium or long run, reaching the necessary political balance for reform implementation becomes an arduous task. Since the groups losing from the reform often have strong influence on the government, their motivation to block the reform is greater than the

‘winners’ motivation to press for the reform. Losers are the groups benefiting from the previous policies, the losses acting as incentives to carry out collective action against reform (Olson, 1971; Krueger, 1974; Sally, 2008). Meanwhile, the benefits of the reform are often diffused over the whole society. Yet the winners have a vague understanding of what benefits the reforms may bring to them. Thus, these two factors may limit the motivation for collective action of the winners in a reform process (Frieden and Rogowski, 1996). Reforms subsequently become harder to implement due to the overwhelming collective action of the losers in the reform process.

The groups that gain the most from protection stand to lose the most from stabilisation and structural reform (Frieden and Rogowski, 1996). Import competing firms that had benefited from government credit subsidies and protection would be hit the hardest by the government’s budget cutback. SOEs would be particularly hard hit as they would lose the government support that had sheltered their operational inefficiencies. Workers in urban non-tradable sectors who had benefited from government subsidies to basic services, such as utilities, transportation and essential food items would also be hit by government budget cuts. Public sector employment would suffer as well, as budget cuts bring an end to wage increases and force a large reduction in the number of government employees (Frieden and Rogowski, 1996). Since reform-related losses are very concentrated in a few groups of society and the gains are widespread and uncertain, these groups often dominate the politics of reform (Bates and Krueger, 1993).

Olson (1982) also argued that strong institutionalised interest groups are likely to become highly rigid and cause deadlocks in individual groups and in the interactions of the groups with the state. The government must have sufficient power to break the deadlock to initiate the reform as well as to avoid the risk of becoming semi-paralysed. A single party rule may thus be seen as a highly positive influence on reform as the government has the power and freedom to over-ride many of the opposition groups to reform, unless the strongest anti reformers are actually in the govt. Policy reform implementation involves encouraging the reorganisation of interest groups by expanding the representation and weight of those benefiting from the reform and either marginalising or compensating the losers. Forming a new pattern of interest groups and



building the capacity of political elites are ways to secure the adjustments to economic policy.

In the case of Vietnam, the most relevant group in concern to the thesis claim of non-compliance to WTO commitments is a politically and financially powerful contingent of elites, who have used positions in the political structure and wealth accrued mostly from improper practices, to dominant control of the system of governance. Their power as an interest group is mostly based on serving the interests of the members as individuals, but their common interests are increasingly consolidating the interest group into a direct challenge to the power of the Party. Yet, nearly all their power is directed through the Party structure and separating them as an ‘interest group’ either in support or opposed to the Party is extremely difficult. Throughout the thesis, this interest group will be referred to and its ability to ‘capture’ control in its own personal ‘interests’ in both the economic and political framework cannot be underestimated.

### ***(3) Ideology:***

The literature on policy reform often shows that ideology can be a critical determinant of policy change (Bates and Krueger, 1993). Although the influence of ideas (or ideology) in policy is not easy to measure, past experience shows us that the prevailing climate of ideas and their interaction with interests and events can influence the set of policies (Goldstein, 1994; Sally, 2008). Indeed, ideology is a mental model that provides a coherent set of beliefs about cause-and-effect relationships (Goldstein, 1999). In the context of economic policy, these mental models typically focus on the relationship between government policies and economic outcomes. Ideas/ideology often stem from economic theories, where they frequently establish clear statements about economic relationships (Biersteker, 1995).

Goldstein and Keohane (1993) have suggested three causal pathways through which ideas can influence policy choices, arguing that ideas serve as ‘road maps’, or understandings of the causal connections between a given set of objectives and different political strategies. Ideas can influence the choice of policy and once they become

embedded in political institutions, they influence the policy choice long after the founding interests of those institutions have changed (Biersteker, 1995). Ideology also guides the beliefs of interest groups (Bates and Krueger, 1993).

In the context of comprehensive economic reform, it is difficult for particular groups to calculate where their interests are: “people subject to economic policy reform would themselves remain uncertain as to how their interests would be affected by policy change” (Bates and Krueger 1993, p.129). It is difficult for agents to estimate macroeconomic contingencies, as ideology and economic theories play an important role in assisting agents to ‘discover’ where their interests lie. What matters, therefore, is not whether a particular idea is true or false, but whether interest groups and people in power believe the idea to be true. As such, ideas can be the source of interest group preferences for or against a set of economic policies, helping to overcome collective action problems during the run-up of economic reform (Bates and Krueger, 1993).

Changes in ideology have often led to policy reform in many developing countries. Since the end of World War II, the ideology of development has been oscillating between the policies of intervention and those of free markets (Sally, 2006). A consensus on import-substitution, state planning and foreign aid was strongly embedded in developing country governments up to the 1970s. This consensus was reinforced by the post-colonial political ideology of mercantilist state-building and state-led economic development. Policy preferences were gradually replaced, however, by the neo-liberal economic ideas enshrined by the ‘Washington Consensus’ package. This package stressed the efficiency of market forces and outward economic orientation in promoting economic development, and led to massive policy reform in developing countries in the early 1980s (Biersteker, 1995; Sally, 2006; Ravenhill, 2006).

Now, the prevailing ‘post-Washington Consensus’ ideology has re-legitimised government intervention in the economy in order to tackle market failures. This does not represent a full return to the pre-Washington Consensus ideology, for the spirit of the latter has been considerably eroded (Sally, 2006).

#### **(4) Institutions:**

Institutions have a significant bearing on the development and political process (Garrett and Lange, 1996). According to North (2004), institutions comprise both sets of formal rules and informal norms of behaviour structuring human interaction. Formal rules constitute the 'rules of the game' such as the constitution, statutes and laws governing and enforcing contracts and property rights, which are the legal framework within which agents produce, consume and interact. Informal norms of behaviour are codes of conduct, taboos, and standards of behaviour that constrain the choice of agents and organisations in their activities and operations (North, 2004; Burki and Perry, 1998). Institutions mitigate market failures, stemming from the informational needs, commitment and enforcement problems, and prisoners' dilemmas (Krehbiel, 1991; Milgrom et al, 1990). They determine the efficiency and existence of both markets and organisations, public and private. Institutions determine the level of investment in both physical and human capital and the dynamics of innovation, determining the perceived risks by individuals and other economic agents of conducting investments and undertaking risks (Burki and Perry, 1998). Countries that have liberalised and accepted globalisation often have stronger institutions. With lower trade and FDI barriers and higher trade to GDP and FDI to GDP ratios, they tend to have better property rights and contract enforcement, better regulated financial markets, a stronger competitive culture, and more transparency in business. These countries also present a higher capacity in terms of resources, human capital, and in formulating and implementing unilateral and multilateral trade policy.

According to Sally (2008), institutions set the scene for government actions, interest group lobbying and the influence of ideas. They are the arena for policy choices and their implementation. These rules influence how people organise and thus determine whether interests organise around factors of production or industry lines (Frieden and Rogowski, 1996). They also influence how interest groups exert pressure on the political process, whether they lobby the legislature or exert influence through political parties. Rules influence which interests politicians, must respond to and thus determine which interests gain representation and which do not.

Garrett and Lange (1996) explain the role of institutions in inducing policy reforms by classifying institutions into two major groups. ‘Socioeconomic institutions’ organise interests in the private sector, affecting the types of distributional demands of societal actors place on government and influence the macroeconomic constraints under which governments operate. They can affect the political power of private sector actors and can play an important role in facilitating collective action. ‘Formal institutions’ aggregate societal interests in the public arena and determine the responsiveness of governments to them, affecting the responses of government to distributional demands and macroeconomic constraints in the public sphere. They also influence the willingness of governments to undertake reform, determine governments’ power to initiate the reform, and affect their capability to sustain the reform process once set in motion (Garret and Langer, 1996; Haggard and Kaufman, 1992; Haggard and Webb, 1993; Nelson 1990; Rius and Walle, 2003).

#### **(5) Factor endowments:**

Ranis and Mahmood (1992) argue that resource endowments are important factors in influencing the policy reform process in developing countries. Reform in countries with relatively rich endowments of natural resources, such as land and minerals, tends to be more complicated than in countries without such endowments. The conclusions from the economic development of East Asian countries show that the relative labour abundance at certain development stages has allowed them to embark on labour-intensive manufactured exports. This industrial specialisation is an engine for growth and, in turn, helped poverty reduction and human-welfare improvements, while many African and Latin American countries were struggling with their economic reforms and low growth rates (Sally, 2008).

By using FDI to develop their labour-intensive export capacity, the East-Asian countries have been able to bring about poverty reduction, employment, better infrastructure and institutions. This specialisation creates and strengthens a constellation of interests supporting further economic reform (Sally, 2006). Land and resource-abundant countries, given their relatively high labour cost, are crowded out of the global manufacturing markets by East-Asian (especially Chinese) competition. This position in

the world economy leaves these countries dependent on cyclical and volatile commodities markets. FDI in resource-abundant countries tends to be capital-intensive. The result is a FDI enclave, with high levels of unemployment, no technology and wealth spill-over into the rest of the economy, and with profits mainly distributed among the corrupt local business and political elites (Sally, 2006).

In conclusion, developing countries have made an unprecedented effort to shift their economic policies away from import-substitution towards more market-oriented ones. Most reforms undertaken in these countries include economic stabilisation and structural adjustment, which in turn consists of three major policies: trade liberalisation and FDI, SOEs deregulation, and construction of market-oriented institutions. Even though the reform packages were very similar, the results were often quite different. The reform process is influenced by five main determinants: crises, interest groups activity, ideology, institutions, and factor endowments. In most strong-liberalising countries, political or macroeconomic crises have contributed to opening-up the economy (Krueger, 1993; Nelson, 1990). This has paved the way to the consolidation of market-oriented interest groups and a challenge to traditional protectionist interests. Gradually, open-market ideas have become entrenched and the resulting stronger institutions turned out to be more capable to support and manage open-market policies. However, this has not been sufficiently studied in Vietnam.

## **2.2 World Trade Organisation (WTO) and its accession process**

### **2.2.1 WTO and its functions**

The WTO administers a trade agreement negotiated by its members and is an organisational structure developed under the auspices of the General Agreement on Tariffs and Trade (GATT). Since the completion of the Uruguay Round the structure has expanded to incorporate agreements on tariffs and trade (GATT), on trade in services (GATS), on intellectual property (TRIPS), the Trade Policy Review Mechanism (TPRM) and the Dispute Settlement Body (DSB).

The WTO inherits many features of GATT, but has also evolved to become a wider and deeper institution. The WTO has numerous functions, including facilitating the implementation and operation of multilateral trade agreements, to provide a forum for negotiations, to administer the dispute settlement mechanism, to furnish the multilateral surveillance of trade policies, and to cooperate with other international institutions such as the World Bank and IMF in order to achieve greater coherence in global economic policy-making (Hoekman and Kostecki, 2001). The WTO is an inter-governmental organisation with its own secretariat, and the agreements it administers are mandatory and permanent. WTO agreements are multilateral and it has a wider scope than the GATT had, covering trade in services, trade related aspects of intellectual property and continues dealing with trade in goods through ‘GATT 1994’ (an updated version of ‘GATT 1947’).<sup>20</sup> The WTO system is faster and more automatic than the old GATT system. The existence of WTO is essential as it provides codes of conduct for international trade and reduces the arduousness of negotiation processes (Hoekman, 2002b).

The WTO is headed by the Ministerial Conference, where members meet at least once every two years. Between the meetings of the Ministerial Conference, the organisation is managed by the General Council, which meets about 12 times a year to carry out day-to-day functions of WTO. The General Council adjudicates on trade disputes or reviews member countries’ trade policies (Hoekman and Kostecki, 2001). The two highest profile activities of the WTO are: initiatives to launch multilateral trade negotiations and the settlement of disputes. These activities are the responsibility of WTO members and not the Secretariat (Hoekman and Kostecki, 2001).

### **2.2.2 Roles of the WTO in economic reform**

The WTO agreements facilitate the free and fair flow of goods and services between countries, but are not specifically designed for direct promotion and assistance of economic development and reform. In an increasingly globalised world, it is difficult

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<sup>20</sup> GATT 1947 largely concerned which commodities would be covered by the agreement tariffs reduction. GATT 1994, extended the agreement fully to new areas such as intellectual property, services, capital, and agriculture and created the WTO.

to find an economic activity that is not related to international trade. Trade and investment play an important economic role in any country and as a consequence of this importance, many countries liberalised their trade and investment regime as a part of the structural adjustment process.

The WTO provides several advantages for developing countries:

1. It provides less developed countries with opportunities for market access and expansion.
2. Developing countries are small in terms of demand and supply compared to the large trading entities from the developed world.
3. It binds reciprocal commitments made in previously undertaken liberalisation programmes and helps to prevent a return to protectionism when faced with adverse economic conditions
4. WTO membership and negotiations can strengthen the domestic policies and institutions created for the conduct of international trade policymaking.
5. WTO accession is a means to accelerate and lock-in domestic reforms. The changes in economic policies and institutions that often accompany WTO accession also increase the credibility of governments in the eyes of the international business community (Michalopoulos, 1998).<sup>21</sup>

In joining the WTO, acceding members accept a number of commitments, which also carry the risk of adverse affects upon their economy. The acceding member risks an increase in the pressures where ‘products, enterprises and industries’ are faced with a new level of competition that forces them to accelerate and extend their market driven reforms. The reduction in domestic protections such as tariff barriers opens up the market to ‘foreign products, services and investments’ and there is a new demand for enterprises to restructure and become more profit driven and competitive as foreign inputs challenge the past preferences and protections that domestic businesses often became reliant on for economic survival (Yan, 2000, p.1). The necessary incorporation of WTO rules into domestic legislation places a heavy burden on the acceding nation,

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<sup>21</sup>Krueger, 1998; Sally, 1999; and Langhammer and Lucke, 1999; Drabek and Laird, 1998

with quick and efficient reforms needed in both the content and the subsequent enforcement of the new regulations and laws. An increasing number of 'losers' in the process becomes a source of interest group resistance to the reforms and this can often spread into the government bureaucracy as administrative elements reveal the levels of inadaptability in the system (Yan, 2000, p.2).

The new competitive and globalised economic environment means that a far higher calibre of human resources eventually becomes a necessity. The whole system of providing the necessary skills for economic survival creates demands that affect everything from the education system to the boardroom. The quality of human resources, in skills and talents becomes the key to making the transition from a developing country (with its advantages such as low labour costs), to a middle income country now providing better quality products and services and relying on its competitive advantages in a global economy. The WTO acts as a tool for development, but places a number of inevitable demands on an acceding Member to reform, and the subsequent changes are costly and require a number of economic reforms that needs to be seen as a short-term burden for a long-term benefit.

In Vietnam the disadvantages are increased by the actual structure of the economy which is predicated on an obsolete production structure that is also impaired by a lack of resources and knowledge required to develop the economy into an energy-saving and environmentally-friendly structure. The Vietnam economy has concentrated on growth in quantity and very little improvements in quality, and the subsequent scenario is one that deepens the extent and impact of the disadvantages in joining the WTO (Bui, 2010, p.1).

### **2.2.3 WTO Accession Process**

Accession to the WTO is an increasingly demanding and lengthy process due to the institution's growing membership and expanded mandate. Accession can be divided into an introductory phase and three substantive phases:



1. The applicant's preparation of a memorandum on its foreign trade regime describing in detail the country's policies and institution involved in the conduct of international trade;
2. The members' examination phase; and
3. The negotiation phase (Michalopoulos, 1998).

In the accession process, the applicant country is required to meet the WTO requirements and provisions, as well as the demands of existing members without the full knowledge about the benefits it will gain from the accession process. These negotiations are often one-sided.

*Introductory phase:* The applicant country begins the accession process by sending a formal letter to the Director General of the WTO expressing its desire to become a member of the organisation. The request is then considered by the WTO General Council who set up a Working Party to consider the accession application.

*The memorandum:* This is the fact-finding phase designed to give WTO members a deeper understanding of the applicant country's economy and trade related regimes. The applicant country submits a memorandum describing in detail its foreign trade regime and providing relevant statistical data for circulation to all WTO members. (Michalopoulos, 1998).

*Questions and answers:* Once the memorandum has been circulated to WTO members, they can ask questions and obtain clarification on the applicant's policies and institutions. The applicant is requested to submit relevant legislation and information on a variety of issues covered by the WTO for the consideration of the Working Party's members. The purpose of the detailed review and negotiations are to ensure that the applicant's legislation and institutions are in conformity with WTO provisions and the applicant will make specific commitments on areas relevant to WTO rules. The results of this phase are then recorded in: Draft Report of Working Party and the Draft Protocol of Accession.

*Bilateral negotiation on terms of accession:* Once offers are settled, the accession process enters its final phase, which involves specific bilateral negotiations between the applicant and each WTO member who wishes to hold such talks. These negotiations concern tariff levels and the degree of openness of the services sector proposed by the prospective member.

When the Working Party agrees on the completion of its mandate, it adopts the Draft Report on Accession, the Draft Protocol of Accession, and the Schedule of Concessions and Commitments. All these documents then are submitted to the General Council for approval. Following a favourable decision by the General Council, the country is invited to sign a protocol of accession under Article XII of the WTO agreement (Guohua and Jin, 2001).

The accession process often takes a long time because members try to make sure that the acceding country enact laws, develop the institutions, and apply policies that conform to the fundamental rules and disciplines of the WTO (Drabek and Laird, 1998). The applicant country has also to guarantee greater stability in commercial policy, which is in itself a consequence of adherence to WTO agreements (Michalopoulos, 2002). Therefore, the accession process encourages acceding countries to overhaul their economic institutions and policies to be in conformity with the market.

Unilateral liberalisers can lock-in their reforms through binding WTO agreements; countries choosing the multilateral track can use the accession process as a springboard for further and deeper unilateral reforms (Sally, 1999). WTO accession affects policy reform through its member's requirements that the applicant country's trade regime and economic policies conform to WTO rules. WTO members investigate whether any part of the applicant's trade regime is inconsistent with WTO rules.

### **2.3 China's WTO Accession**

China was officially admitted as the 143<sup>rd</sup> member of the WTO in 2001 after 15 years of negotiations. Commitments in meeting the WTO requirements resulted in

highly successful economic reform and integration into the world economy (Panitchpakdi and Clifford, 2002; Lardy, 2002; Sally, 2004).

China's reform is seen as the textbook case for strong unilateral economic liberalisation (Sally, 2006). Reforms began in 1978, and accelerated after 1994. Economic liberalisation saved China from the economic and social ruin of the Cultural Revolution but also provided it new economic and political strengths in the world arena, with GDP growth rates often exceeding 9.5%, and significant economic growth throughout the 1991-2005 reform period (Naughton, 2007). Reform was not implemented without difficulties. Technical problems of the reform agenda created difficulties for policy makers in planning, implementing and controlling the process of reform. Disadvantaged groups during the reform applied political pressure to slow down the reforms or force a compromised agenda. Nevertheless, the Chinese government has wisely used its strong determination in acceding to the WTO to cope with these difficulties (Naughton, 2007).

The China economic reform involved unilateral and multilateral economic liberalisation driven by WTO accession. Its experience is highly relevant to the Vietnam's case with China's economic reform processes sharing many similarities. Compared to transitional economies in Eastern Europe and the Soviet Union, Vietnam and China stand apart, as both countries remain under the leadership of the Communist Party and adopted reform models favouring gradual economic reform before political reform. Both countries paths to reform focused on high economic growth, while the governments persisted on continuing single party leadership under the Communist Party. They demonstrated the same enthusiasm for unilateral reform and the use of international commitments as lock-in devices for internal reform. The pattern and ideology of reform in Vietnam is based on China's experiences. In the initial years of reform, Vietnam was faced with a choice of two directions, epitomised by the contrasting strategies carried out by the Soviet Union and China. In the next sections we first, examine the two options that the Vietnam Communist Party faced and then provide the outline of the subsequent preferred option - China. Studying China's economic reform during the WTO accession process is a valuable template from which to evaluate Vietnam's own accession.

### **2.3.1 Soviet and Chinese Influence on Vietnam reform**

A major influence on the Party in deciding the structure and format of reform was the collapse of Communism in the Soviet Union and the turn of China towards a market economy model. Interviewees for the thesis remembered the Soviet experience as a dominant cause of fear within the Communist Party of Vietnam. However, the dominant fear was not for collapse of the economy, or loss of foreign support. The almost totally encompassing fear was for the collapse of the Vietnam Party and a determination to avoid this at all costs. Party survival was already steering towards a route that depended entirely on saving itself and accepting whatever means that would entail (Chi Lan, interview, 2012; Nghia, interview, 2011; Thai, interview, 2012; Thanh, interview, 2011).

In the early years of the Soviet Union's steady decline, the Communist Party chose an uneasy mix of radical and orthodox reforms. Yet, privatisation of the economy became the central focus, with centralisation of fiscal policy, strict monetary policies and free trade becoming the main reforms (Chen, 2010). In contrast, China chose a gradualist approach, with the Communist Party maintaining a strict control and reform focusing on foreign trade and agriculture (Chen, 2010). Chen (2010) argues, that the lessons of the Soviet and Chinese reform experiences were a choice between gradualism or radicalism. Thesis interviewees were almost universal in declaring that, from the outset, the Vietnam policies were determined by an obsessional fear of the Party collapsing in a style and speed commiserate with the Soviet Party example. In addition, the Chinese approach appeared to be working and even strengthening the power of the Party, while the Soviet Party example promised only economic failure and Party destruction.

However, both experiences showed that whether gradualist or radical paths, both needed strong government governance to ensure control of corruption, regulation of monopolies, strong market institutions and efficient financial and regulatory controls, such as with efficient tax collection (Kizilyalli, 1998, p.6). Russia was seen to have undermined this by choosing both political and economic reforms. To add to this

challenge, Vietnam's political system already contained quite powerful elites who were determined how reform and its pace of application would be carried out. Much has been written on the Soviet collapse and China's success in reform (Aslund, 2000; Chen, 2010; Poznanski, 1995). The debate on whether gradualist or radical reform works best is challenged effectively by new research, which points to initial conditions as the primary factor in the success of either pathway (Chen, 2010). Chen (2010) points out that, China's advantages of having a powerful central control that limited rent-seeking by political elites and administered reform efficiently, is two of the major pre-reform conditions that determined the success or not of reform. There were limited entrenched interests in the economy, whereas, in Russia, enterprise managers were in a solid position to take immediate and rich advantage of the reforms. Corruption and rent-seeking were already taking hold and reform did little more than providing new impetus for its growth. China avoided many problems by, for instance, controlling the supply of raw materials to industries through strong economic coordination and control, while Russia suffered rampant diversion of raw materials and illegal speculation on an economy wide basis (Chen, 2010).

Foreign investment levels in China were good, with heavy inputs from the overseas Chinese Diasporas, especially in Macao, Taiwan and Hong Kong and significant contributions from Japan and the USA (Chen, 2010). In contrast, Russia and the Former Soviet Union attracted little foreign investment. These limited initial economic and fiscal conditions, which now can be seen as essential factors in the reform process, rather than specific political and economic policies. However, it would be a mistake to believe that Vietnam political elites were so rationally directed and calculating. Interviewees clearly showed a far more simplistic approach, driven almost entirely by the fear engendered by the collapse of the Soviet Communist Party. As McGough (interview, 2012) noted<sup>22</sup>, "In a decade of conversations with Vietnam political elites, the common factors were a fear of change- any and all change- a desperate level of distrust of anti-Communist elements in Vietnam and the belief that the Soviet collapse was not brought about by economic failure, but by 'external forces'

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<sup>22</sup> Dr Sean McGough is a consultant to Provincial Central Committees, advised Party and Government officials at all levels for over 10 years and served on the Board of Directors in a number of major SOEs, including in the Banking, Agriculture and Textile sectors.

that ‘manufactured’ that failure. Reform was seen as essential, but one that could, and must, be focused entirely on economic reform and avoid political reform at all costs. The Party needed to change, not transform, while economic reform needed to be controlled, not liberated”. Privatisation would be allowed, but only through careful State control. While Fiscal freedom would be channelled through Party dominated institutions and agencies, and economic reforms would always focus on strengthening the Party, while weakening political adversaries. The ‘hidden hand’ of economic liberalism would be replaced by the Party’s own covert control of all things economic, as well as political. To this date, the Party still fails to see economic independence as an essential ingredient for efficient reform of the economy and remains dominated by the need for political survival through central and absolute control of both the economic and political environment.

Throughout the reform process (before, during and after WTO accession), the dominant theme has been a desire by the political elite for survival. The Communist Party’s ideology has been continuously adapted to maintain power, with mainstays of ideology opened to the ‘free’ market, but Party control maintaining its conservative and unbending focus on continuing its absolute authority over all decision-making. This constraining political environment means that economic rationale is rarely the logical basis for decision-making in the economy, and political survival dominates all strategies for development.

Yet, the thesis shows that the Party may have lost even this battle, and its mis-directed control over external forces and its dominance of domestic economic factors allowed a power base to be built and consolidated by an interest group of individualistic driven elites who hold positions of both political and economic supremacy and challenge even the Party’s ability to govern. Corruption and rent-seeking dominates every sector, while political and economic institutions either bend and serve this interest group, or are rendered ineffective by the lack of establishment of mechanisms to enforce regulations or controls. In the quest to covertly maintain the Party’s dictatorial control of all economic and political factors, the Party established the means for this system to provide unbridled opportunities for particular individuals to first direct all political decision-making to their own personal favour, and then use the resulting growth in their

wealth to combine both power and money towards cementing their overall control of the Government, Party and Nation.

The case of China leant towards a more palatable model than that of the Soviet experience. The Chinese Party appeared stronger due to economic liberalisation and, the Vietnam leaders felt that the combination of strong Party control in an Asian cultural context offered a working model of how to combine market economy reforms alongside a continued maintenance of single Party control of the overall political and economic systems (a common view amongst nearly all of the thesis interviewees).

### **2.3.2 China's WTO accession and commitments**

China withdrew from GATT in 1950 due to the Communist takeover in 1949. China resumed relations with the GATT in 1972 and became an observer of GATT in 1982. In 1986, China formally applied to 'resume its status' as a Contracting Party to GATT. After submitting the application, it put forward the 'Memorandum on China's Foreign Trade System' on February 13<sup>th</sup>, 1987 and followed the standard accession procedure of GATT/WTO (Lardy, 2002).

Negotiations concerned tariff concessions, as well as market access on trade in services, and were dominated by the United States and the EU. The negotiations also considered additional commitments in investment measures, protective measures, anti-dumping, subsidies and state-run enterprises, textiles and trade in services (Gertler, 2004). The General Council approved the Decision on Accession and the Protocol on the terms of China accession on November 2001.

Negotiations were far from smooth for China. The rapid pace of China's opening to the outside world, together with limited members' interest in the scope of market access of goods, brought it closer to other major contracting parties, such as the US and EU countries, in reaching an understanding on many key issues (Guohua and

Jin, 2001). However, the Tiananmen Square incidence led to economic sanctions being imposed by the Western countries.<sup>23</sup> Social unrest led to stagnation in reforms with a series of administrative measures to strictly control economic affairs. WTO membership was halted and only resumed in 1992, when the new wave of the economic reforms led by Deng Xiaoping was initiated (Naughton, 2007; Lardy, 2002). However, GATT's negotiations process changed completely with the establishment of WTO at the end of the Uruguay Round. The 'GATT a la carte' approach was replaced with the uniformity of WTO rules of conduct. The New policy 'one single package of understanding' provided a uniform application process for all new Members. Acceding countries accepted additional obligations (WTO-plus). China's rapid expansion of international trade worried WTO member countries and demands from WTO members increased to a point where China negotiations were burdened by the higher level of accession requirements<sup>24</sup>.

### **2.3.3 China economic reforms**

In late 1970s the poor economic performance led Chinese Communist Party (CCP) leaders to reject the old standard planning system (Naughton, 2007). The government started dramatic economic reforms in 1978, rejecting Maoist central planning and reducing the role of communist ideology in economic policymaking, and moving towards a market oriented one (Naughton, 2007). The second phase of reform resumed in 1992 when the CCP adopted the historic decision to implement further reforms to transform to a market economy. The second reform was conducted alongside negotiations for WTO accession.

#### ***2.3.3.1 First stage of reform (1978 – 1993)***

After the Cultural Revolution, the Chinese economy and society had been severely affected because the foundations for economic and social growth had been

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<sup>23</sup> In June 1989

<sup>24</sup> See more detail summary of China commitments in WTO accession in Appendix A.



destroyed (Qian and Wu, 2002). China suffered high levels of unemployment, low productivity and food shortages (Shirk, 2008). Under the strategies of ‘Leap forwards’ and ‘Leap Outward’, the resources of the whole nation were mobilised for ‘industrialisation’ and concentrated in the heavy industries. Economic returns of these capital-intensive investments were often low because capital was tied up on long-term outputs (Naughton, 2007). This bias towards heavy industries meant investments in light industries and agricultural sectors were neglected, which resulted in a shortage of consumption goods and foods for the industrialisation process (Naughton, 2007; Shirk, 2008). After the death of Mao, the CCP decided to undertake reforms to the central command economy and encourage production and productivity. Initial reforms did not aim to eliminate and replace the central command economy, but instead, aimed to adjust the mechanism for better economic performance (Qian and Wu, 2002).

Reforms started with the rural economy, which employed more than 80% of the population. Collectives were given greater autonomy in their production. The government’s procurement prices for agricultural products were sharply increased. These relaxations helped to introduce profit incentives and to encourage production flexibility (Naughton, 2007). Later, collective farm land was contracted directly to households under the ‘Household Responsibility System’ (Qian and Wu, 2000).

In non-agricultural activities, new forms of business, Township and Village Enterprises (TVE), were developed in parallel with the planned sector, while joint ventures with foreign firms and sole foreign invested firms were established in four special economic zones (Qian and Wu, 2000; Naughton, 2007). The outputs of these new business entities were not incorporated in the planned economy and were subject to the market’s principles (Naughton, 2007). The SOEs were allowed to produce and sell the output above the plan to the market. A dual track economy was established with the co-existence of two co-ordination mechanisms (market and plan), with one subject to market prices and the other subject to state plan prices and resource allocation (Qian, 2002; Roland, 2000; Wu and Zhao, 1987).

External trade was gradually liberalised from the system of strict planning to a less restrictive system with import licensing and quotas in the early 1980s. This system

was gradually replaced by a high tariff system (Lardy, 2002). Incentives for export were introduced and trading rights were partially reformed by increasing the number of companies authorised to trade. The Government devalued the highly overvalued domestic currency and relaxed exchange controls by allowing exporters and individuals to use foreign currencies (Qian and Wu, 2000).

The central command economy still remained dominant in the economic system and retained a tight grip on its command of economic sectors. Large non-performing loans created a burden on the state budget and the banking system (Qian and Wu, 2002; Naughton, 2007). No market-based institutions were established, resulting in unregulated competition at all levels (Qian and Wu, 2002). Inconsistency and distortions in the market mechanism amplified economic instability (Naughton, 2007). Macroeconomic cycles in 1989 contributed to a serious economic imbalance with soaring inflation and declining living standards. The economic crisis fuelled people's disillusionment with the Government due to its corruption and arbitrary privileges during the reforms. These led to a political crisis in China when Tiananmen Square demonstrations occurred. The brutal crackdown on the demonstration by the Chinese government halted reforms and encouraged conservative ascendancy from 1989 to 1991 (Naughton, 2007).

### ***2.3.3.2 Second generation of reform (1993-1996)***

Since Tiananmen Square, Chinese leaders became convinced that only through economic development could they gain popular support and retain the legitimacy of the CCP (Qian and Wu, 2002). The collapse of the Soviet Union further strengthened the CCP's view: fearing the greater risk to the Party would come from economic stagnation rather than further deregulation and reforms (Zweig, 2002). Economic reforms had shown an undeniable success in terms of growth, which convinced people that reform might be an alternative to the planned economy (Perry, 1993; Lardy, 2001; Sprayregen et al, 2004). In 1992, economic reforms were revived with endorsements from Deng Xiaoping. This approach rested on its ability to deliver economic prosperity without forfeiting political security (Perry, 1993). Reform covered three major issues: market

reunification, fiscal recentralisation, macroeconomic austerity (Bachman, 1994; Naughton, 2007, Qian and Wu, 2002).

The Dual-track economy was replaced by market reunification, with planned economy elements abolished in 1993 (Naughton, 2007). Re-centralisation of the central and local authorities created clearer responsibilities and strengthened regulatory and macroeconomic management (Naughton, 2007). A new tax system with a broader tax base was introduced, and as a result, budgetary collection was improved. The macroeconomic policy was also regulated to follow an austerity based fiscal policy. The SOEs underwent restructuring but not privatisation (Yang and Zang, 2003). In 1994, the Company Law was issued to strengthen the legal basis for further SOE reform (Naughton, 2007; Li and Putterman, 2008). The central government endorsed it with the slogan of ‘grasping the large and releasing the small’ (Qian and Wu, 2002). Devaluation of the currency and current account convertibility was established. Quotas and high tariffs were introduced to gradually replace the monopoly planning activities. Trading rights were relaxed with more companies allowed to operate in international trade (Naughton, 2007; Qian and Wu, 2002; Lardy, 2002).

Reform in early 1990s changed its nature from ‘reform without losers’ to ‘reforms with losers’. Competition and less protection from Government put a real stress on the SOEs and their millions of employees, as well as a more equal distribution of income than in the planned economy (Shirk, 1996; Naughton, 2007).

### ***2.3.3.3 Problems before WTO accession (1995-1998)***

Many reforms were diluted down in order to avoid social unrest and pressure from interest groups, particularly in the reform of SOEs (Naughton, 2007; Shirk, 2008, Qian and Wu, 2002). Slow reforms of SOEs and trade institutions negatively affected the economic development of China. Qian and Wu (2002) identified that the core issues of many challenges of reforms were mainly from the SOEs. SOEs still accounted for one-third of the industrial output in 1998, compared to 77% of industrial output in 1978 (Lardy, 2002; Naughton, 2007). Enterprises were often laden with excess labour and ‘social burdens’ (Lal, 2006; Lin 2004). Most of them were operating at a loss (Starr,

1996; Lin, 2004). Many managers benefited personally, while the companies suffered losses (Wang, 2000).

The Government was forced to finance them through State loans and trade protection (Riedel et al, 2007; Qian and Wu, 2002). Non-performing loans of SOEs banks increased dramatically to over 20% of total outstanding loans (Qian and Wu, 2002; Lal, 2006). This diverted resources from other efficient sectors (Qian and Wu, 2002; Naughton, 2007).

Problems with reforms were caused by SOEs, as they were embedded in the political system of China as components of CCP ideology and a part of the bureaucracy (Qian and Wu, 2002). SOEs were still considered as the major tool to lead and to monitor the reform (Qian, 1996; Qian and Wu, 2002). Reforms would force mass lay-offs of SOEs' employees (Oi, 2005). Before the reforms, SOEs were the main source of urban employment and considered as the 'iron bow' of the Chinese workers (Nakagame, 2000). Thus reform needed effective social safety nets to avoid social instability (Naughton, 2007; Cheng, 2000; Goldstein, 1998).

The legal system of China had ill defined laws, poor law making institutions, contradictory and overlapping laws at all levels, vague terms and a wide variety of interpretations of laws. This led to tendency for discretionary law application and arbitrary interventions on domestic businesses that were not favourable to government's interests (Sally, 2004). Some of its consequences were corruption and rent seeking in the economic system, which created unpredictable and unfavourable conditions for business development (Qian, 1999; Sally, 2004).

#### ***2.3.3.4 Economic reform with WTO accession process***

Reforms were compromised due to the threats of the social instability and political pressure from interest groups. Further reforms needed decisive political forces to push them forward (Krueger, 2000; Haggard and Web, 1993). By the late 1990s China was ready for a new phase of reform (Qian and Wu, 2000). The Asian Financial

Crisis had serious negative impacts on the China's economic growth (Qian and Wu, 2000; Lardy, 2002). A period of economic stagnation began, with slow economic growth and blame falling clearly on the failure of the policies of a conservative faction. This helped form a political base for a shift in policy and movement of power from conservatives to new leaders willing to accelerate economic reforms (Zweig, 2001). After the 17<sup>th</sup> National Congress (1997) there was a new generation of members in the Central Committee and Politburo, with a better understanding of economics and experience of the market economy (Cheng, 2000; Fewsmith, 1999; 2008). They unanimously recognised the vital role of economic growth in retaining political power (Lardy, 2002; Naughton, 2007).

The decision to join the WTO was not an easy and smooth process because many viewed it as a threat to China's sovereignty and its domestic industries (Zweig, 2001). The top leadership of China was divided on accession and the decision to join was only narrowly passed (Zweig, 2001). The debate for the WTO accession was made public in order to allay popular fears and undermine the resistance from government bureaucrats and the business community (Pearson, 2001; Zweig, 2001). China was preparing to extend "its most credible offer yet to entry the WTO" and was considered a lever for promoting domestic reform (Kynge and Jonquieres, 1999).

### ***International trade reform***

China maintained a complex and highly restrictive system of import controls, and WTO entry provided the necessary impetus to accelerate reform and oppose resistance to China's domestic reform process (Lardy, 2002). The reforms on trade policy during the WTO accession were unilateral, determined and swift (Lardy, 2002).<sup>25</sup> The most important non-tariff barrier measures maintained by the Chinese government were the trading rights.

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<sup>25</sup> The average nominal tariff was reduced from 23% in 1996 to 17% in 1999 (Naughton, 2007). In 2001, the average statutory tariff rate stood at only 15%, which was two thirds less than the peak level in 1980s (Lardy, 2002). This tariff was superior to that of India and equivalent to that of Mexico and Brazil (Lardy, 2002; Sally, 2008).

Changes in the international trade regime demonstrated that China made serious efforts in reducing the trade barriers in order to meet the expectations of the WTO working party (Lardy, 2002). This WTO accession created a sense of urgency for economic reforms in all economic sectors. Upon the accession to the WTO, China opened the domestic market to foreign companies and domestic companies had to face competition with well financed, savvy, and technologically sophisticated foreign companies (Panitchpakdi and Clifford, 2002).

### ***SOEs reforms***

A threat to the continued economic reforms and development was the intention of many interest groups to protect the home-grown industries. Local businesses provided tax revenue and jobs. There was strong domestic pressure to protect them from more advanced foreign companies (Panitchpakdi and Clifford, 2002). SOEs restructuring resulted in massive lay-offs and workers protests (Lardy, 2002; Naughton, 2007; Qian and Wu, 2002; Panitchpakdi and Clifford, 2002). SOEs still enjoyed close relationships with state agencies and officials. This was partly due to important roles SOEs played in the socialist ideology (Zhang and Yang, 2003). They also served as a channel for bureaucrats and state agencies to receive direct benefits and rent seeking, which compensated them for the low state budget and salary, especially in the provinces.

Benefits of the WTO accession included increasing economic efficiency through trade liberalisation and institutional reforms which would lead to a more competitive economy, bring new technology and management skills to the country, attract new flows of FDI, and improve productivity. Pearson (2006) had commented on the decision for WTO accession that “opposition within China was not won over... but rather was run over”. It was a decision to use WTO accession to be a flagpole to balance the demands of the interest groups for protection while creating incentives for reformers and other groups to support reforms (Panithchpakdi and Clifford, 2002; Hai, 2000; Bajona and Chu, 2004).

WTO accession put more pressure on the SOEs via the reduction of trade barriers from WTO commitments, which would increase the competition for the domestic market. SOEs had to restructure themselves to adapt to the new environment (Lardy, 2002). Accession acted as an umbrella for reform's supporters and a shield for policy makers to avoid pressures for protection from the SOEs (Rieden et al, 2007; Qian and Wu, 2002).<sup>26</sup>

### ***Institutional reform***

China had a weak and inadequate institutional framework for the market economy. The decision to build strong institutions faced technical, political and social challenges (Wolfensohn, 2001; Panitchpakdi and Clifford, 2002; Lubman, 2001). Swift and decisive reform after 1992 had transformed the economy. Reform involved a decentralisation process and rapid growth of the private sector, but institutions were finding it harder to play 'catch-up'. As a result, the gaps between the development of the market and the legal framework led to problems and tensions, with corruption, smuggling and social injustice prevalent in China (Fewsmith, 1998; Starr, 1996). Inadequate legal and institutional frameworks supporting economic development were inhibiting the attraction of FDI (Qian and Wu, 2002; Lubman, 2001). With ambiguous laws, vague property rights, local protection, corruption and the limited power of courts, development of the modern market economy was severely undermined.

China promised to apply and administer its laws in a 'uniform, impartial and reasonable' manner and to make sure of transparency in making and implementing laws and regulations (Panitchpakdi and Clifford, 2002).<sup>27</sup> The capacity of China's courts was enhanced to render fair judgements, free of corruption, and of the pressure from the government, as well as to execute those judgements once rendered.

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<sup>26</sup>Zweig, 20020; Panithchpakdi and Clifford, 2002; Lardy, 2002; Cheng, 2000; Bajona and Chu, 2004; Yang, 2002

<sup>27</sup>Over 1400 laws, regulations and similar documents were reviewed by the end of 2000. In the first two months of 2001, the various ministries and commissions of the State Council reviewed some 2,300 laws and regulations (Clarke, 2002).

## **2.4 China's implementation of the WTO's commitments and economic reform post- WTO accession**

Reforms were swift and strong under the accelerated negotiations for WTO accession in late 1990s (Sally, 2008). The process helped to strengthen the political will for further domestic economic reform (Yang, 2002; Farah, 2006; Zhang, 2005; Sally, 2010). However reforms slowed down during the implementation period and stalled again at the end of the implementation process. In addition, the global financial crisis and later the economic recession created strong demands for slowing down reform (Sally, 2011).

In the first five years of WTO membership, China worked hard to uphold its commitments, especially in tariff and quota reduction commitments (USTR, 2007; 2008). China was ahead of schedule in significantly reducing its tariff rates, decreasing the number of goods subject to import quotas, expanding trading rights for Chinese enterprises and increasing the transparency of its licensing procedures. China undertook a huge programme of aligning national technical standards with international standards (Erixon et al, 2008; Sally, 2011; Clarke, 2008). They also revised its FDI law in 2004 to allow both domestic and foreign enterprises to have automatic trading rights through a registration process (Sally, 2011).

The SOEs reforms were deepened by restructuring large and medium SOEs. Reforms involved the separation between the policy-making functions and SOEs' ownership function. It established an arms-length relationship between the regulator and the regulated companies. It also separated ownership and SOEs management functions (Yang, 2003). A new State-Owned Assets Supervision and Administration Commission (SASAC) was formed in 2003 to act as the central agency for supervising and exercising the restructuring process of the largest SOEs (Gallagher, 2005).<sup>28</sup>

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<sup>28</sup> The number of SOEs decreased from nearly 50,000 units to just over 20,000 units from 2001 to 2007.



China was serious in implementing WTO commitments right after the accession process (USTR, 2009; Zhang, 2005). However, since the implementation period has ended the motivation for further reforms has been slowing down (Saich, 2007). Although the economic growth had been maintained at a good rate, the Chinese economy had been criticised for creating greater inequality and endemic corruptions (Saich, 2007).

China increasingly used opaque trade measures to promote industrial policies. Export quotas, export license fees, minimum export prices, export duties and other export restrictions have been used to restrict exports of a growing number of goods in which it has advantages, such as raw materials and agricultural commodities (USTR, 2008; Sally, 2011). These provided substantial artificial advantages to a wide range of downstream producers in China (USTR, 2008; Erixon et al, 2008). There are also signs of a slow reduction in services barriers. Foreign services providers have experienced high and discriminatory capital requirements for market entry in several service industries such as telecommunications, insurance and construction. Foreign enterprises complain of a lack of transparency in Chinese standard-setting bodies and conformity assessment bodies due to restricted membership, voting rights and information dissemination (Erixon et al, 2008; Sally, 2011). This is exacerbated by standards set by different agencies at national and provincial levels.

A number of increasingly restrictive investment rules were used to protect many domestic industries (USTR, 2008). In November 2006, the National Development and Reform Commission (NDRC) stated in its Five-year Plan that it would tighten the foreign acquisition of leading domestic enterprises (Erixon et al, 2008; Sally, 2011). New rules governing mergers and acquisitions contained vague language on 'national economic security' and 'critical industries'. The new Anti-Monopoly Law limited the merger and acquisition process (Sally, 2011). In addition, the Government also expressed their interests in the development of 'pillar' and 'backbone' sectors, which might limit the foreign investment in these sectors (Saich, 2007; Erixon et al, 2008).

Government procurement continues to explicitly discriminate in favour of domestic enterprises (Erixon et al, 2008). China has applied to join the WTO's

Government Procurement Agreement (GPA), in line with its WTO-accession commitments, but negotiations have been predictably slow (Sally, 2011). This was further aggravated by the pronounced ‘Buy China’ programme operating at national, provincial and municipal levels under the fiscal stimulus package in 2009 (Sally, 2011).

Signs of slowing down in SOEs reform have been observed since 2006. Trade, investment and regulatory barriers have become more restrictive and sophisticated to protect SOEs and assorted ‘national champions’, which mainly dominate in ‘upstream’ resource and capital intensive industries, such as coal, gas, crude oil, old processing, electricity, iron and steel, communication, and mining (Zhao, 2009; Sally, 2011). Other industries are protected by national standards, investment policies and tax incentives. The privatisation process was also facing increasing criticisms from Chinese society (Saich, 2006). People have seen this process as a way of stripping the State assets for personal benefits. China remained a guiding example to the Vietnamese and their actions and strategies in the accession process offered Vietnam decision-makers an experience to learn from and a framework to copy.

China was serious in implementing WTO commitments right after the accession process (USTR, 2008; Zhang, 2005). However, since the implementation period has ended the motivation for further reforms has been slowing down (Saich, 2007). Although the economic growth had been maintained at a good rate, the Chinese economy had been criticised for creating greater inequality and endemic corruptions (Saich, 2007; Saich, 2006). Conservatives claimed that the market-based reform process was to blame for many of these problems. These problems also created high demands for market intervention in many areas due to the market failures caused by reforms (Saich, 2007). On the other hand, the reform process also created interest groups<sup>29</sup> that were resistant to further liberalisation. In addition, the recent global economic crisis has also affected China’s economy, which has fuelled doubt on further economic liberalisation (Sally, 2011). As a result, debate on the future of reform has been more

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<sup>29</sup>National regulatory agencies, state-owned enterprises (SOEs) and other “national champions” in the private sector (or with hybrid forms of ownership), state-sponsored trade associations, as well as provincial and municipal governments.

intense and virulent (Saich, 2007). Facing these pressures, the willingness of the government for further unilateral reforms has been greatly influenced, especially decision-making in Hu-Wen's government has become more collegiate, cautious and incremental (Saich, 2007; Erixon et al, 2008). Reform is not reversed, but is much slower (Sally, 2011; Erixon et al, 2008; Saich, 2007). Such turns towards a more incremental approach encouraged Vietnam leaders to adopt a more cautious approach. However, McGough (interview, 2012) said "the fascination with the Chinese example was taken in a too simplistic fashion. Vietnam did not understand that many of the differences, size, capital reserves, a better and more practical approach to reforms, etc made following the Chinese example a mistake". In concluding this chapter it is pertinent to repeat that this thesis study is predicated on a hypothesis that finds Vietnam accession to the WTO as a failure, and that is mainly due to a consistent strategy of non-compliance.

## **2.5 Conclusion**

In late 1980s, many developing countries had undertaken economic reform to save their unbalanced economies suffering from 'import substitution industrialisation' policies. The reform often involves measures to reduce the roles of Government and replace them with market principles. Reforms involve stabilising the macroeconomic situation then restructuring the economy for better resource allocation. Although roadmaps for reform are quite clear, the implementation of this reform is not easy and can fail due to both internal and external factors. Internal factors mainly reflect the political resistance of vested interests and the technical problems inherent to the reform process. Reform tasks often encounter political resistance due to the redistribution of income (Krueger, 1994; 2000; Haggard and Web, 1993; Nelson, 1990). External factors stem from the overall scepticism towards globalisation and economic liberalisation (Sally, 2008). In such circumstance, the World Trade Organisation (WTO) emerges to play an important role in facilitating difficult unilateral domestic reforms. Many researchers have shared the view that the WTO provides developing countries market access and expansion for export, protection against the selective protectionism and predatory behaviour of more powerful players from the developed world, prevention of the return to protectionism, and strengthening the domestic policies and institution

capacity for the conduct of international trade policymaking (Krueger, 1998; Michalopoulos, 1998; and Langhammer and Lucke, 1999; Drabek and Laird, 1998).

China's WTO accession process was a typical example of the successful use of multilateral liberalisation as a lever to unilateral liberalisation. The Chinese government consciously and strategically used the WTO accession process as a pillar to bolster domestic reforms (Sally, 2008). A series of structural adjustment measures were undertaken unilaterally and gradually in order to restructure the economy from a central planning model to a socialist market economy. However, reform was not implemented without difficulties as economic and political pressures not only slowed down the reforms but also created a compromised reform agenda. The next wave of further reform was initiated with a whirlwind of economic liberalisation in 1999 when the Government publicly declared its intention to accelerate the progress of the WTO accession in 1998 (Naughton, 2007; Sally, 2008). Self adjustments to meet WTO rules and regulations alongside its own commitments set much of the momentum for the Government and economy to accelerate their internal and external liberalisation. WTO accession has acted as a channel for leveraging the economic and legal reforms by locking in the reforms and making it irrevocable, thus maintaining the pace and speed of the reforms.

However, the reforms have been slowing down since the end of the implementation period of the WTO. Side effects of the market economy such as inequality and corruptions have been the main reasons to slow down the reforms. The sentiment against the reforms was further increased by the down turn in the economic situation resulting from the global economic crisis. It showed that the WTO had provided a motivation and political protection for reformers to push further reforms. However, the WTO accession cannot sustain and guarantee enough motivation beyond the end of its implementation period.

Vietnam and China have shared many similarities in culture, reform conditions, and the reforms agenda and implementation. In the next chapter, the Vietnamese economic reform will be investigated to comprehend the progress of the reform and to see challenges encountered by the reform process.

Chapter 3 examines how the processes of economic reform are structured by the Vietnamese economic and political systems. Central to this is how the political decision-making proceeds through the Vietnam authorities, as this reflects the constant divide between conservative elements in the Party and system and the economic and political reformers. Each interest group defends its position based on their own self-interests. WTO entry has become the ‘battle-ground’ for this conflict of interests and interests groups and also reflects the tension and opposition found in the political reform of the system. Essential here is to also define and explain the interest groups involved in managing the accession of Vietnam to the WTO

## CHAPTER 3 VIETNAM'S POLITICS AND INTERNATIONAL INTEGRATION PROCESS

### 3.1 Overview of the Vietnam Economy

After the war for unification in 1975, the Vietnamese economy faced paramount difficulties (Le and Liu, 2006). Desperate shortages of food led to famine and economic collapse, with the only solution being the shift from a centrally controlled communist economic system to free market economics, but still under a communist political system. Two decades of reforms brought the country out of economic crisis and collapse.

The Government faced many difficulties in restructuring the war-torn economy.<sup>30</sup> During French colonisation some industries did develop, but only on a small scale and for exploitation rather than development. During the war, economies of both South and North Vietnam were left with severe problems in their economic structures. In the South, the market economy was established, but fully dependant on US aid. While in the North, the central command was fully applied to mobilise the resources for the war. As a result, the economy was severely damaged and distorted by the war.

After 1975, the difficulties of the economy were exacerbated by the full application of the central command economy in both parts of Vietnam. Central to this was the supreme role of State in the economy. The Government owned all means of production; made decisions on resources allocation, and the production and distribution

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<sup>30</sup> War, it was devastated by 7.8 million tons of US-dropped bombs dropped upon its major cities. It destroyed 70-80% of industrial capacities and infrastructure, while also leaving 400,000 hectares of cultivation fields fallow (Le and Liu, 2006).

process via physical plans; distributing the income by labour contributions (Fforde and Vylder, 1996). The Government nationalised the private sector and applied collectivisation to agriculture.

The command economy was characterised by serious sector and investment imbalances due to the decision-making on resources allocation. Resources were invested heavily into the SOEs, and production had long lead times and little practical use for society (Beresford, 1989). The SOEs had low capacities combined with shortages of inputs, which resulted in the failure to meet arbitrary government targets. Farmers were grouped into collectives with specific targets and resource allocations and paid for their labour regardless of their productivity. Economic distribution was not appropriate for creating incentives for individuals to increase productivity. This led to 'shared poverty' rather than rising overall living standards (Beresford, 1997; Phong, 2009). SOEs and collectives stagnated through a lack of incentives and efficiency, which generally created the chronic disequilibrium between supply and demand. A side effect was the development of the black market, where market prices were much higher than official prices in order to meet the demands of the citizens (Fforde and Paine, 1987; Phong, 2009). Capital was badly used and led to large unfinished constructions. Shortages in every facet of the production process (fuel, coal, spare parts, etc) occurred in the whole economy (Phong, 2009). In agriculture the volume of output was just half of the target set by the Government. Declines in production output and Government purchases led to famine in many areas. Imported foods jumped to the highest record of 1,570,000 tons in 1980 (Phong, 2009). The central command economy blocked all the other distribution channels.

The inappropriate economic mechanism was pushing Vietnam into deeper recession (Chi Lan, interview, 2012). There was acute shortage of foods, basic consumer goods, and inputs to agriculture and industry, and a growing external debt (Arkadie and Mallon, 2003). The Government imported foods to meet the domestic demand (Le and Liu, 2006). The incompetence of the economy was reflected in the low GDP per capita (Le and Liu, 2006). The underdevelopment of the economy led to low levels of foreign trade and constant trade deficits (Le and Liu, 2006; Phong, 2009). Chi Lan (interview, 2012) and Thai (interview, 2012) both confirmed that the Vietnamese economy was entirely dependent on foreign aid at that time.

By mid-1980s, the economic situation became worse. Foreign aid was insufficient and was mainly in the form of consumer goods such as rice, sugar, milk, and medicine etc. Foreign aid from China, the Soviet Union and Eastern Europe dried out due to their own economic difficulties and economic reforms. The government passed measures to loosen the rigidity of the central command economy, such as increasing the price-salary-money to meet the market price. The reforms could not save the economy from shortages because they did not tackle directly the problem of ownership, freedom of doing business and motivation to work in the central command mechanism (Phong, 2009). The average budget deficit of the 1981-1985 increased 64 times compared to that of 1976-1980 period (Le and Liu, 2003). The Government was forced into printing more money. Inflation became a chronic disease of the economy. The consumer index of Vietnam in 1986 reached 587.2% compared to 1985 (Phong, 2009). The Communist Party in 1986, agreed to abandon the system of bureaucratic centralised management in favour of a policy package aiming for a market-oriented economy.

Chi Lan (interview, 2012) said “the reforms not only lifted the country out of systemic crisis but also transformed it into a new dynamic developing country”. Vietnam’s economy showed a growth rate of 7.8% per year during 2002-2007.<sup>31</sup> Vo Tri Thanh, Vice Director of CIEM, (interview, 2012) stressed that “the economic reform has had a significant impact on the performance of the economy, turning it from a backward, aid-dependent, slow economy to a very dynamic one”.

Economic transformation helped control inflation, contributing to a stable macroeconomic performance (Arkadie and Malton, 2003). Vietnam curbed hyper-inflation of 774% in 1985 to a healthy average rate under 10% annually (GSO, 2011).

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<sup>31</sup> Despite being hit by financial crisis, the growth rate still remained positive at 6.31%, 5.32%, and 6.78% in the years 2008, 2009 and 2010 respectively (GSO, 2011). A GDP per capita of US 1244 dollars in 2010 compared to merely US 239 dollars in 1985 (WB, 2011). By 2009, agriculture dropped to 16.14% from 40.8% in 1990, while industry increased from 22.8% in 1990 to 40.24% over the same period. The service industry expanded from 36.4 to 39.1% during the same period (GSO, 2010).



The rate was kept low until inflation suddenly jumped to 28% in 2008, caused by the expansionary macroeconomic policies and massive unprecedented capital inflows as results of the WTO accession (Khanh, interview, 2012). Vietnam concentrated on maintaining a relatively prudent fiscal position, despite the tendency to rely on public investment to boost growth. The annual budget deficit increased from an average of 3.5% of GDP in the 1990s to an average of 4.9% after 2000 (Goldman Sachs, 2008). In 2009, the total public debt was 52.3% GDP due to a fiscal stimulus package. Accumulated foreign debt remained below 30% of GDP, while the ratio of debt service was no more than 4%. Most of them were medium and long-term loans. Vietnam foreign reserves rose dramatically from US\$ 11.5 billion in 2006 to 23 billion in 2008.

The reforms helped Vietnam integrate rapidly into the world economy, moving from state monopolies on foreign trade toward a freer trade regime.<sup>32</sup> Tran Quoc Khanh, (interview, 2012) said, “tariff and non-tariff barriers to trade have been reduced and gradually eliminated. They have been further pursued and secured by joining various multilateral trade agreements”.<sup>33</sup> Vietnam became a member of ASEAN in 1995 and agreed to implement the AFTA. It joined APEC in 1998. In 2001, Vietnam signed the BTA with US, paving the way for Vietnam to become the 150<sup>th</sup> member of the WTO in 2007 (Thai, interview, 2012).

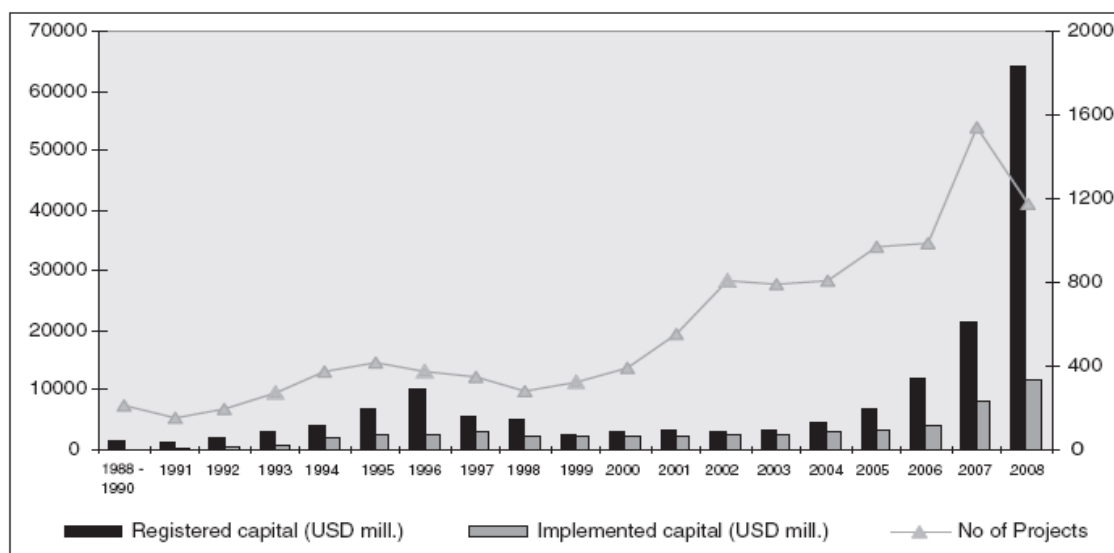
Open trade promoted foreign investment, with accumulative implemented FDI in 2009 at US\$ 66.9 billion compared to US\$ 328.8 million in 1991 (GSO, 2009). FDI flows to Vietnam amounted to US\$ 11.5 billion in 2008, increasing from US\$8 billion in 2007 and merely US\$328 million in 1991. FDI declined dramatically due to the

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<sup>32</sup> The total value of exports and imports reached USD 126 billion in 2009 from a mere USD 2.9 billion in 1986, equal to 130% of the real GDP. Export to GDP ratio, the standard indicator of export orientation, increased from around 5% in later half of the 1980s to 47.8% in 2000 and then to 86.6% in 2006 (GSO, 2010).

<sup>33</sup> Tran Quoc Khanh is the Vietnam Chief Negotiator and also the Vice Minister of the Industry and Trade.

global crisis in 2009, but still amounted to 10 billion USD (WB, 2010; GSO, 2011).<sup>34</sup> There was an increasing awareness of commitments of the Vietnamese government in economic reform and the improvement of the investment environment (WB, 2010).



**Figure 3.1: Number of projects and volumes of FDI to Vietnam**

Source: OECD (2009).

**Table 3.1: Distribution of FDI in different sectors in Vietnam**

	Registered capital (million dollars)		Share of total registered capital (percentage of total)	
	1995–2000	2001–2007	1995–2000	2001–2007
Manufacturing	14 871	33 698	44.8	62.2
Real estate, renting business activities	3477	9068	10.5	16.7
Hotels and restaurants	2524	3090	7.6	5.7
Construction	4152	2209	12.5	4.1
Transport, storage and communications	2706	1493	8.2	2.8
Electricity, gas and water supply	716	994	2.2	1.8
Mining and quarrying	1541	716	4.6	1.3
Agriculture and forestry	1852	637	5.6	1.2
Other	1342	2296	4.0	4.2

Source: UNCTAD, 2008.

<sup>34</sup> FDI enterprises play an important role in the economy, contributing 18.33% of GDP in 2010; 10.52% of national budget; accounting for 53.2% of export value and 44.4% of total industrial output (GSO, 2011).

Manufacturing rapidly became the primary driver of FDI and of the economic diversification and structural transformation from the agricultural base towards an industrial base. Since 2001, the manufacturing sector accounted for almost 60% of the FDI projects registered in Vietnam. During the early reform stages, the standard intensive goods such as T&G and footwear dominated the export composition of foreign invested enterprises. Foreign investors began to enter into assembly activities in electrical and electronics industries (UNCTAD, 2008).

Success had positive effects on social indicators. Income per capital reached US\$1,160 in 2010 compared with a US\$170 in 1993 (WB, 2010). In purchasing power parity (PPP), per capital GDP was estimated at US\$3100 in 2010, up from US\$941 in 1990. The poverty rate declined from 58% in 1993 to 37.4% in 1998 and 14.5% in 2008 (WB, 2009). All targets for Millennium Development Goals were achieved, together with improvements in living standards, life expectancy, adult literacy and infant mortality.

Nevertheless, great caution has to be made in assessing Vietnam's reform success. Closer examination of the result points to endemic corruption and misrepresentation of the 'real' picture. Government statistics are extremely unreliable and often false, designed to avert pressure for political responsibility or even reform, and the general strategy has usually been to protect the interests of a political/business elite interest group, rather than create national holistic economic development for the society and economy. The statistics and national data hide a growing poverty gap, serious deficiencies in the economic infrastructure, an embedded aversion to privatisation and genuine equitisation. Failures to comply with WTO commitments and carry out the necessary structural reforms that would transform the economy are leading to an economic crisis of critical levels. Central to these failures has been a Party predicated on surviving at all costs and limiting reforms to an extent where their face is genuine, but their actual impact has been negligible and often restricted to benefiting only a small group of politically and economically dominant individuals. With the lack of accountability and transparency, a growing crisis manifested in internal power struggles that have set the very senior levels 'at war' with each other. The lacks of capacities to cope with the demands of a modern economy mean that the very legitimacy of the political system has been brought into question. Vietnam faces not

only an economic crisis, but also, its political system is fighting for survival with growing public unrest, increasing numbers of arrests for public dissent (especially internet ‘bloggers’) and a steadily declining economic performance mired by Bank debt, bankruptcy, declining foreign investment, inflation and corruption. Such a dramatic and critical situation has been caused by faults within the political system. The next section examines how that political system actually makes and enforces decisions.

### **3.2 Political System of Vietnam**

The reform process in Vietnam is a political process, where fast market-oriented economic reform has occurred, while Vietnam is still a socialist country under the sole leadership of the Communist Party. Vietnam has chosen to conduct economic reform gradually while maintaining the status quo of the political system. The market economy requires a different set of ideological and institutional frameworks, where the market principles prevail over the administrative commands from the ruling authority (McCarty, 2002).

Central to the political structure is the Communist Party. They intended creating the right conditions for the market economy to gain economic growth, while also needing to maintain the regimes stability and its vision of communism. In both cases, they would appear to have failed. Economic growth has been achieved, but without sustainable development, while the Party is being challenged for power both from within and without.

#### **3.2.1 The Communist Party of Vietnam**

The Communist Party of Vietnam (CPV) is the only political Party and was established in 1930. The CPV is the leading force of the State and the society and “represents the vanguard of working people and the whole nation with the aim to make Vietnam a strong, independent, prosperous and democratic country with an equitable and civilised society to realise socialism and ultimately communism” (CPV, 2012b). Thai (interview, 2012) suggested that “with only three million members, the Party is

able to have its representatives in all important positions across the State administrative apparatus, from Central level to provincial, city, district and communal levels, as well as in administrative bodies, schools, enterprises, social organisations, army and police force, etc”.

The CPV’s National Congress is held every five years, with over 1,000 representatives reviewing the Party’s work and discussing guidelines and policy of the Party in the next five years. The National Congress elects the Central Committee for a five-year term and it is the leading organ of the CPV. The Committee has currently 160 members representing CPV members countrywide. They meet once every six months to decide and review the implementation of important guidelines and policies of internal, external and public affairs, and organisation of the Party (CPV, 2011). Chi Lan (interview, 2001) suggested that “the guidelines serve as the policy for almost all activities in any political and government organisations”. The Central Committee is responsible for the Personnel management of the CPV, elects the Politburo, the General Secretary of the Central Committee and establishes the Secretariat, other Commissions and the Head of Central Inspection Commission.

CPV power is concentrated in the Politburo and the Secretariats and is considered as the ‘brain centre’ of the CPV (Phong, 2009). They meet monthly to decide major guidelines, policies, organisation and personnel issues, as well as to organise and prepare for meetings of the Central Committee. They also do the planning and appointment of high level ranking officers in the political and government apparatus (Phong, 2009).

The CPV exerts absolute power in the Party’s policies and personnel in all government branches and political organisation. Resolutions are issued by the Central Committee to define major policies and directions for all aspects of the political, social and economic life. The priority and content of these policies and directions for the Central Committees Meetings are prepared by the Politburo. Resolutions are compulsory and the magnetic needle for all activities of the Government and political apparatus (Thanh, interview, 2011).

The CPV has consensus governance, with power shared through collective decisions. The resolutions show the solidarity in the Party and the unity and consensus in political ideology on major issues. But, documents are often vague and ambiguous, making them difficult to implement effectively (Phong, 2009; McCarty, 2001).

The Central Committee manages the senior personnel appointments in the political system and government apparatus. An (interview, 2012) suggested that “personnel from the Vice Minister level in the government system; the vice- chairman of provinces or cities, heads of large SOEs, heads of Vietnam television and major newspapers are under the management and appointment of the Central Committees. The Politburo is responsible to make appointments and personnel decisions on government officers from the minister level upward including the Provincial Secretary of CPV and its Chairman. The Secretariats are in charge of making appointments and personnel decisions for officers from Vice Minister level to Minister level including the Vice Chairman and CPV’s Vice Secretary of any province”. Thai (interview, 2012) said “there is a Personnel Commission, which is the advisory agency for main guidelines and policies on personnel for the whole political system. They act as the gatekeepers for the Central Committee on human resources matters”.

The appointments and transfer of a post is based on certain rules and criteria. However, the process is often seen as undemocratic one by the Western standards. There is often only one candidate and no option to nominate any others. A candidate is often suggested by the Personnel Commission based on the position’s demands and suggestion from the employing organisation. However, this process is an internal political process, in which final decision rests in the hands of the Politburos or Secretariat. As a result, the appointments, transfers or dismissals are subject to the influence and will of a very small group of leaders (Thai, interview, 2012).

The power structure is shared between the General Secretary, President, Prime Minister and the Chairman of the NA. The formula for power distribution is based on the regions, which are North, Middle and South of Vietnam. This formula helps to encourage unity and solidarity among regions (Stern, 1998). The Northern leader often holds the General Secretary position. The Southern leader often fulfils the Prime

Minister positions, because the South always is the economic engine for the economy. The Central region often fills the Presidential post. The other pillar of the top leadership of Vietnam is the Chairman of the National Assembly. This formula builds blocs that have client relationships at each region powerful enough to represent their interests at local government and central government levels. These blocs may be formed by political interests, business interests or regionalism (Koh, 2004).

Each province or city has its own Communist Party Committee, in which the Secretary of the Province or city's Committee is the member of the Central Committee. The Provincial Committee controls the local government policies and personnel. It directly guides the implementation of the Central Committee Resolutions and issues its own resolutions for the provincial matters based on the Central-Committee's Resolutions. It also manages and makes decision on the personnel appointments in almost all management posts in the provincial political and government apparatus (Thai, interview, 2012; An, interview, 2010).

Intra-party relationships are dominated by reformists and conservatives. Conservatives worry that reforms lead to a danger where the CPV cannot control the economic and political situation. They are often the people from the veteran and founder groups of Vietnam, the Army, or the CPV's advising and research organisations. They put a high priority on the stability of the CPV and worry on the consequences of rapid reforms on the Vietnam society and CPV role. The leaders from the North are more cautious about the reform process and its negative impacts on the society and the CPV than the leaders from the South (Koh, 2001a; Phong, 2009). They prefer to build an economy with internal strength and less dependent on the external forces (Phong, 2009). Reformists are often people who understand the local reality and the difficulties of local business communities, the younger generation, have good education, and have more opportunity to come into contact with the international environment, are more open-minded and believe that a good international economic environment will bring improvement of the national economy, giving more credibility and strength for the CPV.

Intra-party fractions consist of a series of reformers, conservatives and the balancers (in the middle), opportunists and independents in the Central Committee (Dixon, 2004). They are not fixed groups but entangled with each other representing different interests such as socio-economic sectors, regional divisions, ideologists and various ministries and departments (Dixon, 2004; McCargo, 2004). Groups are reinforced, cut across and divided by the interests groups outside of the Party such as the SOEs, private business, foreign businesses, and local businesses. As a result of the complicated matrix of representation of the CPV members, many individuals and groups have been assembled to represent a position based on a particular measure and circumstances, rather than a process of a general representation (Dixon, 2004).

The levels of participation, scope, and pace of international integration depend on the decisions of the Central Committee and the Politburo. Khanh (interview, 2010) suggested that “negotiations and concessions on international integration must be consulted upon within the Politburo and the Secretary. Negotiations are not allowed to stray from the approved lines and policy”.

### **3.2.2 Formal structure of the Vietnam Government**

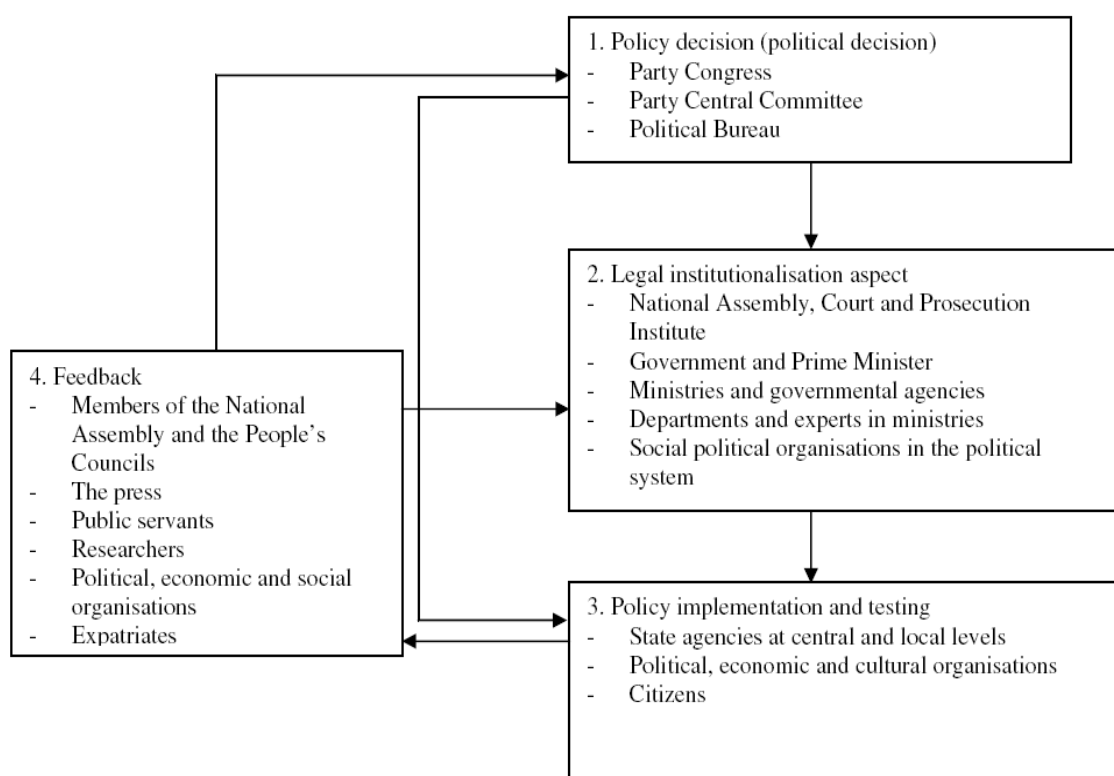
The President is the ceremonial Head of State and represents the State of Vietnam in domestic and foreign affairs. The President is elected by the National Assembly for a five year term, and he appoints the Prime Minister from among members of the NA; the Prime Minister then appoints the Deputy Minister. The Prime Minister proposes a Cabinet, which then is appointed by the President, subject to the ratification of the NA. These personnel appointments have been pre-decided internally by the CPV (Koh, 2004; Stern, 1998).

The Government is the executive body of the National Assembly and the highest administrative agency in Vietnam. The central government is chaired by the Prime Minister and currently comprises 18 ministries and several other agencies (GOV, 2011). Each minister follows the instructions issued by the Prime Minister, is accountable later, and receives from the Prime Minister’s instructions in connection with any subject deemed to be on the borderline of or beyond the formers power (McCarty, 2002).



The Prime Minister appoints the Chairman of Provinces or Cities. Each province and city has their own executive organisation, in which they have the same functional department as in the central government. These departments take care of the central policy at local level.

### 3.2.3 Vietnam's National Assembly



Source: adapted from Cong (2001), in McCarty (2002).

**Figure 3.2:** Summary of the policy making process in Vietnam

The National Assembly (NA) is the highest representative body of the people, endowed with the highest State power of the Socialist Republic of Vietnam. It governs the constitutional and legislative rights, decides fundamental domestic and foreign policies, socio-economic tasks, and national defence and security issues (McCarty, 2002). It exercises the right to supreme supervision of all activities of the State. The National Assembly elects, dismisses, and removes Prime Minister at the request of the

President. The NA is organised into the Standing Committee, the Ethnic Council and several specialised Committees, and it convenes twice a year (VNA, 2011).

### **3.2.4 Policy making process**

In figure 3.2, the CPV holds the central role in policy-making and all economic policy starts from its headquarters. The National Congress issues policies and lines for a long-term plan of the country (Phong, 2009). In Politburos, the General Secretary holds the highest and most influential position for making policy of the CPV. The Politburos receives information on important issues needed to be addressed from day by day and decide the importance and priority of the problems. If there is a need for issuing new policies or revising them, the Politburos will ask a member of the Politburos in charge of the matters to prepare a programme on the matter with the related ministries. It is then discussed and voted upon in the Politburos, and later in the Central Committee for forming new resolutions or instructions. In some matters, the Politburos can make the immediate decision without discussion and vote at the Central Committee. The Politburo is the central player of this process because they are in-charge of preparing the agenda and problem solving options. The General Secretary has the decisive role in the decision process and this role has been empowered by the formal power in CPV. It is strengthened by the Vietnamese culture in which the authoritarian leader was honoured throughout its history (Phong, 2009). Phong (2009) notes that the personality and beliefs of the General Secretary and leaders have been important factors in the policy making process. As the highest leader, he has the power to lead all the meetings and agendas of the Politburo meetings.

A group of advisors assists the General Secretary and Politburos in making decisions and play a key role in the process. It is comprised of the advisors of General Secretary, CPV's think-tanks such as the CPV's Commissions, and its research centres. They draft the documents on issues and influence the process by their writing and views (Phong, 2009).

During the drafting process for law the business community and socio-economic organisations are consulted for suggestions and feedbacks (McCarty, 2002). When the

final draft bill is completed, the Committee will prepare the Official Bill to submit to the Standing Committee of National Assembly for adoption in a NA session. Before submittal, however, the Bill is required to pass the examination of the NA's evaluating agency and receive comments from people and members of National Assembly (McCarty, 2002).

The CPV and the government review policy implementation through their feedback channels. First, is the Government's reviewing report to the Politburos and the Central Committee, conducted once every six months. Second, is the research and reports from the research centre and think tanks, which are often State run centres. The CPV also has its own think-tank for the development of the CPV, which is the Ho Chi Minh National Academy of Politics and Administration. Third, is the media and public opinion on the policies and lines. This channel is under strict control of the CPV, but left considerable room for criticising and evaluating the policy. International donors play an important role in forming policy and provide assistance and guidance for the development of the country (Phong, 2009; Thai, interview, 2012). For the ODA funders there are at least two Consultation Group meetings every year for them to express their views on policies of Vietnam.

Vietnam governance is 'democratic centralism', as prescribed in Article 6 of the Constitution 1992. The 'democratic' aspect of this organizational method describes the freedom of members of the political party to discuss and debate matters of policy and direction, but once the decision of the Party is made by majority vote, all members are expected to uphold that decision. This latter aspect represents the centralism. As Lenin (1965) described it, democratic centralism consisted of 'freedom of discussion, unity of action'.

The CPV is seen as 'soft governance' (Koh, 2004, Dixon, 2002; McCarty, 2001). The implementation of policies is often carried out gradually to see the reactions of people to policies. Local governments' often try to evade implementation of the central policies. Although high homogeneity in culture and linguistics, there is always differences in natural resources, social characteristics and interests between regions in Vietnam (Dixon, 2004; Pike, 2000). Division was increased by the autonomy of the

local administrative during the wartime and the process of resource allocation during the central command economy (Dixon, 2004; Beresford and McFarlane, 1995; Mallon, 1993; Thrift and Forbes, 1985). As a result of the division in the CPV, they need to reach a consensus between different interests.

The central government has been often blamed for slow and rigid policies in contrast to the reality of the economy. The economic development strategy and major policies are often set at the beginning of the new term of the National Congress for the next 5 or 10 years. Problems are identified and discussed by the Politburos, then the Central Committee. A slow and out-dated process of discussing problems in closed political sessions, containing only a few leaders and advisors, leads to decisions that do not reflect the reality of the times. Feedback channels are limited or not truthful, which leads to the wrong perceptions and subjective decision-making in the policy implementation process (Phong, 2009). Decision making at all levels is developing new strategies for solutions, which includes consensus-seeking as the strong guiding principle, engaging a wide range of actors before decisions are finalised. This helps in sharing responsibilities and reducing the political risks involved in making difficult decisions. The emphasis on collective leadership and consensus has the merit of maintaining stability and involving many elements of society in decisions, but it is also the root cause of many problems in relation to the slow government response to critical issues.

### **3.2.5 Relationship between the Party and the State**

The CPV shares its authority with other organs of the state structure. CPV focuses on the making major policies for the development of Vietnam, while the National Assembly implements laws and policies. Since independence the relationship between the Party and the State has changed (McCarty, 2002). From 1945-1954, when the country had just gained independence and the need for reconciliation of the whole nation and support of international community, the Party accepted the participation of non-Party members in Government and a greater role of the National Assembly. From 1954-1986, the Party moved into a domination role and imposed central planning and state ownership of the means of production. The CPV took the lead in drafting policies,

replacing the roles of Government and the National Assembly. From 1986 to the present, the political process changed in line with economic reforms. The Party retreated from direct control over the state affairs and gave increasing autonomy to the Government and the National Assembly (Phong, 2009; McCarty, 2002). McCarty (2002) has described the new form of the governance of CPV as ‘state corporatism’, with a less authoritarian mode of policy-making and taking more into account the feedback from the society. This adapted it to the new demands of development and produced more careful analysis and specification, and reflected a move to a more democratic power (Heng, 2001; Dixon, 2004). State corporatism in this thesis is perceived as involving ‘outside’ interests to the Party governance structure, but traditionally retaining authority and decision-making mechanisms of control. The State corporatist model did result in reform of how ‘interest groups’ in business and society interacted with the State, and how their interests were better reflected in decision-making, but the Party intended retaining their central control.

The command management system was no longer appropriate as State management capacities and efficiencies were inappropriate for the economic development. The improvement of the living standards meant the growth of the middle class and the enhancement of the society’s intellectuality. This new middle class with higher income and a good education demand better governance of the society. So faced with these challenges, the CPV adopted a softer role in leading the country, letting other groups participate in the process of decision-making for meeting the demands of the society and ensuring the long-term legitimacy of the regime (Dixon, 2004).

The CPV still retains close patronage over its personnel and major policy making tools. It still provides guidance on all major issues of the Vietnam society, from education, economic policy, foreign policy and government control of the military and the bureaucracy (Thai, interview, 2012; Chi Lan, interview, 2012). It is an unofficial rule of thumb that being a member of the Communist Party is a pre-requisite for any appointment and promotion at management level in all State and Local bureaucracy units (Thai, interview, 2012). The CPV has the power to nominate only one candidate for the posts of the Chairman of National Assembly, President and the Prime Minister to the National Assembly. All Government ministers are members of the Party Central Committee. At local level, each unit of the government is shadowed by a unit of the

Communist Party, who are involved in implementing the Central Committee resolutions, defining lines and goals as well as personnel management.

The influence of the CPV also reaches into the business community. All the SOEs chairman of the boards and general directors are personnel under the management of the CPV. They must be approved by the Personnel Department and the Secretariats of the CPV. Chi Lan (interview, 2012) suggested “the Party has become increasingly opaque because it can issue orders that cut across all levels of the government”.

### **3.2.6 Relationship between Central and Local Governments**

Sub-national government is administered through 63 provinces and municipalities with three levels of local administration: provinces, districts, and communes. Each level of local administration has an executive arm (People’s Committee) and a legislative arm (People’s Council). The People’s Council represents the citizens at their local level, which decides matters concerning the legislative matters of the local government. They have to report and obey the decision of the higher levels (Kerkvliet et al, 2004). The People’s Committee is the executive arm of this local council. Administrative responsibilities of the People Committee include maintaining law, order and security within their jurisdictions; forwarding budget requests to higher levels; reviewing and approving plans for socio-economic development within their delegated authority; executing the budget; and undertaking duties as assigned by higher levels of administrations, etc. (Wescott, 2003; Arkadie and Mallon, 2003). The Prime Minister has authority to suspend or cancel decisions of the local government as well as to dismiss the Chairs and deputy chairs of local People’s Committee (Kerkvliet, 2004).

Local government and central government relations are complex. Provincial governments enjoy significant levels of decentralisation and autonomy (Arkadie and Mallon, 2003). This has been common practice in Vietnam as an old Vietnamese maxim states that ‘the emperor’s rule has to stop at the village’s gate’ (Painter, 2008). Central policies and regulations are often ambiguous and over bureaucratic for the local government. They have a wide degree of interpretation of these policies for the local application, but the central government is often considered as bureaucratic and lacking

control mechanisms and enforcement measures due to the low levels of capacities in staff and a lack of local information. As a result, the local government must act to meet the demands of the local development rather than obeying the central policies and regulations. Local government acted as the initiator for reform before 1986, as they overruled the central government regulations simply for the survival of their local community. This act is often dubbed as ‘fence-breaking’ activities or reforms from below. The local government has their own responsibility for budgets, collecting taxes and fees and receiving percentages of this collection from the central government. Although the system appears to be centralised, the local government still also have their own source of income from various sources such as their properties, their SOEs and other fees and charges. The system is not very transparent and strict, so the local government may own some funds separate from the national budget and not disclose these to the national authorities (Arkadie and Mallon, 2003; Ffordes, 2004; Wescott, 2003).

Coordination problems between central and local government often occurs, both due to unclear laws and a continuation of the tradition of local autonomy (Wescott, 2003). Many central government decisions are defined inadequately, with very little supporting documentation and little explanation of the ruling, making it difficult for local government to implement. Local governments often issue regulations contradicting those of central government, and they regularly increase fees and charges outside the formal and legal channels, and often in such a way that there is little opportunity for central government oversight (Painter, 2008). Local governments launched and expanded SOEs, managed natural resources and undertook imports and exports often contrary to central policy (Westcot, 2003). Wescott (2006, p.217) suggested that “The unclear demarcation of the mandates of various agencies continues to leave room for discretion in interpretation of responsibility and accountability where there are overlapping functions and duties”.

This autonomy and decentralisation has attracted much criticism (Vo and Do, 2005). There is concern over lax control and allocation of fiscal resources at local level, which affects the government’ capability to invest in the national level. Currently, only 44% of national budget is allocated to local government. Secondly, autonomy and decentralisation in a weak institutional framework often leads to localism. Vietnam

local governments insist on wanting to develop their own local economy, regardless of the Central governments master plan and in consequence create an inefficient use of limited resources. The local governments are granted rights to draw up a master plan for local socio-economic development with central government approval, to grant licenses to Foreign Direct Investment to a certain scale, to issue local bonds, etc (Thanh, 2005). Each province or city has their own, but similar, master plan for economic development depending on their own structure of industry, agriculture, and services, and their own airport and seaports. Thai (interview, 2012) agreed that “local governments try to build a self sufficient local economy but this is leading to the insufficient uses of resources and creates extra burdens due to bureaucracy and duplication”.

### **3.2.7 Relationship between state and society**

There are three broad models of party-state-society relations in contemporary Vietnam. The ‘dominating state’ model claims that although state affairs are discussed within the state and influenced by the external events, the society is effectively in compliance to the bureaucratic polity in which decisions are made entirely within the bureaucracy (Womack, 1992, Thayer, 1992). The second model asserts that the state uses other mass organisations to control the society and to mobilise various social and economic groups in support for their policies. This is often called ‘state corporatism’, in which there are channels for society to influence state, but only within strictly prescribed limits (Kerkvliet, 2001). The third model emphasises that the state has to decentralise its powers and needs to maintain its popular legitimacy, so it has to respond to the social pressure for modification of policies, which undermine this legitimacy (Woodside, 1979; Thrift and Forbes, 1986; Fforde, 1989; Lam, 1992; Kerkvliet, 1995).

Before the economic reform, Vietnam was a ‘dominating state’, where power was highly centralised and discretionary within the Party. While during the economic transition, the authoritarianism was ‘softened’ by the efforts of promoting closer relationships between the people and the Party-state. Signs of this change were the increasing independence and voice of the National Assembly in debating and approving the Government and Party plans and policies. They supervise the government activities; ratify the government budgets and major projects, but also create open debates about the



government policies. This is seen as a channel for the government to negotiate their policies with the society (Kerkvliet, 2001). The CPV increasingly use a 'soft' approach to test and implement their policies. Many policies have been implemented and re-adjusted following the expression of public opinions. The media has played an important role in receiving feedback from the society, although the government is still strictly controlling the media and does not tolerate any 'undesirable' media coverage. To Huy Rua (2007), a politburo member – Chief of Ideology and Culture Committee has publicly stressed the importance of the media and its effectiveness as a channel of communication between the 'people' and the Party and Government.

The Party-State is gradually adjusting itself to be more a 'dialogue' regime with a softer power approach and the appearance of benevolent rule (Kerkvliet, 2001; Dixon, 2003). The marketisation process is diversifying the current social structure with the introduction of new social forces such as new economic entities with new interests, new economic and social relations, etc. As a result, the CPV must adjust itself towards a less authoritarian role in the society. Secondly, the Party-State is facing the problems of a shortage of resources and capacities in planning, implementing, coordinating and enforcing its programmes (Woodside, 1979; Thrift and Forbes, 1986; Kerkvliet, 2001). This, together with the marketisation process, has created wide discrepancies between what the State claims and what actually occurs (Thrift and Forbes, 1986). The Party-State has often been blamed for rigidity in decision-making, excessive bureaucracy and for being slow and insensitive in the face of demands for change from the market and society (Fforde, 1989; Lam, 1992; Kerkvliet, 1995; White, 1985). The Party-State must incorporate other components of the society in their decision making process, in which its political organisations such as the Fatherland Front have been used for gaining support and channelling citizen's concern and criticisms to its leaders (Kerkvliet, 2001). The transition from a command economy to the market economy left a vacuum in economic institutions and the Vietnam market. The economic institutions were not ready for the market economy, leaving many gaps in laws and regulations and inappropriate structures for a market economy. Officials from local and central government have utilised their positions to fill these gaps through their own discreet ways. Market forces were little understood and the strategy for coping became one of 'on the spot' decision-making. Informal arrangements were made between officials and citizens based on providing private benefits. Personal connections such as family's ties,

friendship or relationships became the primary means to 'do business' (Kerkvliet, 2001; Gainsborough, 2010; Dixon, 2004; Fforde, 2012; Koh, 2001). These expanded into exchange and bargaining arrangements, which were even more susceptible to corruption and bribery.

Corruption has become increasingly widespread in terms of money and material exchange, and its prevalence has gradually rooted itself in the business culture of Vietnam (Kerkvliet, 2001; Gainsborough, 2010; Thayer, 1992). This problem is also increasingly undermining the legitimacy of the CPV. These widespread activities have led to social instability and encouraged increasing numbers of citizen's protests or the formation of dissident groups protesting against the corruption and bad practices found at many levels in government authorities (Kerkvliet, 2001; Nhi Le, 1994).

A turning point that totally changed the behaviour of the CPV towards the corruption issue was the violent outburst of peasants in Thai Binh in 1998. The local government had used their authority and power to mis-allocate land for their own benefits; to confiscate land for private sale or exchange it for other material needs; to use local tax revenue for their own private purposes; extract the public budget for private usage by claiming higher public expenditure, etc. These officials used public money for their own private means with the building of new houses, buying private cars and luxury goods, while ordinary people and peasants were losing their lands and jobs as well as living in desperately poor conditions. However, their complaints through official channels, at all level of the government, were ignored. This led to large-scale protests in the Province, and at their height, there was 10000 demonstrators gathering together to take over and damage the local government headquarters. The scale and nature of this unrest alarmed the CPV and government about issues of the corruption, abuse of power and the relationship between State and society. After the investigation, nearly 2000 officials in the province were removed from office, which included the Secretary of the provincial CPV and the Chair of the People's Committee (Kerkvliet, 2001). This also rang an alarm for the CPV legitimacy if they did not take into account the pervasive corruption and continue the bureaucratic and authoritarian approach to citizen's complaints and demands (Thayer, 2009). As a result, the CPV developed new approaches including popular propaganda, democratic political reform, and 'grassroots democracy'. The CPV encouraged the strengthening of the participation of communities

and people at the local government level. Later, the government issued Decree 29/1998/ND-CP, with the slogan “the people know, people discuss, people execute, and people supervise”, to improve transparency and accountability of local government and stipulate that local officials must disseminate information on policies, law, long-term and annual socio-economic development plans, land-use policy, and on the annual draft budget. Decree 79/2007/ND-CP on ‘Grassroots Democracy’, was issued to approve the participation of community-based organisations in development activities at the commune level (Thayer, 2009). The relationship between the State and the society involves linkages with professional associations, the business community, and the public media.

### *Associations*

The CPV uses various mass organisations to support government programmes and policies. These also serve as channels for communication between authorities and important sectors of the society and helped to maintain social order (Kerkvliet, 2001). As a result, the Party-state strictly controls these organisations and sets up a system of dependent relationships between these organisations and the Party. These official social and professional associations are strictly managed by the CPV under the umbrella of Vietnam’s Fatherland Front (VFF). They are considered as extended arms of the CPV in the decision-making process and policies implementations, serving as the bridge between CPV, the State and citizens (Thong, 2007).

The VFF is “a voluntary union of political organisations, social organizations and individuals representing their class, social class, ethnicity, religion and overseas Vietnamese” (VFF, 2011, p.1). It expresses the will and aspirations of the ‘People’; setting the template for national unity and promoting people's rights, through consultation, coordination and unity of action of its members, contributing to maintaining national independence, national sovereignty, territorial integrity, and successfully implementing the industrialization and modernization of the country (VFF, 2011). However, the head of the organisation is currently a member of Central Committee, so its activities are greatly dependent on the CPV and State’s policies.

Social and professional organisations have been revived since economic reform. The government has recognised the need to strengthen relationships with these organisations and actively engages with them (Thayer, 2008). There are 140,000 community-based organisations, 540 international NGOs, 1000 locally registered NGOs and 200 charities (Dang et al, 2006; Thayer, 2008). Most of them are involved in social or humanitarian causes and aim to improve social welfare (Dang et al, 2006). However, these organisations have limited influenced on the policy-makers (Dang et al, 2006; Koh, 2004; Shanks et al, 2004; Norlund et al, 2003).

### ***Business***

The State business sector was the sole owner of the means of production and distributor of the outputs of the economy (Le and Liu, 2006). The private sector was not officially allowed to operate in the economy, and gradually eliminated from any active participation (Arkadie and Mallon, 2003). The relationship between SOEs and the State was based on a ‘give and take mechanism’, in which the state enterprises asked for output targets to receive the inputs for production (Le and Liu, 2006)

Chi Lan (interview, 2012) suggested that “The economic reforms brought a substantial change to the business community and the relationship between the State and the business sector”. At the 6<sup>th</sup> National Congress, the CPV decided to reform the ownership rights to create a multi-sector economy. Ownership was divided into three groups: State ownership, Cooperative ownership and Private ownerships. Six main economic sectors were allowed to form including the State-run economic sector, the Collective-run sector, the Private sector, an Individual and small holder-run sector and the State capitalist sector (Quy, 2008).<sup>35</sup> For the first time, the private sector was recognised and allowed to participate officially in the market. In the 7<sup>th</sup> Party National Congress (1990), the concept of a multi-sector economy was defined more precisely, with specific identities given to owners and users of the means of production (Quy, 2008). Foreign investors were officially recognised with the introduction of joint

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<sup>35</sup> Political Report at 6<sup>th</sup> National Congress (CPV, 1986)

ventures with state companies. All economic establishments regardless of their ownership relations operated according to the mechanisms of business autonomy, equal cooperation and competition. Chi Lan (interview, 2012) suggested “business had greater freedom and were guaranteed rights of legal possession and earnings”. In the 9<sup>th</sup> National Congress (2001), the CPV reaffirmed that “other ownership forms may be established based on the three basic ownership forms of public, collective and private ownership (Quy, 2008). A new economic sector in foreign investment was officially recognised. The 10<sup>th</sup> Congress continued to reaffirm the development of the market economy with multi sectors. It stated “all economic sectors operating according to the law are a component of the socialist oriented economy, being equal before the law, in long term development together and healthy cooperation and competition” (CPV, 2009, p.83).

The Foreign Investment Law was introduced in 1987 and created more favourable conditions for doing business in Vietnam. Private companies were regulated by the Company and Private Law’s (1990). Liberalisation of trading rights in the private sector came with the Enterprise Law in 1999 (Le and Liu, 2006; Arkadie and Mallon, 2003). The United Corporate Law (2005) combined all previous laws on different types of enterprises and created a level playing ground for all types of business (Chi Lan, interview, 2012)

The reforms created a rapid emergence of new economic elites. Following the approval of the Company Law in 1990 the number of non-state sector businesses expanded remarkably.<sup>36</sup> The Enterprise Law (2000), saw 14,444 new enterprises registered in the first year, an increase of 2.5 times on 1999 (Arkadie and Mallon, 2003; Hakkala and Kokko, 2007). By 2005, there were more than 200,000 registered enterprises in Vietnam (Tuoi Tre News, 2010).<sup>37</sup>

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<sup>36</sup> With 190 joint-stock companies, 8,900 limited liability companies, and 21,000 private enterprises registered by 1996 (Arkadie and Mallon, 2003).

<sup>37</sup> In 2010, enterprises would increase to 248,847 enterprises (Vneconomy News, 2009).

The State sector still played an important and distinct role in the Vietnam economy. The GDP share of SOEs decreased rapidly over the years, but still continues to hover around 35% of GDP during the last five years (GSO, 2010). Despite the rapid shrinking of the SOEs, they are still large in number. They enjoy a near-monopoly status in many important industries of the economy.<sup>38</sup>

SOEs tend to be involved in capital-intensive industries, and their capital increased from 130 billion VND in 2000 to 768 billion VND in 2008.<sup>39</sup> Although there is heavy investment in the SOEs, these enterprises are often blamed for inefficient use of resources (Kokko, 2004; Riedel and Turley, 1999; Sjöholm, 2006). Productivity compared to capital investment in the SOEs has decreased. This has been reflected in the average ratio of turnover to capital of the SOEs, which decreased to 1.1 compared to 21.0 for the whole business sector in year 2009. In 2000, this gap is only 1.6 in SOEs compared to 8.8 in the entire sector (WB, 2011). The growth of labour productivity in SOEs has also not been sustained in comparison with the rest of industry. Between the 2000 and 2008, the turnover to employee ratio in the SOEs was up from 0.6 to 1.7. Meanwhile, this ratio in the overall enterprise sector increased from 2.7 to 16.3. The increase of the productivity of the rest of the enterprise sector was much faster than that in the SOEs. The productivity for using fixed assets such as land and machinery, which is measured by turnover-to-fixed assets ratio, also diminished between 2000 and 2008 (WB, 2011).

Throughout the economic reforms, SOEs were central to the process of change. The focus was on transforming SOEs into market-oriented entities. However, SOEs remain government led actors operating in the market rather than important independent elements in the market economy. The role of the SOEs remains rooted in its past

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<sup>38</sup> For examples, SOEs account for 99% of fertiliser, 97% of the coal industry, 94% of electricity and gas, 91% of telecommunication and 88% of insurance. They have also taken a large market share in many consumer goods market such as 51% in cement, 41% in beer; 73% in refined sugar, 21% in textiles and 21% in the chemical industry (WB, 2011).

<sup>39</sup> During the same period, an average SOE also invested 677 billion VND in fixed assets and investment, which increased six fold from 110 billion VND. The capital to employee of SOEs increased to 1.5 in 2008 compared to 0.4 in 2000, which was nearly double the figure of the private sector (WB, 2011)

heritage of being part of the command economy and vanguards for the economic face of the CPV's ideology. The CPV has developed its own model of development often dubbed as a 'market economy with socialist orientation', but would more accurately be named a central command economy with free market elements. The market economy with socialist orientation was clearly stipulated as "the multi-sector commodity economy operating under a market mechanism with the state management under the leadership of the Communist Party. The economy is "based on, led, and governed by the principles and essence of socialism", and, "all forms of market participation are respected, together with long-term development, cooperation, fair competition, healthy and civilized conditions, of which the State holds the leading role" (CPV, 2011, p.34-36). The existence and influence of SOEs in the market is rooted deep in the philosophy of development of the CPV. SOEs are considered as a tool of the government to coordinate and to govern the market (Nguyen Thao, 2012). The reality has been far from this with SOEs staying unproductive and inefficient, while also holding a monopoly over the economy.

It is difficult to see the SOEs as separate entities from the political ideology, and a true conversion to a market economy is likely to be challenged by this refusal to open these 'government arms' to real market forces based on productivity, profitability and competitive market pressures. Although implementing economic reform, the Party-State has no intention of major political reforms in the near future. Through Marxist ideology, the Party-State still keeps close vigilance on political competition from the private sector, especially the bourgeois class (Reidel and Turley 1999; Thang, 1995; Gainsborough, 2010). SOEs are central to CPV strategy of marketisation as a process of socialism, with the economy actually remaining under state control via the SOEs (Masina, 2006). The strategy is seen as reasonable and understandable, as they identify it with the models of Japan, Taiwan and Korea, which relied upon large state conglomerates for their post war industrialisation. They see large scale conglomerates as little more than identical reflections of their own SOEs, believing that the enterprises in these countries were strategically developed to be the main forces for guiding the industrialisation process (Wade, 1990). The Party see it merely an exercise in semantics to argue whether ultimate ownership is a politically connected rich bourgeoisie or the Government.

In this ideology there is a strong belief that private ownership within a government framework is a 'sensible' way to reform the 1000 year old culture of Confucian rule of mandarins, combined with Leninist rule of the 'Communist elite' and in the transition period to full socialism makes it psychologically understandable that the Party rejects carte blanche release of its power to the 'masses' (or business in particular- which is seen as pursuing wealth alone, while the Party represents the health, safety and social welfare of the people, as well as the interests of business and national security). The Vietnam culture is overtly seen as trusting and friendly, but its deeper roots, nurtured by centuries of war and internal conflicts, famine, poverty and continual problems with corruption in politics and business, is a culture more reflected by distrust, secrecy and power 'games'. The importance of relationship factors in business, and the tendency to 'do business' through complicated and often secretive means, is a culturally embedded practice pre-dating Communism and central control, and chiefly based on a certain belief that 'strong leaders' are needed to control and direct a mass of people often seen as greedy, emotional and impractical. They are seen as needing the 'guiding' hand of good leaders and actually welcome and embrace a 'paternal and knowledgeable' authoritarianism. This culture has developed through centuries of colonisation where there has been a hatred and resistance to 'foreign' control and a following of strong and powerful domestic leaders resisting the foreigner. Such a history means that the 'masses' want a 'voice', but only where 'great' individuals are trusted with total autonomy in power, and are expected to make all the important decisions. To suddenly expect a 'hidden' hand of the free market to operate in this environment is unrealistic, and Party, Government and the 'People' expect that the economy can only improve if strongly led by 'on hands' governance of the leaders. The Party fulfils this role and both government and society often expect the SOEs to be the practical mechanisms for actually applying the reforms and 'managing' the economy.

SOEs are seen as having a social responsibility for under the central command economy, these companies are the major sources for employment, especially in urban areas. The perception of 'durable stability' in public sector employment has been developed and become rooted in the minds of Vietnamese of all ages. SOEs have a duty to employ large numbers of the population and put 'productivity' second to this requirement. Chi Lan (interview, 2012) suggested that "The SOEs received more than 45% of total investment from 2000-2006" and "are believed to be too large to fail".



SOEs are managed by the government line ministries and local government officials and they are part of the system where benefits and duty are entangled in complicated political matters. Through these SOEs the ministry and also its officials may accumulate material benefits for their own institutions or individuals. The budgets for these ministry's and local government offices are often limited or strictly monitored, so using their own SOEs to finance their personal needs is a popular solution for the limited resources of the state agencies (Thanh, interview, 2011). The Ministry or local government office is also the state management authority in charge of planning and issuing policy and mechanisms for the operations of all companies in particular areas of business- thus, having its own company is inevitably a conflict of interests, but also a lucrative way to do business. This suspect level of inter-dependence brings unfair benefits to both SOEs and regulators.

SOEs transformed into State-Owned Economic Groups (SOEG) in 2005 that enjoy privileged access to factor inputs and a higher level of operational autonomy, which helps them to attract large investments. SOEGs are state-owned business conglomerates in strategically important sectors, formed by consolidating independent SOEs into a holding company structure. Companies that have relations in terms of capital or corporation were grouped together to create larger corporations that could theoretically dominate the entire domestic industry and compete on the global market. The core element for the establishment of each SOEG is the General Corporations operating in the industry and focused on restructuring. The SOEGs play the role of leaders in Vietnam's key industries, including rubber, shipbuilding, coal-mineral mining, oil and gas, electricity, textile and garment, insurance, chemistry, construction and housing and urban development (Amcham, 2012). However, many of them diversify outside their core competency and this has allowed them to compete unfairly with private sectors in many other areas of the economy (WB, 2011). The advantages of government support, privileged access to decision-makers and an ability to control regulators means that private sector companies are faced with various forms of unfair competition from SOEs.

SOEs are a market distortion force and an obstacle for promoting further economic growth and development of the country (Masina, 2006). Although they have a number of advantages, the reality is that they often waste resources, especially finances. The quality of their work and standards of service are often worse than those in the private companies, but they remain dominant in many industries because they enjoy a 'privileged' status, with direct access into areas such as licensing, connections to suppliers, and the ability to use other 'regulators' such as the police as barriers to their competitors.

The influences of the SOEs on the policy making process can be through several channels. SOEs are the strongholds of the CPV in advancing its ideology of control and distribution and they enjoy a close political link with the Party and State. Most of the SOEs 'saved' from the privatisation process are large enterprises at central level and 'fully' privatised ones are actually still 'ruled' by high-level politicians who balance their State role with a private business identity (Clarke, 2004; Masina, 2006; Painter, 2003). SOE appointments are carefully monitored and approved by the Party Personnel Department before the final appointment by the Prime Minister. Similar to the SOEs belonging to ministries, they also enjoy close relationships with ministry's highest-ranking officials and Party-State officials. This relationship is viewed as reciprocal. The SOEs 'payments' to the Ministries and the Government to do business such as land allocations; cheap credit, market domination guarantee, etc are in exchange for 'advantages' being given to the SOEs. Chi Lan and Thai (interviews, 2012) agrees that "They provide the material benefits for these ministries to compensate for shortage of budgets and these relationships become dubious with opportunities for corruption or benefit exchange and strong bargaining positions due to being able to take advantage of weak institutions and poor oversight in checks and controls".

As SOEs have been granted more and more autonomy, the opportunity for them to abuse the system has grown, with SOEs able to lobby for special treatments or protection. The situation is so serious that it is almost impossible to see where politics ends and business begins. Chi Lan (interview, 2012) suggested "In Vietnam, politics is focused on providing 'material' benefits to individuals and profits guaranteed to those individuals through the dual avenues of political influence and business advantages. The consequence is that even the education and health systems are based purely on a

‘business’ status and ruled by a pure capitalist theme of ‘profit’ alone”. McGough (interview, 2012) commented “such a situation makes WTO membership extremely difficult to manage, or understand, with most of the business relationships hidden under a veil of political impartiality, but actually working in a situation where business is government and government is business.”

The Private sector is a young sector and has developed rapidly and made a significant contribution to growth, employment and poverty reduction. The relaxation on Laws for the private sector, as well as the conditions for opening business, has meant the private sector has expanded rapidly (WB, 2006).<sup>40</sup>

The private sector is still considered as being neglected and having much room for further development. Most of the private enterprises are Small and Medium Enterprises. They often employ less than 300 employees or are registered with capital under US 500,000 dollars. The bulk of them were upgraded from household enterprises, which operated on a very small scale and with simple technological capacities (Kokko, 2004).

The hesitation of the leaders to develop further the private sector comes from three sources. First source is the political aspect. The Party-State was reluctant to increase support for the private sector precisely because the emergence of autonomous business elites might be a force to challenge to its power (Forsyth, 1997; Dixon, 2004; Masina, 2006). Secondly, the private sector had the ability and conditions to accelerate industrialisation, although only on a limited basis as they lacked capital and technology (Masina, 2006). Lastly, the private sector was considered weak and young, and this was feared would open the door to transnational and international corporations to dominate and intervene into the domestic market, faced as they would be very little effective competition. SOEs dominated the profitable areas of the economy, strengthened and

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<sup>40</sup> There are 238,932 private enterprises (excluding the FDI sector) operating in Vietnam in 2010, a significant expansion from merely 35,004 enterprises in 2000 (GSO, 2010). They account for 38.4% of industrial production in 2010, which is up from 24.5% in 2000. In 2007, the private sector employed nearly 4.7 million workers and each year, they can absorb more than 1.5 million workers (WB, 2006).

supported by unfair political advantage and protected from market forces by 'relationships' (Masina, 2006). The WTO entry was seen as a way to further develop the economy, but most decision-makers believed the existing economic system could remain intact and actually be strengthened by the opening up of the economy to the global markets. The strength of the economy was seen as being the ability of the government to (behind closed doors and covertly) remain in overall control of business and the main recipients of its 'profits'. Although 'free' market and 'privatised', the words 'free' and 'private' have to be understood in this system where 'relationships' and 'influence' are based on a synergy of the political and the economic.

Tuat (interview, 2010) suggested "the private sector was still regarded with apprehension and often discriminated against in relation to competing with SOEs. Before reform they were seen as 'enemies' of the ideology, but after the reforms they were seen as necessary, but only when tightly controlled".

Truong (interview, 2012) suggested that "the private sector had very limited capability to influence the policy makers for more favourable conditions. As the SOEs have better resources, access and protection, many private enterprises have to become 'affiliated' to the SOE". Private companies need to use or develop strong relationships with officials or the ministries, and many of these relationships are established only through bribery and corruption (Fforde, 2005). This further distorts the business environment and actually weakens the overall position of the private sector to influence policy makers, with 'favoured' private entities relying on their support of the status quo as their main means of survival.

The third major sector in the business community is the Foreign Invested Sector. Despite its late establishment, this sector has become an important component of the economy.<sup>41</sup> It is mostly focused in industries such as oil and gas, manufacturing and

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<sup>41</sup> In 2009 there were 6,546 FDI's enterprises, employing 1,919,600 employees (21.5%), they had 55.1 % of total export, 43.1% of total industrial inputs, and represents 18.43% of GDP (GSO, 2009; 2010). In 2010, Vietnam attracted USD11 billions in FDI in 969 projects, which makes the total inflow FDI of USD77.9 billions from 1988-2010 (GSO, 2010).

processing industries and services such as banking, insurance, hotels, restaurants and transportation. They bring in new technology, management skills, capital and market access for economic development (Doanh, 2002).

The official view is that FDI has constructively and positively contributed to the development of Vietnam. Since 2000, the CPV has officially accepted foreign investors as an integral part of the national economy with equal market footing with other sectors (Doanh, 2002). The regulation framework has been constantly revised in order to make better conditions for investing in Vietnam (Kokko, 2004).

FDI plays a vital role in the economy and its 'voice' has become an important element in the decision making process. Before 2000, the FDI sector was confined to joint ventures with the SOEs. This requirement was aimed at preventing direct competition to the SOEs while also providing the means to reform and renovate them (Hakkala and Kokko, 2005; Leproux and Brooks, 2004). However, this format not only served the purpose of building state led industrialisation of the Party-State, but was also a way to closely control the operation of the FDI enterprises (Masina, 2006). It was designed to prevent the possibility of building up a strong independent private sector led by FDI and be a vehicle for capitalists to weaken the role of the Communist Party. It was referred to as the 'sugar coated bullet' for implementing 'peaceful revolution', underpinned by the CPV propaganda for vigilance against the economic power of the capitalist (Masina, 2006). Instead, The FDI became a life buoy for inefficient SOEs with budget constraints, backward technology and management skills. The FDI influence rescued many SOEs from almost certain collapse and became a vital element in reforming the economy.

However, it should be noted that in 2012 FDI has dramatically declined, and while neighbours continue to see investment growth, the levels of corruption, increasing anti-foreigner attitudes on the part of officials such as the Police, a lack of trained human resources and the growing debts of banks and the government is eroding the former confidence investors had in Vietnam (WB, 2011).

## *Mass media*

The Party has kept close relationships and control over the mass media. Before the economic reforms, the mass media was limited to a role of spreading propaganda and educating people, and was less focused on reporting news on the reality of the situation in Vietnamese society (Mandy, 2001). With the expansion of the market economy and the opening up of Vietnam into the world, the mass media has been given far more freedom, but again this to some extent is just appearances as major constraints still exist on the 'free' press.

The Party and State needs candid information and feedback from society for their fine-tuning of the decision making process (Phong, 2009). The operation of the market economy has led to more free and democratic channels of information. But, the CPV still uses media extensively as a tool for spreading their policies and propaganda. The CPV allow more freedom of the press to utilise its contribution in providing constructive criticisms and a reflection of society on the government policies and performance (Kerkvliet, 2001; VNA, 2012). The CPV believe that relaxation of press control is one of the channels for providing a 'release valve' for deflating some of the most pressing issues.<sup>42</sup>

Relaxing controls of media should not be directly equated to freedom of the media. The rights of reporters and media companies are respected but they must obey the Press Law and many other vague and stringent laws and regulations. The Government does not tolerate any breaches of these laws and regulations. Journalists face grave consequences, such as fines or jail if they do not abide by these broad and vague provisions on media freedom (Kerkvliet 2001; Human Right Watch, 2011).

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<sup>42</sup> There are now nearly 850 press agencies, including 786 printed press agencies, 1 national news agency, 61 internet online newspapers and magazines, 191 social networking webpages and thousands of websites of the CPV, governments, NGOs, and business. There are also 67 television broadcasting services including 3 national services, and 64 local services; and 500 radio broadcasting services (VNA, 2012). More than 17,000 press cards have been issued (VNA, 2012). Nowadays, the Internet is also booming in Vietnam with 23 million users (27.18% of the population) (GSO, 2010).

### **3.3 VIETNAM'S ECONOMIC INTEGRATION AND WTO ACCESSION**

#### **3.3.1 Vietnam's economic integration process**

Vietnamese leaders have changed their approach in international relations, shifting from ideology to pragmatic interests, deepening and broadening the levels of integration, and now participating in various regional and global economic integration institutions (Chuc, 2009).

The 6<sup>th</sup> National Congress (1986) identified the 'open economy' as one of key tasks of the economic reforms in Vietnam. The CPV's Political Reports (1986, p.20) affirmed "Nowadays the development of the technology and science revolution is the trend of expanded labour division, cooperation between countries including countries having different socio-economic regimes, is also an important condition... We have to make good uses of all opportunities for expanding trade relations, economic cooperation and science and technology with outside countries". In 1988, the Politburo issued Resolution 13-NQ/TW on foreign relations to define a breakthrough view on foreign affairs and initiate an open door policy, which abolished the Cold War's hostile stance and set up the foundations for the integration process (Chuc, 2009). The view changed from prioritising security to concentrating on economic development and expansion of foreign relations as "our country must participate in the international system of labour division in order to combine the strength of the nation and the power of the era. We need to grab the chance to expand economic and technological relations with the third world, industrialised countries, international organisations and individuals on the principle of equality and mutual benefit" (Le and Liu, 2006). The changing view on the open economy led to the passing of the Law on Foreign Investment in 1988 with attractive terms to open the economy for investments (Phong, 2009). The ideological view of FDI, that identified it as a mean of exploiting developing countries by the more powerful developed countries was gradually reviewed and changed to accept FDI as a necessary transition step to economic growth (Phong, 2009).

At the 7<sup>th</sup> National Congress of CPV (1991), the open economic policy was further clarified as “Vietnam wishes to be friend of all nations in the world, striving for peace, independence and development, and advocates the equal and mutual beneficial cooperation with all nations regardless of their different socio political systems on the basis of peaceful co-existence principles” (CPV, 1991, p.35). Vietnam actively promoted the normalisation of relationship with many countries and international organisations such as IMF, ADB and the World Bank as well as with the United States (Masina, 2006).

Admission to ASEAN reflected the fundamental changes in the foreign policy orientation, showing that Vietnam was taking into consideration the relationship between its external environment and the development of Vietnam (Amer, 2001; Nien, 1996; Binh and Duong, 2001). The reason for this turning point was the pressure of the unilateral economic reforms of Vietnam in the last 10 years. The newly reformed economy needed markets, supplies and capital for its restructuring. Before the reforms, Vietnam had foreign relations and trading with only 26 fellow communist countries (Goodman, 1996). Vietnam depended on these countries for its export markets and the imports of production and consumptions resources, as well as capital for the economy. The collapse of the Soviet Union narrowed down the traditional export markets and dried out the capital and import material sources for Vietnam (Le and Liu, 2006). Under the US embargos and blockade, Vietnam fell further into isolation, while the move to reform needed new markets, capital and technology for the development of the economy (Chuc, 2009). Regional integration was considered a strategic step for Vietnam to break the isolation with its neighbouring countries and to take advantage of the recent economic emergence of South East Asia (Thayer, 2004).

The accession to the ASEAN also meant joining the ASEAN Free Trade Area (AFTA) (Thayer, 2004). AFTA is the centrepiece of ASEAN economic cooperation, and was the first time Vietnam had participated in an international free trade agreement with commitments to trade liberalisation, with a concrete time schedule and a need to abide by international law and regulation standards (Thayer, 2007). AFTA established a free trade area in the region removing all trade barriers among the ASEAN members to create a single production base and regional market (Bowles, 1997). The main instrument for the AFTA is the Common Effective Preferential Tariff (CEPT) Scheme,



in which a member is required to classify all manufactured goods into 4 categories: Inclusion List, Temporary Inclusion List, Sensitive List and General Exclusion List. AFTA members agreed to reduce scheduled tariffs in the first two lists to no more than 5%. All other trade restrictions on virtually all commodities were eliminated by 2003 (Nguyen, 2004; Phuong, 2002). AFTA facilitated trade through harmonisation and simplification of custom procedures, streamlining custom administration, and the elimination of technical barriers through mutual recognition of technical regulations and conformity assessments (Lao-Araya, 2003). Vietnam committed to remove all barriers in 2015 in the AFTA framework and selected 12 priority areas to eliminate trade barriers before 2012 (Nguyen, 2004).

**Table 3.2: Average tariff reduction under CEPT implementation of Vietnam**

<i>Year</i>	<i>1996</i>	<i>1997</i>	<i>1998</i>	<i>1999</i>	<i>2000</i>	<i>2001</i>	<i>2002</i>	<i>2003</i>	<i>2004</i>
<i>Total</i>	<i>12.7</i>	<i>12.6</i>	<i>12.1</i>	<i>11.9</i>	<i>11.4</i>	<i>10.9</i>	<i>10.7</i>	<i>9.3</i>	<i>7.4</i>
<i>Year</i>	<i>2005</i>	<i>2006</i>	<i>2007</i>	<i>2008</i>	<i>2009</i>	<i>2010</i>	<i>2011</i>	<i>2012</i>	<i>2013</i>
<i>Total</i>	<i>5.3</i>	<i>3.0</i>	<i>2.33</i>	<i>2.77</i>	<i>2.72</i>	<i>2.68</i>	<i>2.6</i>	<i>2.53</i>	<i>2.45</i>

Source: Ministry of Finance, personal communication, 2012

The tariff reductions under AFTA were not very effective for trade liberalisation, because it was typically small and occurring over long and delayed implementation periods. Thayer (2004) believed that these limitations of AFTA were indeed an appropriate level of trade liberalisation for a low-level development country like Vietnam. It provided reasonable times for adjustments and helped Vietnam to gain experience in participating in international economic institutions and to cope with competition in the regional market. It also has room for Vietnam to protect its industry through the General Inclusion List (Loc, 2001). Vietnam submitted its schedule for tariff reductions up to 2006. Implementation of AFTA's commitments was a real test for the international economic integration of Vietnam. Tariff reductions led to fiercer competition in the domestic market, putting enormous pressure on the Vietnam economy. This fuelled domestic reforms in many areas, which included reform of the

tax system, protection of property rights, SOE equitisation, and promoting the private sector (Loc, 2001).

The success of ASEAN accession and pressure from AFTA integration prompted the CPV to issue Resolution 4-NQ/TW in 1996 on expanding and enhancing the effectiveness of the international trade relations in between 1996-2000 (Thuong and Hung, 2010). CPV's declared it "should be active and proactive to penetrate and expand the international market" as well as "take prompt and solid preparation for the negotiation of the US Bilateral Trade Agreement, accession for APEC and the WTO" (CPV, 1996, p.36).

In 2001, Vietnam concluded the negotiations for the US-Bilateral Trade Agreement. This agreement was a milestone in Vietnam's international economic integration process (Wiemann et al, 2006; Thai, 2005; Nguyen, 2004). The BTA required Vietnam to review and revise its trading and legal system for meeting international standards (Parker, 2005). It had a deep impact on reforms of the trade and institutions in Vietnam, and provided a benchmark and focus on modernising Vietnam's economic and legal institution to support the market economy and economic integration (Parker, 2005, Weimann et al, 2006; Bao, 2004; WB, 2006). Implementing these commitments meant anticipating most of the WTO requirements and facilitating WTO accession (Weimann et al, 2006).

After 2 years of the US-BTA coming into effect, the BTA led to sharp rises in US –Vietnam trade.<sup>43</sup> Many believed that after the BTA, the weak Vietnamese economy would not be able to compete with the US and it would create more harm than good (Masina, 2006). However, the reality showed that the Vietnamese economy adjusted quickly to take advantages of larger markets and actually benefited from the challenges of new competition. This further strengthened the determination of the government to engage further in the integration process (Chuc, 2009).

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<sup>43</sup> Volumes of trade reached US 6.2 billion in 2004 compared to US 1.158 billion in 2000. Vietnam's trade surplus with the US accounted for US 5.1 billion in 2004 (Masina, 2006).

The 9<sup>th</sup> National Congress in 2001 was increasingly aware of the globalisation process and the necessity to participate further in this process (Thuong and Hung, 2010; Le and Liu, 2006). In its Political Report and National Plan for Socio Economic Development 2001-2005, the CPV identified that “globalisation takes a new development, becomes an objective tendency, attracting participation of many countries, having both positive and negative aspects as well as cooperation and struggle with each other. It is necessary to proactively integrate Vietnam’s economy into the world and region in the spirit of making full use of internal strength, increasing the effectiveness of international cooperation to ensure national independence, sovereignty and socialist orientation, protect national interests, national security, preserve national identities and protect the environment” (CPV, 2001, p.35-38). Khanh (interview, 2012) suggested that “the Politburo issued Resolution 07-NQ/TW in 11/2001 on international economic integration, which specified clearly the targets, as well as specific tasks during the integration process and delegated tasks for ministries to actively prepare and negotiate for WTO accession”.

At the 10<sup>th</sup> Congress (2006-2011), the CPV re-confirmed the commitment to continue the market economy reforms, and focusing on perfecting the market economy institution with socialist orientation, while accelerating the industrialisation and modernisation process. Restructuring institutions started by enhancing the roles and effectiveness of the government’s management through proper strategic planning and using market friendly measures to manage the economy. The Congress also declared to develop more markets for the economy and reduce the roles of the SOEs and accelerated the development of new market such as the property market, the financial market; the labour market and the technology market, while removing the government monopoly for the private sector in many industries. In line with it, the Party aimed to promote heavily the other economic sectors and organisations as well as committing to restructuring the SOEs towards a more level playing field, transparency, efficiency and more independence from the government, mainly through an accelerated equitisation process (CPV, 2006). The Party also reconfirmed that “Vietnam should actively integrate into the world economy and expand its cooperation in other fields. Vietnam is a trusted friend and partner of other countries in the world, participating in the cooperation process in the region and the world” (CPV, 2006, p.39). The attitude and

level of commitment of Vietnam for the international integration was also upgraded in this Congress. It was enhanced from ‘participating’ level in the 9<sup>th</sup> Congress (2000) and by ‘actively integrating to the world economy’ level in the 10<sup>th</sup> Congress (2006). The economic integration of Vietnam progressed from the regional level (ASEAN) to the inter-regional level (APEC) and then to the global level (WTO) and brought encouraging results (Le and Liu, 2006). It created favourable conditions for Vietnam to enhance its political, diplomatic and economic position in the world, and support the development of Vietnam’s international trade (Chuc, 2010).

At the 11<sup>th</sup> Congress in 2011, the policy for development was refined for quality rather quantity. The Party shifted their focus on sustainable growth, balanced development between economic and social cultural development and balanced development between rural and urban areas. This change resulted from the Party awareness of the challenges and distortions that happened during the last fast phase of reform. The tone for promoting the leading role of the SOEs was also at a minimum, while the Congress focused more on creating the level playing field between different economics sectors and controlling and restructuring the SOEs for more efficiency and transparency (CPV, 2011). Another significant change in the 11<sup>th</sup> Congress was the commitment for deeper international integration. The Party wanted to promote international integration on all fronts such as politics, military, technology, etc rather than only economics. This has been a totally new advance step in the international policy that may help Vietnam fully integrate into the global economy.

### **3.3.2 WTO’s accession process and the commitments of Vietnam**

#### **The WTO accession process**

Vietnam WTO accession took 11 years of negotiations, with over 200 negotiation rounds, 14 multilateral negotiation rounds and 28 bilateral partner negotiations (NCIEC, 2007). Vietnam’s WTO accession process consisted of three major components: multilateral negotiations on the rules in goods, services and TRIPS; bilateral negotiations related to market access concession in goods and commitments in the services sector with individual Working Parties’ members interested in access to the

applicant's market; and lastly drafting the legal documents for the WTO accession (NCIEC, 2007)

The 'Memorandum on Vietnam's Foreign Trade System' (1996), explained the country's trade and legal regime (NCIEC, 2007).<sup>44</sup> Vietnam offered detailed replies and explanations to these questions. In the 6<sup>th</sup> meeting round (2003), Chairman of the Working Panel concluded that Vietnam completed this session and could prepare for the second phases of bilateral negotiations (Hiep, 2005).

The reasons for the delay in this phase were that members' country wanted to understand and see whether Vietnam trade policy and legal regime complied with the WTO regulations. Khanh (interview, 2012) said "many trade policies and the legal regime of Vietnam were complicated and a contradiction with the standards of the WTO, which made the process take a long time to complete". This phase of negotiation was in parallel with the period of the accelerated industrialisation process of Vietnam. For a small economy like Vietnam, the number of interested countries seeking bilateral agreement seemed to be excessive for Vietnam. Khanh (interview, 2012) suggested that the "reasons for huge interests in Vietnam accession to the WTO might rest in the potential of this country in world trade". Foreign investors see Vietnam as a promising market for trade and investment (Bank of Tokyo, 2010). Vietnam is a favourable location in the terms of regional trade routes for land, sea, and air transportation. The second reason was derived from the competition of some WTO's members who share the same export structure as Vietnam (NCIEC, 2007). Their involvement in the negotiations was in order to protect their own trading advantages.

In the bilateral negotiations, the United States and the EU were the main representatives and the most important members. These members were negotiating not only on their own interests but also on behalf of WTO's interests as a whole (NCIEC, 2007). Vietnam concluded bilateral negotiations with the United States in November 2001, which paved the way for the market-access deal with the EU and other members

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<sup>44</sup> From 1998 to 2003, WTO's members raised 3,516 questions about the trade and legal regime in Vietnam's memorandum (Hiep, 2005).

in Working Parties. Another tough case was the negotiations with China. Both countries already had a free trade agreement under the ASEAN Framework and did not need another bilateral agreement. However, China still expressed its interest in having bilateral negotiations with Vietnam in the WTO framework (NCIEC, 2007). Vietnam's bilateral negotiations with 28 members were concluded in July 2006 (WTO, 2008).

### **Vietnam's Commitments for WTO's accession**

Vietnam accepted all WTO's agreements and committed to have a ceiling rate for the whole goods tariff table of 10,600 lines and 11 services with 110 categories out of 155 categories specified by the WTO (NCIEC, 2007). Khanh (interview, 2012) said "the commitments were rather strong for a country with low levels of development, including a tariff ceiling on goods and 'second generation' institutional reforms such as transparency procedures, judicial and administrative review and other domestic regulation such as intellectual property and product standards".

Khanh (interview, 2012) commented that "Vietnam achieved good acceding commitments compared with other countries. Although the commitments are detailed and concise, but secured for Vietnam, they put a lot of pressure on the domestic economy but, also allow enough room for the domestic economy to adjust under these pressures".

**Table 3.3: Summary of the WTO's commitments of Vietnam and China**

<b>COUNTRY</b>	<b>VIETNAM</b>	<b>CHINA</b>
<b>Policy Area</b>	<b>Commitments</b>	
	<b>TRADE IN GOODS</b>	
<b>Tariff reductions</b>	<p>Average tariff reduction to a final bound of 13.4% from 17.4%</p> <p>Agricultural tariff declined to 21% from 23.5</p> <p>Non agriculture tariff declined from to 12.6% from 16.6%</p> <p>Tariff reductions implemented over 5-7 years.</p>	<p>Average tariff reduction to a final bound of 9.8%.</p> <p>Agricultural tariff declined to 15%</p> <p>Manufacturing products tariff reduced to 9.5%</p> <p>Tariff reduction implemented over 3 year transition period</p>
	<b>TRADE IN SERVICE</b>	
	<p>Committed in 11 service categories, including 110 sub-categories (out of 150 sub-categories). They are business, communication, construction, distribution, education, environmental, financial, health care, tourism, recreation, and transport services.</p>	<p>Committed in 9 categories, including 88 sub-categories. They are business, communication, construction, distribution, education, environmental, financial, and social, tourism and travel related and transport services.</p>
	<b>MULTILATERAL ISSUES</b>	
<b>Trade framework</b>	<p>Complied WTO requirements on Non discrimination, transparency, uniform administration, judicial review, special economic areas...</p>	<p>Complied WTO requirements on Non discrimination, transparency, uniform administration, judicial review, special economic areas...</p>
<b>Trading Rights</b>	<p>-All firms and individuals are allowed to engage in import and export activities, except items subjects to state trading. Importer can choose their domestic distributors</p> <p>- No minimum capital requirements for firms engaging in trading</p>	<p>- All firms and individuals allowed to engage in import and export activities except items subjects to state trading (within the transition period -3 years).</p> <p>- No minimum capital requirements for firms engaging in trading activities after 3 year transition</p>

	activities	period
<b>State Trading Enterprises</b>	Natural monopolies included manufactured tobacco products; cultural sensitive products such as newspapers, journals and audio-visual material, petroleum and aircraft...	Including tea, rice, corn, soy bean, tungsten ore, ammonium paratungstates, tungstate products, coal, crude oil, processed oil, silk, unbleached silk, cotton, cotton yarn, antimony ores, antimony oxide, antimony products, silver...
<b>Price Control</b>	Committed fully the WTO requirements and ensured the transparency in price control by publishing the list and related regulation on the Government bulletins.	Committed fully the WTO requirements and ensured the transparency in price control by publishing the list and related regulation on the Government bulletins. But reserved 10 commodities groups and some utility. Some other essential services are subject to government pricing or guiding
<b>Tariff Rate Quotas</b>	Egg, un-manufactured tobacco, sugar and salt. Quota volume increases at 5% annually	Wheat, Corn, Rice, Sugar, Wool, Cotton, Vegetable oil. The quota will be averaged of import in the last three years or 3-5% of domestic consumption.
<b>Quantitative Restrictions</b>	Import bans on cigarettes, cigars, large motorcycles, and used cars to be abolished. Cigarettes and manufactured tobacco products to have production quota (including imports).	To be removed from 2002 to 2005. Quota applied for 15 products: processed oil sodium cyanide, chemical fertiliser, Natural rubber, Tires of rubber used on car, motorcycles and key part, car and key parts, Air conditioner and compressor, Recording apparatus, Magnetic sound and video recording apparatus, Recorders and transport mechanism, Colour TV, Crane Lorries and chassis, cameras and Wrist Watches.
<b>Export Restrictions</b>	Export controls on rice for food security reasons. Control on wood	Raw material



	products and materials for environmental reasons and to prevent illegal exploitation.	
<b>Standards</b>	Comply with TBT and SPS upon accession	Comply with TBT and SPS upon accession. Fully implemented by June 2003.
<b>Agriculture Subsidies</b>	'Amber box' or supports that have direct impact on prices or quantities of 3.96 trillion dong in addition to the de minimus allowance to developing countries of up to 10% of the value of domestic agricultural production	Agreed to limit subsidies to 8.5% of the value of production and to eliminate all agricultural export subsidies upon the WTO entry.
<b>Agreement on Subsidies and Countervailing Measures</b>	Comply upon accession. Subsidies in the form of investment incentives contingent upon exports to be phased out over 5 years for existing beneficiaries.	Comply upon accession. Subsidies in the form of investment incentives contingent upon exports to be phased out upon accession.
<b>TRIMS</b>	Comply upon accession. Preferential state credit and import tariffs contingent upon localisation ratios to be abolished	Comply upon accession. Removing the trade and foreign exchange balancing requirement, local content requirements, joint venture requirements etc.
<b>TRIPS</b>	Comply upon accession	Comply upon accession
<b>Safeguard and Trade remedies</b>	12 years for transition to be market economy. During this time, member countries can use price comparability to determine dumping or subsidies case of Vietnam imported goods.	12 years for <ul style="list-style-type: none"> <li>• product specific safeguard, allowing other members to limit imports if import of Chinese products cause market disruption</li> <li>• Textile is specifically added for this term of safeguard</li> <li>• Non-market economy by examining the price comparability in determining subsidies and dumping</li> </ul> 8 years for transitional review

		mechanism to review China's implementation of its WTO commitments.
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Sources: Adapted from NCIEC, 2007 and Zhang, 2005

### **i. Multilateral Commitments:**

Vietnam agreed to abide fully on the Article X of GATT 1994, Article III of GATS and other requirements on WTO's policy transparency, including requirements for notice, comments and publicity. Upon the accession, Vietnam fully committed to leave 60 days for public comments on proposed laws and regulations under the WTO's requirements. It also disclosed publicly all legal documents in Ministry and industry's newspapers and websites. Laws and regulations relating to WTO obligations had to be applied uniformly throughout Vietnam's customs territory and other territories under its control. Independent and impartial tribunals review administrative acts including implementation of WTO commitments. Individuals, agencies and organisations have the right to lodge a complaint against administrative decisions issued by, or administrative actions taken by, a State administrative agency or a competent person of the State administrative agency (NCEIC, 2007). All these have been fundamental innovations in the legal system in Vietnam, which were major steps in the direction of the 'rule of law' (MUTRAP, 2007).

Commitments on non-tariff barriers of Vietnam were equally bold in liberalising the trade regime. Vietnam reserved import bans on very few goods, basing these on the concern for social security, environment and health protection such as arms and ammunitions, explosive materials, toxic chemicals, used electronics, etc (MOIT, 2007; NCIEC, 2007). These bans fully complied with WTO regulations, and were based on scientific research. Under the WTO commitments there were several import bans. Import and export quotas have been eliminated upon accession, except in the case of four goods; sugar, eggs, tobacco leaf and salt, which are reserved for tariff-quotas

(MOIT, 2007).<sup>45</sup> These industries are very important for a large rural population of Vietnam, which provides jobs and earning for them for many generations. Vietnam agreed to bring its customs valuation, non-preferential rules of origin, custom procedure and pre-shipment-inspection procedures into line with relevant WTO agreements from the date of accession. Vietnam adopted the WTO's agreements on Technical Barriers to Trade (TBT) and on Sanitary and Phytosanitary Standards (SPS), also without transition periods as the current legal system and SPS measures do not contradict the SPS and TBT Agreements (MOIT, 2007). Vietnam also committed to apply fees and charges for public services under the WTO regulations, which reflected the right value of these services, such as custom fees and charges.

Vietnam agreed to apply fully WTO's regulation on SOEs operations upon the accession. SOEs would operate based purely on the market criteria. The State would not intervene directly or indirectly in SOEs operations, except when allowed by the WTO or by their role as shareowners in these SOEs. Vietnam agreed to submit its annual report on its equitisation progress to the WTO. Upon the accession, Vietnam allowed foreign enterprises and individuals to enjoy the same import and export rights as the Vietnamese enterprises and individuals, except several products under the State-trading list such as Petroleum, cigarettes, cigars, video, newspapers and magazines. Some other sensitive products such as rice and medicines were opened up to foreign enterprises and individuals after a transition period (NCIEC, 2007).

Vietnam agreed to abolish all subsidies prohibited by the WTO's regulations and committed to eliminate trade-distorted subsidies for agricultural products from the date of accession. Subsidies for poverty reduction, infrastructure building and agricultural encouragement under the green box are allowed (MOIT, 2007).

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<sup>45</sup> The in-quota tariff rates for these 4 products are equal to the current MFN tariff (i.e. 40% for eggs, 25% for raw sugar, 40-50% for refined sugar, 30% for tobacco, 30% for cooking salt). Out-quota tariff rates are much higher. It committed to apply, allocate and manage tariff quotas in the manner of transparency, non-discrimination and in conformity with WTO rules (NCIEC, 2007).

As Vietnam's domestic legal system on intellectual property right conforms to the corresponding regulations of *TRIPS Agreement* Vietnam adopted WTO's TRIPS agreement in full without a transition period. Vietnam also issued several legal regulations to comply with the Berne Convention. Vietnam committed to applying WTO's relevant agreements on antidumping, subsidy and countervailing measures, safeguard measures, and to inform the WTO on its countervailing and safeguard measures. (NCIEC, 2007)

## **ii. Commitments on Opening the Market:**

Vietnam is committed to reducing the average tariff rate to 13.4%, which was a significant reduction from 23.32% in 1997(MOIT, 2007; WB, 2006). The most drastic tariff reductions were in garments and textiles, fish and fish products, wood and paper, other manufactured goods, electric and electronic machines and equipment (NCIEC 2007).

Vietnam participated fully in three sectoral liberalisation agreements (IT, textiles and garments, and medical equipment). It partially committed in agreements for aircraft equipment, chemicals, and building materials (MOIT, 2007).

## **iii. Commitment in Services:**

The level of WTO commitments in services is the same as the level committed in the US BTA. These commitments are considered as strong with some breakthrough commitments in banking, telecommunication and stock exchange services. As a result, the service industries encountering heavy pressures for change. Vietnam allowed foreign companies to operate in service sectors and buy shares in Vietnamese companies (NCIEC, 2007).

### **3.4 Conclusion**

During the last 25 years, the economic reforms of the Vietnam have achieved some admirable results. From being an exhausted and exceptionally aid-dependent country, Vietnam's economy has maintained a high growth since 1990s. The structure of the economy has advanced with more macroeconomic stability over the last two decades. One of the features of the success was the quick integration of the Vietnam economy into the world.

Although economists and investors consider Vietnam as an emerging market and a good example for economic transition, Vietnam has maintained a very different political regime to that found in most Western developed countries. It is still maintained the leading role of the CPV, exerting absolute power over political economic life.

The CPV has adopted a 'corporatist' model and switched from giving direct commands to trying to form a consensus on strategic issues. It is also trying to include a wider representation of society in its decision making process. The reform in ownership has led to the rapid emergence of the new economic elite, the business community, although the CPV continues to perceive the SOEs sector as the leading sector for the Vietnam economy. The private sector and foreign sector have proved themselves more efficient and dynamic than the SOEs.

The economic reform in Vietnam has owed much to the new policies of the Vietnam government. The leadership's view on international relations was changed radically from the basis of ideology towards pragmatic interests, which has led to new views on the role of international economic cooperation. This change was clearly seen in the parallel development between the process of domestic reform and the process of economic integration of Vietnam.

It is clear that the political system is itself in a period of crisis. A major power battle exists between the President, the Prime Minister and the General Secretary of the Party. Sections of the elite interest group are chiefly behind high ranking politicians.

SOE reform, development of the infrastructure and tackling the problems of debt, inflation and economic decline are chiefly secondary to the internal battle for political power. Even more concerning is that the true nature of the State is now seen as one of “the ethos of a rent-seeking state” creating barriers and “extract rents from society” (Vuving, 2013, p.325). As Vuving (2013, p.325) declares “Rent-seeking finds fertile ground in Vietnam, where the state owns all the land, controls the press, and is accountable to none but itself”. Vuving (2013) openly lays the blames Vietnam leaders, who he calls ‘the leading rent-seekers’ heading an interest group of elite politicians with large-scale business interests and growing wealth. Vuving (2013, p.326) reflects the thesis findings as he warns of a growing likelihood of a “severe political, economic and national security crisis”. The connection between the corruption of the banking sector, the Party and the SOEs is clearly pointed to as “the lion’s share of the bad debts”, and is a result of “corruption in the state-owned conglomerates, which received preferential treatment because of ideological bias and personal ties” (Vuving, 2013, p.328). An example is the hostile takeover of Sacombank (Vietnam’s largest private bank) by investors with vast business connections and even greater political power, who were able to perform what has officially been declared, “was not just hostile; it bordered on the criminal” (Vuving, 2013, p.329). This pattern of cross-shareholding, debts and corruption is discussed further in the case study on banking. Investigations revealed that the group behind the takeover was relatives of high-ranking political figures together with “ACB Bank owner Nguyen Duc Kien and millionaire businessman Tram Be, backed by an elite interest group who were attempting to control the entire financial-economic system of the country” (Vuving, 2013, p.330). Both President Sang and Secretary Trong have warned that corruption is a ‘powerful trend’ threatening the ‘demise of the party’ (Vuving, 2013, p.336). This thesis provides supporting evidence of the depth of corruption and rent-seeking within the Vietnam economy and illustrates how this has subverted much of the positive impacts of WTO accession and membership and created a system of non-compliance with both the word and the spirit of the commitments involved in entry to the WTO.

In understanding the relationship between the commitments made by Vietnam and the WTO the important factor is to realise that the majority of Vietnamese official participants had a very simplistic understanding of the Agreements and its consequences. At present, recent interviews by the thesis author with active participants

in the forthcoming Tran-Pacific Partnership Agreement showed that there remains a problem with the capacity of Vietnam negotiators to fully understand the sophisticated and high level factors involved in an international agreement. The level of influence of this a decade ago was far higher and more influential. The WTO accession process was undertaken in an atmosphere of confusion and lack of knowledge that all interviewees for this thesis all reflected on (Chi Lan, interview, 2012; McGough, interview, 2012; Thanh, interview, 2012, Thai, interview, 2012). Commitments were often made on the basis of hoping to later realise what they actually meant and knowledge of the consequences was often superficial at best. Few negotiators were actually of a capacity necessary for such a high level and complicated negotiation process, while this was further aggravated by some officials believing that commitments made internationally could soon be 'got around' domestically. Interviewees made numerous requests for 'off the record' comments and these usually focused on the internal lacks of capacities and understandings of elements in the Vietnam WTO negotiating team and the main decision-makers. Even more sensitive conversations were on comments that related to the very real influence of decision-makers who were clearly aware that some commitments would have to be 'altered' in actual domestic application. This was reflected in the growing strategy in the domestic regulatory environment for 'making laws' but not enforcing them. The WTO was to be no different, and the combination of not understanding and actually believing that accession commitments 'application' would be easily the same process of regulation without enforcement provided a leeway for 'signing up' in an atmosphere of back room confusion, lack of knowledge and a firm belief of many that 'commitments' was a fluid and non-binding concept.

This overview of the political system and WTO accession of Vietnam helps set a background for the analysis of the impacts of WTO accession on the domestic economic reform of Vietnam in the next chapter.

## **CHAPTER 4      IMPACT OF THE WTO ACCESSION PROCESS ON VIETNAM'S ECONOMIC REFORM PROCESS**

Twenty years of economic reform have brought remarkable changes to the Vietnamese economy and socio-economic life in Vietnam. Reforms have gradually transformed it into a dynamic market economy with high levels of international economic integration. The CPV is leading the economic reforms but fears the loss of their monopoly on political power. The reform process is similar to China's, where economic reform has not meant political reform. Vietnam has pursued 'economic reforms with a socialist orientation' and sought to establish an economic model with market economy principles but, retain the role of the Communist Party and the State sector.

Reform has been cautious and gradual. Reform helped economic development but also created unhealthy competition and social problems, with corruption severely harming economic growth and the business environment. Despite economic growth, the sustainability of this development is threatened by the rampant corruption and the lack of long-term thinking and planning. This chapter will look at the evidence of this and provide a clear indication of the need for alternative policies, before the collapse of all the benefits of the WTO process of entry and membership, and the possible return of Vietnam to poverty and economic disaster.

Reforms were undertaken in parallel with the accelerated efforts for WTO accession. WTO accession and Vietnam reforms provided economic opportunities through international market access, helped in adopting international rules and standards on trade and investment and improved FDI. Accession was essential to the growth of the Vietnam economy, boosting economic growth and accelerating reforms using WTO rules and regulations to resist conservative opposition to reforms (Painter, 2003).

The basis was the movement from a controlled economy to a free market model while retaining a communist political system and one Party rule, but was beset by problems and barriers to reform created by conservative elements and those such as



SOE managers who feared that change would bring only negative results for their own situation. The basic fear was that economic liberalism would eventually mean the end of the communist rule and ideology in Vietnam, while many supporters of this resistance to political change found significant support from various interest groups facing new demands in an inevitably far more competitive economy under a free market system. The WTO provided the means to accelerate and re-enforce change, while also presenting a central focal point upon which both conservatives and reformers could contest the battle for control of the economy and the ideology under which it would be managed.

Reformers were not driven by any desire for ending communist rule, as both conservatives and reformers generally believed that a free market economy in a one-Party communist system was both feasible and necessary. Many reformers were committed to a strengthening of Communist rule through economic prosperity brought about by closer inclusion into the global economy and adoption of economic liberalisation, and were convinced that the two different political and economic ideologies would become interdependent and complementary, with the Communist Party rule growing more secure under the clear benefits of increased trade, profits and opportunities brought about by economic transition.

The chapter describes the reasons for ending the centrally planned economy, focuses on the reforms implemented by the Party and examines how the WTO accession provided incentives and tools for reformers to conduct further reforms.

#### **4.1 Pre-reform period (before 1986)**

In the 1940s, Vietnam was a poor, agriculturally based and under-developed economy, built for exploitation rather than development by the French after a century of colonisation (Le and Liu, 2006). After defeating the French, the country was divided into two parts, the North and the South. In the North, the Soviet-style centrally planned economy was adopted since the 1950s, with the State having the supreme role in the economy, strictly controlling output targets, allocating resources to production units, and taking care of the distribution of products to consumers and other production units

(Fforde and Vylder, 1996; Le and Liu, 2006). In the South, the economy was built on the market economy model but dependent on massive US aid (Le and Liu, 2006).

From 1975, the command economy was extended over the entire country (Riedel and Turley, 1999; Pike, 1977). It soon suffered with increasingly serious sectoral and investment imbalances due to its inefficient resources allocation planning. Beresford (1989, p.185) suggested that “resources were chiefly allocated to SOEs with heavy industrial capacity, long lead times and little practical use for the society”. New SOEs saw low productivity combined with shortages of inputs. As a result, the industrial sector never met the arbitrary government targets (Beresford, 1989; Phong, 2009). Farmers were grouped in collectives with specific targets and resource allocations and the workers were paid for their labour regardless of their productivity. Rationing and the distribution mechanism led to a ‘shared poverty’ problem, with a failure to create adequate incentives for individuals to increase productivity (Beresford, 1997; Phong, 2009). Production SOEs and collectives stagnated through a lack of incentives and efficiency. This led to the chronic disequilibrium between supply and demand (Phong, 2009).

By the end of 1970s, Vietnam was facing a ‘major economic crisis’ with acute shortages of both foods and basic consumer goods for consumption and inputs to productions (Le and Liu, 2006).<sup>46</sup> The government imported hundreds of thousands of tons of foods to meet the domestic demand (Le and Liu, 2006). The economy was entirely dependent on foreign aid and built up large foreign debts as the foreign grant loan averaged 63.2% of the non-military state budget. All demand depended on the government supply mechanisms (Phong, 2009; McWilliams, 1983).

Hardship induced the local governments to secretly undertake spontaneous production activities outside the central government plans (Arkadie and Mallon, 2003). Local governments made contracts with farmer’s households for rice production, in

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<sup>46</sup> Annual economic growth of Vietnam averaged only 0.4% in late 1970s, while population increased by about 2.3% annually (Phong, 2009). Agricultural production showed low growth rates (0.6%) due to the bias in investment to heavy industries. The Yearly agricultural output was below subsistence levels.

which they were provided certain inputs for the production process in exchange for fixed levels of output. The excess output was free for farmers to use at their own discretion (Le and Liu, 2006). These contracts were prohibited under the central government. However, the practices expanded rapidly over the country due to its ability to produce some extra food for households (Le and Liu, 2006).

Economic shortages convinced the CPV to issue Directive 100, approving experiments in the contract mechanism in some regions (Phong, 2009). Although not publicly announced, many local governments immediately applied it (Phong, 2009; Le and Liu, 2006). Each farmer was required to provide the State a quota of grain in the form of rent, but any grain produced on the land beyond the established quota could be consumed or sold on the free market (Duiker, 1995). This concept was also then applied to the industrial sectors in urban areas (Phong, 2009; Le and Liu, 2006). The 'Three-Plan System' confirmed that enterprises could perform additional activities after completing planned targets. The priority of SOEs was State planned targets. Second was the production and free disposal of the SOEs main products after completing the First Plan. The 'Third Plan' was the production of products that resulted from the factory's own attempts at diversification (Fforde and Vylder, 1996; Le and Liu, 2006). The command economy gradually decentralised to cope with its own shortage of production and became known as 'reform from below' (Fforde and Vylder, 1996; Webster and Taussig, 1999; Arkadie and Mallon, 2003; Phong, 2009).

Increasing problems in the centrally planned mechanism diverted even more scarce resources out of the main economy production units, the SOEs. Increased input prices due to the differences between official and free-market prices were further putting inefficient SOEs operation into more difficult situations (Phong, 2009). The government had to finance them more heavily and imported more inputs for production, but had no other choice than printing more money and inflation increased (Ninh, 2003). Conservatives called for tough actions on the economic relaxation (Beresford, 1997). From 1985, the Government attempted to restore stability by increasing wages, adjusting official prices and introduced a new *dong*. These measures were to retain operation of the central command economy, but only worsened the situation, causing hyper-inflation and economic decline (Fforde and Vylder, 1996; Le, 1996; Phong, 2009).

The leaders had no intention of turning away from a socialist path and feared that the growth of the private sector threatened the socialist system (Chanda, 1984; Duiker, 1986). A struggle continued between economic reform and ideological purity. This led to several campaigns against illegal economic activities and corrupt cadre (Chanda, 1984). Policy reform continued to only progress slowly and sufficient only for food self-sufficiency (Phong, 2009; Duiker, 1986). Reforms were blamed for the negative economic situation and were criticised for deviation from socialism (Phong, 2009). The fear was it was a ‘Trojan Horse’ to sabotage and defeat socialism in Vietnam.

Mounting economic problems with hyperinflation, low levels of development, and large budget deficits and foreign debts were the prominent features of the economic situation in the first half of the 1980s.<sup>47</sup> The economic difficulties led to a range of social maladies, which created a sense of pessimism and cynicism about the Party and the Government (Duiker, 1986). The centrally command economy was failing and negative economic planning caused the spread of fence breaking activities in the Provinces (Phong, 2009). There was little choice but to turn to new ways to avoid the collapse of the economy.

#### **4.2 Economic reform process in Vietnam since 1986 to 2006**

The failure of the partial reforms to save the collapsing central economy left bold imprints on the CPV leadership and shaped their experience and awareness of the potential of the market economy and the limitations of the central economy. Chi Lan (interview, 2012) said “economic crisis threatened the collapse of the system, and the CPV had little choice in making decisions on economic policy development, pushing ahead a more comprehensive economic reform. They abandoned the command

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<sup>47</sup> The annual rate of inflation reached 500% in 1985. The GDP was at very low rate and the value of exports was considerably less than half the total value of imports, which led to the huge budget deficit. The total foreign debts were already equivalent to the annual GDP (Mallon, 1999).

economy system after many attempts to save it". The reform process accelerated, but was now portrayed as a delicate compromise between hardliners and pragmatic elements within the Party leadership (Duiker, 1986). Beresford (1997) argued that Vietnamese leaders have behaved much like politicians elsewhere and that their power is contingent upon building coalitions of interest which provide support for particular sets of policies. Reforms were in a stop and start manner.

A broad thrust of the economic reform was officially adopted by the 6<sup>th</sup> Party Congress in December 1986. The CPV agreed to abolish the system of bureaucratic centralised management based on State subsidies and moved to a market oriented economy (Le and Liu, 2006). Like the Chinese approach, the CPV had undertaken the economic reforms while averting from political reforms. The Party were still holding the sole power to run the country while leading the economic reform process. The Doi Moi policy was predicated on the change of the thoughts on the way and route to the socialism, which accepted a transition period for building market forces and a market economy to accelerate industrialisation and modernisation (Le and Lui, 2006). As a result, a controlled market economy, later called a market economy with socialist orientation, was promoted by the Party. "It is an economy with various ownership types and multi economic sectors, in which the state economic sector plays a leading role. The state sector together with the cooperative sector set the firm foundation for the national economy" (CPV, 2006, p.26). Reforms have taken place in a gradual mode, and concentrated on social and political stability. Although, reforms first started in 1986, they were still considered by many international economists as shock therapy, as the reform programs were quickly applied to transform the central command economy to the market economy. The economic reform process has focused on major issues as follows (Le and Liu, 2006):

- Reforms on multi ownership types and economic sectors
- Reforms on market economy institution and management
- Openness and international integration
- Industrialisation and Modernisation
- Rural reforms
- SOEs reforms

The reforms process from 1986 was divided into 2 major stages. The first stage of reform was generally from 1986 to 2002, when Vietnam gradually achieved macro-economic stabilisation and set up the basic foundations for the market economy. The second stage of reform started since 2002, when Vietnam actively participated in international economic agreements to assist its structural reforms.

#### **4.2.1 First stage of reform (1986-1995)**

In the 6<sup>th</sup> Party Congress (1986) the CPV agreed to abolish the system of bureaucratic centralised management based on State subsidies and moved to a market oriented economy, with the Party focused on reducing macroeconomic instability and accelerating economic growth (Le and Liu, 2006; Chi Lan, interview, 2012).

The reasons for decisive reforms were the pressure of the economic crisis and changes in the external environment. Economic crisis, with low growth, low productivity, and huge budget deficits, exhausted the economy, and failed to provide enough consumption goods and foods. The Vietnamese economy was totally dependent on foreign aid from the Soviet Union (Phong, 2009; Le and Liu, 2006).<sup>48</sup> Thai (interview, 2012) said “the changing international environment critically impacted on Vietnamese leaders in this difficult time”.

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<sup>48</sup> Soviet’s aid not only provided the full military support for Vietnam’s operations in Cambodia, but was also the largest donor of economic aid and biggest trading partners. In 1979, the figure for military aid was almost US\$1.4 billion and increased to US\$1.7 billion annually in the 1982-1985 period (Cima, 1987). Soviet non-military economic aid in 1978, estimated at between US\$0.7 and US\$1.0 billion, was already higher than Western assistance. By 1982 it had increased to more than 1 billion annually, close to US\$3 million per day (Cima, 1987). During the 1981-85, the Soviets provided some US\$5.4 billion in balance-of-payments aid, project assistance, and oil price subsidies (Cima, 1989). By 1983 they were supplying 90 percent of Vietnam's petroleum, iron and steel, fertilizer, and cotton imports and 70 percent of its grain imports. The Soviets was also the major supplier of food and commodity aid on a mostly grant-aid or soft currency basis (Cima, 1989). Total economic aid for 1986 was an estimated US\$1.8 billion. Since 1982, the foreign grant loan averaged more than 63.2% of the non-military state budget of Vietnam’s government (McWilliam, 1983).

Phong (2009) suggests an important factor was the changes to Communist ideology and the political balance toward reforms. Before the 6<sup>th</sup> Congress, the General Secretary Le Duan died, and had been most influential leader of the Party (since 1953) and the main architect of the collective economic model for the North before 1975 (Phong, 2009). His ideological arguments for building socialism in Vietnam was imprinted on every economic vision and policy of the Vietnam economy from 1960 to 1986, and resistance to economic reform and the market concept was at its height (Phong, 2009). Chi Lan (interview, 2012) noted “the market economy concept raised increasing attention and debate in the meetings of the CPV since 1984 and gained supported from many local leaders and the SOEs from the South”. Le Duan’s death opened the way to technocrats and economic specialists to challenge orthodox ideologues (Esterline, 1988).

Truong Chinh, (The President) was appointed to be the transitional General Secretary. Chinh was considered a conservative (Phong, 2009). He voiced doubts about the command economy and problems at the central level and appointed personnel and an agenda for discussion on the market economy (Phong, 2009). He replaced the previous think-tank for analysing the economic situation and travelled widely to regions to find out the truth of the socio-economic situation in Vietnam. His prestige and respect as the General Secretary encouraged progressive CPV members to speak up and discuss the real situation. New ideas to overcome the old-fashioned and obsolete ways found Chinh as their advocate (Phong, 2009).

The Congress declared policies based on principles of the market economy, such as recognition of the multi-sector economy and the appropriate use of money-goods relationships, The Party declared “look at the truth, respect the truth and speak the truth, on the path to the socialism” (Phong, 2009). Many Party members still had concerns about these new ideas and saw them as dramatic deviations from the old ideology. However, Truong Chinh was able to protect and explain the ideas in the Politburo and the Central Committee (Phong, 2009).

The Congress adopted the policy for economic development of Vietnam and the direction and target for socio-economic development prepared by Truong Chinh was adopted unanimously (Phong, 2009). Reports focused on three major issues:

1. Accelerate agricultural production, putting a high priority on consumer goods production;
2. Recognise the multi-sector economy; and
3. Increase exports and open up foreign policies (Phong, 2009).

There were substantial changes in the structures of the Party Membership and it reverted to a younger generation, with less experience of revolutionary activity and less investment in the ideology (Beresford, 1997). The revolutionary generation, such as Truong Chinh, Pham Van Dong, and Le Duc Tho, all retired from their offices, but still played important roles as mentors (Esterline, 1988). But the leadership selection process still showed a struggle between the pragmatist and the conservatives (Phong, 2009; Cima, 1989; Esterline, 1988).

The National Election and the Assembly Congress were both organised late and indicated that there was a struggle between the pragmatists and the conservatives for the positions in the Party and the Government (Esterliner, 1988). This was further supported by the Foreign Minister Thach's remark that much debate occurred prior to the convening of these two events due to the 'different opinions' (Esterliner, 1988). A reformer, Nguyen Van Linh was appointed to head the CPV. The previous leaderships, with strong views of socialism and the central command economy, still retained their positions and played roles in smoothening the period of transition. These included Pham Hung as Chairman of Council of Ministers (Prime Minister) at the age of 75 and Vo Chi Cong as President of the State Council at age 74. Although part of the 'old guard' pragmatism prevailed and they supported the movement towards a free market economy. Most were reformers and the younger generation, including the chief economic planner, Vo Van Kiet and the Foreign Minister, Nguyen Co Thach (Esterliner, 1988).



The reform programme was launched with concrete policies in 1986. General Secretary, Nguyen Van Linh, introduced market pricing and abolition of the command economy. He initiated and supported open debates on development paths and solutions, a move that demonstrated a firm break with the traditional CPV methods (Phong, 2009). The first reform was the liberalisation of the ownership in economy practices. Decree 27-HDBT, on the private sector, and Decree 29-HDBT on the household sector in 1988, were issued to restore the concept of private ownership in the economy (Phong, 2009). Following the recognition of the private sector, the CPV also issued a resolution on measures to reform the circulation of goods and their distribution. The dual track price and circulation blockages were abolished completely. Subsidies in the price system were abolished and new administrative measures in economic management introduced (Phong, 2009; Masina, 2006; Le and Liu, 2006).

The government implemented a series of price reform measures, which were considered as a strong 'orthodox' to end the central command economy (Phong, 2009). The rationing system was abolished for almost all commodities, which raised the official prices of non-essential goods to a level close to free market prices. Consumer goods sold at state outlets were sold at prices very close to the free market level and were frequently adjusted to keep pace with free market prices (Arkadie and Mallon, 2003; Phong, 2009; Esterline, 1988). Price reforms ended the dual-track economy (Phong, 2009). By 1990, commodity prices were largely market determined and direct subsidies in pricing of commodities had been eliminated (Le and Liu, 2006).

Parallel with the price reform, the government paid attention to macroeconomic stability by strict control of the budget and tax reform (Arkadie and Mallon, 2003; Le and Liu, 2006). Strict fiscal policies involved expenditure cuts, while direct subsidies to the SOEs and the government's expenditure in defence and food subsidy programs were reduced (Arkadie and Mallon, 2003; Masina, 2006). The fiscal base was strengthened by tax and fiscal institutional reform. By late 1980s, the National Tax Collection Office and the National Treasury system were established (Arkadie and Mallon, 2003). The Tax base was broadened and included the introduction of new profit and turnover taxes and income tax.

The banking system was reformed to support the tight monetary policy and to build a healthy market economy (Arkadie and Mallon, 2003). Under central planning, resources were allocated directly through the plan, so the bank role was minimised to being a component of the state accounting system. The banking system was reformed to create a two-tier banking system with a clear division between the central bank and commercial banks (Arkadie and Mallon, 2003; Le and Liu, 2006).

The price reforms and tight monetary policies consequently affected those segments ill adapted to respond to the new system, especially the SOEs (Arkadie and Mallon, 2003). In 1987, the Government introduced Decision 217-HDBT, setting SOEs free to manage their own business (Phong, 2009). Enterprises gained the freedom to recruit workers and to acquire and dispose of resources that were outside the constraints imposed by the Government Plan (Fforde and Vylder, 1996). SOEs had only two Government targets, volume and budget contributions. Later, commercial banks started to lend money to SOEs on a market basis, thereby reducing state subsidies to SOEs. High interest rates placed strong financial pressure on the SOEs, which forced them to liquidate their inventories and reform (Masina, 2006; Phong, 2009). From 1990 to 1994, many SOEs pursued rapid liquidation and sought to merge, especially non-viable enterprises.<sup>49</sup>

There was the creation of new market institutions, including the legal framework for business that defined the accepted forms of ownership and business organisation (Le and Liu, 2006; Arkadie and Mallon, 2003). Several regulations on ownership and business organisation were ratified in 1998, and recognised the freedom of citizens to engage in private economic activities. Together with the recognition of the private sector, the legal system for administration was also developed, and led to the introduction of a range of new important laws for the market economy.

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<sup>49</sup> The number of SOEs reduced from 12,000 in 1988 to 6,000 in 1992 (IMF, 1995). The total employment in State enterprises fell from 2.7 million in 1988 to 1.7 million in 1993 (Schwarz, 1995). Net transfers from SOEs to the budget increased from zero in 1988 to 12 per cent of GDP in 1994; net credit flows from Commercial Banks to SOEs fell from 9 per cent of GDP in 1998 to about 2 per cent in 1993-1994 (IMF, 1995; 1998).

The first reform was in the adjustment of the exchange rate towards the market price. The exchange rate for imports was kept at a very low rate compared to the market rate, in order to provide low price machines and inputs for domestic production processes (Phong, 2009). The Government subsidised the exchange rate with one billion USD and the Vietnam Dong was gradually devalued to match its real market price. The trade policy instruments such as tariffs, quotas, and licenses were introduced (Auffret, 2003). The Law on Import and Export Duties (1988) introduced the present trade tax system based on the Harmonised System of tariff nomenclature. Along with tariff reform, the government gradually removed the quotas and administrative barriers, which were left by the central planning system (Auffret, 2003; Athukorala, 2005). Custom reform commenced with the Ordinance on Customs (1998) and aimed at reduction of the number of required supporting documents for custom clearance. Procedural simplification reduced customs clearance times (Le and Liu, 2006). Reform in this area started with increasing trading entities outside the state's system. Private companies newly established under the New Privates Enterprises Law and Law on Companies in 1990 were allowed to engage in export-import activities. These companies basically broke the monopolies of SOEs in international trade (Athukorala, 2005; Thai, 2005; Riedel and Comer, 1997).<sup>50</sup>

Foreign investment was encouraged with the enactment of the Foreign Investment Law (1987). Investment laws were very liberal compared with South East Asia standards (Arkadie and Mallon, 2003). It allowed foreign ownership, tax holidays, and concessions to invest in priority areas. It was subsequently amended in 1990 and 1992 to adapt better to the development of the issues, and went further than most other developing countries (Le and Liu, 2006).

The first years of reform were challenging for the reformers because of the negative response of the economy to the 'shock' therapy of the reforms (Phong, 2009; Masina, 2006). Price escalation across the board and competition due to the

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<sup>50</sup>The number of enterprise allowed to engage in direct foreign trade increased from around 300 in 1991 to nearly 500 in 1992, including six private firms (Hiebert, 1992).

marketisation process not only put 60% of SOEs onto the edge of bankruptcy, 500,000 into unemployment, and piles of unsold inventory, but also the life of ordinary people became difficult. As a result, the pressure and criticism to roll back reforms heightened (Phong, 2009). However, the economic crisis still left the Vietnamese leaders with little choice but reform (Chi Lan, interview, 2012; Pike, 1992). The international environment also pointed to a need to accelerate the economic reform. The collapse of Eastern European Communist countries in 1989, and later the Soviet Union, strengthened the determination of the leadership to reform (Phong, 2009).

Since 1990, hyper-inflation was reduced to single digits and macroeconomic stabilisation was achieved together with the fast economic growth (Arkadie and Mallon, 2003). From 1987-1996, the GDP growth was an average 7.3%, increasing to over 9% in 1995 and 1996 (Masina, 2006). The macroeconomic stabilisation and growth gradually brought the Vietnam economy into the world economy.<sup>51</sup> Openness to trade was accompanied by openness to foreign investment. FDI became an important stimulus to growth, accounting for up to 28% of the total investment expenditure in the country in 1996 (Masina, 2006). By 1994, the first stage of economic reform was over and successfully achieved the goals of macroeconomic stabilisation and high economic growth. The reforms were not without pain and the negative consequences, such as higher unemployment, which strengthened the conservative's resistance to change and brought about a period of relative stagnation.

#### **4.2.2 Slow reform (1996-2001)**

From 1996 to 2000 the Vietnamese economy slowed down with a lower GDP growth rate, deflation, and a sharp reduction in domestic and foreign investments (Pham, 1999). The economic slowdown was due to the regional financial crisis that hit most of the economies in Southeast Asia and to the standstill in further economic reform and the inward-oriented development strategy since 1995 (Athukorala, 2005;

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<sup>51</sup> Exports growth went on an explosive path of 23% in 6 years to 1994, far more rapidly than GDP, and as a result the proportion of total output exported has increased dramatically from 46% of GDP in 1989 to 97% in 1996 (Masina, 2006).

Masina, 2006; Kokko, 1998). Economists and investors called attention to several problems in the economic policies of Vietnam, and focused on the import-substitution policies and the Government reliance on the SOEs as the main vehicle for realising reform and economic development, as well as a lack of business transparency and stability in the economic management institutions (Masina, 2006). Vietnam targeted the development of capital-intensive industries and using trade and investment policies and SOEs to promote these industries with the aim of rapid industrialisation (Martin, 2001).

**Table 4.1: Nominal rate and effective rate of protection in 1997 and 2001.**

	<i>1997</i>		<i>2001</i>	
	<b>Nominal Rate of Protection</b>	<b>Effective Rate of Protection</b>	<b>Nominal Rate of Protection</b>	<b>Effective Rate of Protection</b>
<b>Vietnam</b>				
<b>Agriculture</b>	8.12	7.74	6.28	7.43
<b>Mining</b>	9.42	6.05	8.91	16.39
<b>Manufacturing</b>	30.63	121.47	25.28	95.97
<b>Total traded-goods</b>	20.95	72.22	17.92	58.46
<b>Overall Simple Average</b>	<b>23.32</b>	<b>59.54</b>	<b>20.14</b>	<b>54.1</b>

Source: Athukorala (2005)

Foreign observers sensed that the reform process was losing momentum and direction was becoming uncertain; a common phenomenon in the reform process of many countries after a crisis ends (Krueger, 1993; Bates and Kruger, 1993; Haggard and Webb 1994). Chi Lan (interview, 2012) said “serious economic crisis pressed the leaders into converging the will and sharing the common need for an alternative way or solution to overcome the difficulties”. As a result, when the economy overcame the difficulties, the motivation for further reforms declined. Chi Lan (interview, 2012) noted “the motivation for the reform was started from the pragmatic thinking of finding a

solution for the crisis rather than from absolute change in their economic and political ideology”. Thai (interview, 2012) commented on this period with “high growth rates and large flows of FDI and ODA deflated the sense of urgency for implementing sensitive reform measures”. The Vietnamese economy showed rapid economic progress growth since 1992.<sup>52</sup>

‘Shock therapy’ for the economic reform also created losers, who then collectively organised to pressurise the government into slower reforms. Since 1992, the Government restructured SOEs by allowing more autonomy and cutting subsidies. SOEs faced new challenging operating conditions, where they were now responsible for capital management and outputs and faced increasing competition from the private sector (Tuan, 2006). A legal framework for protecting private investment was established and the private sector expanded from a mere 414 firms in 1991 to 39,180 in 1998 (Tai, 2006). The open policy provided a better environment for the flow of imported goods into the market (Le and Liu, 2006). This placed further competitive forces upon the old-fashioned and inefficient SOEs. The market was flooded with cheap and smuggled goods from across the Chinese border following normalisation of the relationship between China and Vietnam in 1991. All these pressures became too much for inefficient and obsolete SOEs, and resistance against reform declined.

Opposition also came from the newly unemployed as SOEs were restructured and employment in them was significantly downsized in the early 1990s (Le and Liu, 2006; Mekong Economics, 2002). Nearly one million workers were laid off from 1988 to 1994 (Riedel and Turley, 1999; Mekong Economics, 2002). Reforms led to rapid industrialisation of agriculture and lands were easily confiscated to convert into industrial sites, without any master plan and adequate compensation. Farmers lost their main possession, land, and left rural areas to find work in the cities, putting even greater pressure on jobs and social stability (Son, 2008).

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<sup>52</sup> GDP grew by an average of 8.2% since 1991, and reached 9.5% in 1995 (Womack, 1996). Total cumulative total of approved licenses for foreign investment rose to 16 billion USD in July 1995, while Aid increased steadily since 1993 with an average of 2 billion USD every year (Womack, 1996). Inflation was kept under 10% since 1993 after years of hyper-inflation (Bui, 2008, Womack, 1996).

The reforms also increased the tensions between the central and local government. Most of the SOEs liquidated and privatised were in the provinces. The central government further centralised the economic resources allocation process, and thus, limited the power of the provincial governments. Uneven distribution of the resources and development aid remained a problem. The new ‘losers’ in the reform process were populous provinces facing unfair distribution of resources and their protests caused the Party to question its own ability to remain in control (Womack, 1996).

The newly established multi-sector economy was expanding rapidly with more complicated economic relations, which also exposed some negatives aspects of the market economy. Due to the inadequate legal and economic institutions, the Government feared losing control of Vietnam’s economic and political development. Weak and inadequate development of institutions was opening the door to rampant levels of corruption (Sidel, 1998; Arkadie and Mallon, 2003). In the face of unbridled corruption, social unrest peaked with mass protests (Sidel, 1999; Masina, 2006).

The bureaucratic and authoritarian way of thinking, as well as the continued belief in the communist ideology was still deeply imprinted into the minds of government officials and the leaders. The development of a private sector and SOEs privatisation was still of extreme concern to many conservatives, and perceived as a direct threat to communism (Phong 2009, Le and Liu, 2006; Masina, 2006; Pike, 1992). The concerns of the conservatives were aggravated by the negative attitudes towards the free market economy resulting from the catastrophic impact of the Asian financial crisis. Thai (interview, 2012) revealed that “the Party was really concerned by failures of these countries [Other Asian countries affected by the Crisis] and influenced that this model could lead to the wrong direction and the collapse of the economy”. Conservatives were worried about the deviation from socialism and the growing instability of the society and the economy. These negative effects of the market economy reforms provided the ideal environment for strengthening the voice of the conservatives. They were particularly concerned for the maintenance of the leading role of the CPV (Masina, 2006). The CPV and the Government reformers were forced to

cede power to the conservatives and the scope and pace of reform suffered. Policies were introduced that demonstrated this negative approach to reform.

The trade regime still accommodated many distorted incentives provided by the complex, non-transparent, and high restrictive practices. Government employed many instruments to impede imports, including formal tariffs, the use of reference prices in customs administration, excise taxes and surcharges levied only on imports, formal quotas, other quantitative restrictions, import licenses, and foreign exchange controls, which greatly reduced the transparency of the regime (Kokko, 1997).

Apart from the biased tariffs against the export sector, a full set of NTBs could be found in Vietnam: specialised licensing for certain goods, certain customs surcharges, special sales taxes, minimum pricing at customs, anti-dumping and counter-veiling duties, foreign exchange allocation restrictions, export bans and controls and tax stamps of cleared goods. These restrictions cover around 40 per cent of imports, but, if the effect of other less transparent NTBs were considered, the overall impact would be much higher (CIE, 1999). The quotas were introduced in 1994, and played an important role in the trade barriers of the Vietnam's trade policy (Thanh, 2005). Formal licensing procedures, administrative rigidities and delays in the Customs administration also played important non-tariff barriers. Delayed and strict requirements on clearing Custom procedures often increased costs and time, which clearly discouraged the international trade activities.

A number of key problems and constraints in SOE reform remained. Most SOEs were operating inefficiently and with weak and poor performances due to obsolete technology, weak incentive structures and poor management practices. Many were forced to borrow capital, creating a significant financial burden. Most of this capital was provided under the preferential scheme through SOE Bank or financial services.<sup>53</sup> SOEs and its foreign joint venture partners were not the economically important, but closely connected with various levels of political decision-making. Empowered by their

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<sup>53</sup> The IMF (2002) estimated that 45% of total credit in 2000, which was down from 54% in 1996, was still channelled to SOEs under State Owned Banks schemes.



economic and social importance, they were in a position to use their political influence to oppose trade liberalisation and other reforms that would reduce their privileges. In addition, they could influence future policy decisions through their own investment behaviour. There was limited progress in the liquidation of non-viable SOEs, due to a cumbersome legal framework and procedures for liquidation that made it difficult to enforce creditor rights and for the authorities to declare bankruptcies. The pace of equitisation was slowly constrained by factors including: a cumbersome administrative process; non-suitability of some SOEs to equitisation given that they were not commercially viable enterprises; too small sizes of some SOEs to operate under a joint stock management structure; difficulties in the valuation process and resolution of enterprise debts and resistance of vested interests, including controlling agencies, SOE managers, and the SOE workers who feared loss of control, revenues, and jobs.<sup>54</sup> Poor accounting and auditing standards made the scrutiny of many enterprises' financial performance difficult, further discouraging potential investors (Arkadie and Mallon, 2003; IMF, 2005).

In 1998 the Government issued a new decree further instructing the process and requirements, which helped to accelerate the process (Arkadie and Mallon, 2003). The fundamental factor in the limited scope and slow pace of SOE reforms related to the continued commitments of government to the role of the state in the economy, and their consistent aim of maintaining a significant role for SOEs (Arkadie and Mallon, 2003; IMF, 2005).

The financial sector was largely dominated by the SOEs Commercial Banks (SOCBs). The four biggest SOCBs accounted for 82% of total bank assets and 80% of loans and deposits (IMF, 1999). The Central Bank made public estimations in which non-performing loans (NPLs) were 14.5% in 2000 of the total lending, while other state publications reported an estimate that it could be as high as 28% (WB, 2000; Masina, 2006). This high level of NPLs was the result of political interference, as the Government continued commitments to support the SOEs and the four large SOCBs were forced to comply (Masina, 2006). The loans often lacked sufficient collateral or

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<sup>54</sup> A more politically correct expression for privatisation, with equities sold to employees and employers.

credible evidence that the debtor could service the loan. This problem with the lending to SOEs, together with the lack of investment evaluation tools, caused banks to have little room for lending to the private sector and the collateral requirements were extremely restrictive. SOEs were assured that the Government would not default on its obligation, and felt immune from the forces of the economy, particularly in long term investment and planning, financing human resource training or any other area of development that required capitalisation in the short-term. These loans were little more than back door subsidies to inefficient and unproductive SOEs, while denying that investment to the growing and mostly productive private sector companies (Hakkala et al, 2001).

The development of the private sector was disappointing and stunted by the complex regulatory environment and the competition from SOEs benefiting from political contacts and privileged access to capital, land and other resources. The GDP share of the domestic private sector, excluding farmers and informal household enterprises, reached only 7.5% in 1995, while the modern private sector consisting of limited liability companies and shareholding companies, accounted for at most 1% of GDP (Webster, 1999. Hakkala et al, 2001).

Public administration reforms were needed in order to manage reforms in other sectors. Vietnam undertook a number of changes of its legal system and legislation but, the institutional reforms undertaken were still far from sufficient. The business environment suffered from excessive regulation, red tape, widespread corruption and non-transparency. A number of problems were obstacles to building the concept of rule of law in the Vietnam economy. A lack of clear boundaries between the substantive areas of different government agencies as well as legislative or quasi-legislative powers of local executives and jurisdictional bodies, allowed different agencies to make regulations pertaining to the same substantive areas. This resulted in overlaps and inconsistencies, non-uniform application of legal provisions, and fragmentation of administrative powers (Rose, 1998;Dinh, 2000; Hoang et al, 2000). Excessive regulations and cumbersome administrative procedures lead to opportunities for abuse of power and corruption of state officials. Faulty and opaque implementation of legislation and inefficient supervision and investigation of violations of law negatively

affected the respect for individuals' lawful rights and their effective exercise of rights to complain and obtain judicial reviews.

The lack of an efficient and well supported legal framework meant that many government officials were finding the lucrative offer of 'back-hander's' and corrupt payments to by-pass the system more attractive than enforcing the law. The legal system itself moved to being a facilitator of the corruption, with the business systems efficiency often relying on the corruption to provide an efficient way to carry out business.

#### **4.2.3 Accelerated reforms under the WTO accession process (2002-2006)**

After years of reforms, the negative sides of the market economy, such as income distribution discrepancy, corruption and negative impacts upon private domestic industry led to fears that CPV's socialist leadership and ideology was under attack (Sidel, 1999, Hung, 2000). The external political situation supplied even more problems, with the collapse of the communist countries in Eastern Europe still fresh in peoples minds and creating insecurity in the CPV and the fear that the free market was nothing more than the first 'seeds' of a coup d'état (Sidel, 1999; Thayer, 2002). Chi Lan and Thai (interviews, 2012) revealed that "the pessimism and anxiousness of the leaders resulted from the lessons of Southeast Asia and East Asia countries wrestling with the Asian Financial Crisis. All these countries once served as models for Vietnam, but were now victims of their own market economy reforms". This reality was utilised by the conservatives to reject further reforms (Chi Lan, interview, 2012). Prime Minister Khai's said the government would move cautiously in adopting economic reforms in 1999(Hung, 2000).

The peak of the conservative opposition came with postponement of the signing of BTA in 1999. The Agreement was intensively negotiated over three years, with Vietnam gaining little penetration into the American market, but committing to widespread reforms (Thayer, 2001; Masina, 2006). The original signing of BTA was delayed at the very last minute with Conservatives convincing decision-makers that it did not serve Vietnam's 'best interests' (Hung, 2000; Masina, 2006). According to Chi Lan (interview, 2012) "there was much distrust of US intentions". She also mentioned

that the delayed decision was influenced by China top leader's advice to Vietnam that "do not sign the agreement until China joins the WTO as Vietnam may enjoy more favourable conditions after China enters the WTO". Not only were Vietnam concerned about the US intentions, reform itself was seen as a 'problem', with the view that Vietnam was being expected to reform too much, and too soon (Masina, 2006; Thayer, 2001). Thayer (2001) notes that the decision to delay was also greatly influenced by the vested interest groups asking for protection, including SOEs and military owned enterprises. Hung (2000, p.99) mentioned "Vietnam's leadership chose political stability and Party supremacy even at the risk of the country falling behind". The leadership decided to back away from economic reform and concentrate instead on maintaining socio-political stability from 1998 (Hung, 2000). The CPV focused on the issues of Party building, and building itself politically, ideologically, and organisationally stronger in order to cope with the new political and economic environment (Thayer, 2000). Changes indicated a power struggle between reformers and conservatives (Thayer, 2002; Hung, 2000). Party conservatives used the fight against corruption to purge the reformers, successfully laying the blame on reformist policies and ridding the Party of their influence (Hung, 2000).

The conservatives found themselves facing low economic performance and their anti-reform policies were found to be economically as bad, if not worse, than the reformist strategies (Sidel, 1998; 1999; Hung, 2000; Masina, 2006). A large part of the GDP was unsold inventory, especially in the State sector (Pham and Le, 2002). The disbursement of FDI also significantly reduced (IMF, 1998; Arkadie and Mallon, 2003). Many foreign companies withdrew their business.<sup>55</sup> This mass exodus was extremely damaging to the Vietnam economy, as it depended largely on FDI (Hung, 2000).<sup>56</sup> Anti-reformist policies aligned with the impact of the Asian financial crisis created an atmosphere of crisis, even impending doom as total economic collapse seemed possible (Masina, 2006; IMF, 1999; Pham and Le, 2002; Dang, 2002; Vu and Tran, 2002; Painter, 2005). Vietnam often only accepts true change when faced with a catastrophic crisis and the choice is 'change or die'. This is much to do with the Vietnam culture and

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<sup>55</sup> Such as Cables and Wireless, three top Japanese banks and Chrysler.

<sup>56</sup> Asian Wall Street Journal 1999 7 Sept.

its self-defence mechanism of usually choosing conservatism when faced with the challenge of change and often only turning to reform when there seems no other choice.

The poor economic performance eroded the credibility of the conservatives and put pressure on the CPV (Thayer, 2002). The Party could not afford to undermine their authority given the increasing calls for economic reforms and increasing social instability, with large scale and violent protests in many provinces and cities (Thayer, 2001). Chi Lan (interview, 2012) suggested that “the CPV could not risk damaging their prestige and power by avoiding the calls of the society. The CPV had compromised to reach a practical solution for the pressing economic demands, which allowed the private sector a complete freedom of doing business”. The new Enterprise Law was issued in 1999, with breakthrough reforms favouring private business (Tai, 2006). The Law on Foreign Investment was revised to create a better environment for attracting more FDI. Chi Lan (interview, 2012) commented “this period of reforms had been characterised as two steps backward and one step forwards. This practical solution was not signs of the demise of the conservatives in this time, but rather the compromise of the conservatives for ensuring the leadership of the CPV”.

The 9<sup>th</sup> National Congress (2001) chose a new leadership. Conservatives focused on anti-corruption strategies and strengthened their positions by proposing some organisational changes to centralise power. The Central Committee rejected the changes as they feared a return of the command economy (Thayer, 2001). Chi Lan (interview, 2012) said “with no sign of improvement and a change in the policies, these conservative policies for a difficult period had diminished the trust of many other politicians and people, who expected the Party to make reforms to cope with the poor economic performance and to accelerate the development”. Thai (interview, 2012) commented that “the need and expectation for economic policy change was also influenced by the rapid recovery of other Asian countries after the Asian Financial Crisis. This trend had left Vietnam only limited choices for future economic policies”. Domestic economic difficulties and increasing international competition led to the demise of the conservatives. Their policies were criticised for not reviving the economic stagnation in Vietnam, while many leaders of the conservatives were blamed for ineffective leadership (Thayer, 2002). Their hard policies caused disappointment (Thayer, 2002). The General Secretary and seven senior members of the Politburo were

retired. The new members were proactive and younger reformers under the command of the General Secretary, Nong Duc Manh. The Politburo Standing Board was replaced by the Secretariat, and the Members of Secretariat were elected by the Central Committee rather than the Politburo (Thayer, 2002). The CPV called for high economic growth through domestic mobilisation of capital for self-reliance, finding its own competitive advantages and creating a better environment for attracting external sources of capital, technology and expertise (Thayer, 2002; CPV, 2002).

Reform was resumed in 2001 and tied up closely with the negotiation and implementation of the BTA (Thayer, 2001). It aimed to tackle the unfinished reform agenda including liberalising trade and investment policies, restructuring the SOEs sector, promoting the private sector, restructuring the financial sector, and building transparent and efficient economic management institutions. Implementation of the reform was slow and cautious, but with a Party intention to develop a multi-sector commodity economy operating under the market mechanism-with a socialist orientation (Thayer, 2002). The pace of the reform picked up when the Government actively engaged in bilateral, regional and multilateral agreements, especially the accelerated efforts in negotiation for WTO membership (Abrami, 2003).

However, we must begin to question whether the WTO process was the actual initiator of reforms; or rather the tool to carry reforms through, and the actual trigger for reform was the threat of catastrophic crisis. Vietnam only changes at the very point of disastrous crisis, and this is the only real cause of reform, while international treaties, WTO entry, etc are the methodologies referred to for change and reform, mostly because the Governments own intent for reform can be hidden beneath a cloak of pressure forced upon the Government and country to reform by the conditions of, for instance, entry into the WTO. The thesis research revealed that change and reform has only come at the very pinnacle of crisis (whether the collapse of the command economy in the 1980s, the Asian financial crisis in the 1990s or the conservatives mishandling of the economy in 1996-2001). It is crisis that is the only answer to the embedded culture of Vietnam to prefer conservatism and tradition before change, and that only the forces of crisis actually overcome this traditionalist approach.

### **Trade and investment reform**

Trade reform accelerated in 2003 to meet requirements in various international agreements (Arbami, 2003; Masina, 2006; Hoang and Le, 2010).<sup>57</sup> As a result of the implementation of AFTA and US-BTA agreements, the trade policy of Vietnam was adjusted significantly to reduce distortions remaining in the economy. On 1<sup>st</sup> September 2003, a new tariff system took effect that was based on the eight-digit Harmonized System and conformed to ASEAN's Harmonized Tariff Nomenclature.<sup>58</sup>

The most impressive changes in tariff reduction were seen in the period from 2003 to 2006, when Vietnam accelerated its process of WTO accession.<sup>59</sup> Tariff rates were reduced most significantly for products at higher rates, leading to a compacting of the frequency of tariffs rates from a bi-modal distribution with a substantial frequency of tariff rates from 35% to 50% in 2003, to a more uni-modal distribution with almost 80% of all tariff rates at 20% or lower (WB, 2006). The high tariff rates were often concentrated in the transport sector; some agricultural products; beverages; tobacco, fish processing; minerals and metals; chemicals; leather goods, and electrical machinery.<sup>60</sup>

Under the BTA and WTO negotiations, non-tariff barriers were progressively eliminated. Goods subject to Quantitative Restriction greatly reduced from 17 products

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<sup>57</sup> such as the ASEAN Free-Trade Agreement (AFTA), the BTA and WTO negotiations

<sup>58</sup> The simple average tariff rate increased slightly from 16.8 % to 18.2 % in 2003, and the maximum tariff came down from 200% in 1997 to 120% in 2001 and then to 113% in 2003 (Athukorala, 2005). The simple average Effective Rate of Protection reduced dramatically from 59.54% in 1997 to 54.1 in 2001, and then to 26.23% in 2003 (Athukorala, 2005). The ERP for import competing production in all traded goods sectors was down considerably from 58% in 2001 to just 25% in 2003 (Athukorala, 2005).

<sup>59</sup> The simple average tariff rate decreased from 18.4% in 2003 to 13.7% with the WTO's commitment in 2006 (CIEM and US STAR Project, 2008). In the December 2006, the tariff reductions were extensive and deeper, reducing tariffs in 1,986 lines, while increasing tariffs in only 6 lines (5 of which were for tobacco).

<sup>60</sup> The most significant reduction was recorded in tariff rates for textiles and clothing, which went from 48.7% to 19.6% for clothing and from 30.6% to 10.5% for textiles (NCIEC, 2007).

in 1999, to 7 products in 2000 and 2 products in 2003. Under the WTO commitments, all these quotas were eventually removed and replaced by TRQ, which applied for only eggs, sugar, tobacco leaf and salt (Mutrap 2007). This was a strong commitment to liberalisation of agriculture.<sup>61</sup>

Under the Enterprise Law (2005), domestic firms were free to export non-prohibited commodities while free to import commodities registered in their business license (Thai, 2005). The WTO process eliminated all discrimination in the field of trading rights and import licensing, thus allowing foreigners to import and export commodities (Mutrap 2007).<sup>62</sup>

Custom reforms gained momentum in 2001 and export and import activities were clarified and simplified, reducing customs clearance time. The results were remarkable – the average time for customs clearance was reduced from 1-3 days to a half day (Thai, 2005). Custom valuation for calculating import duties was based on the transaction price in accordance with the WTO Customs Valuation Agreement (Thai, 2005; MUTRAP, 2007). The Harmonised System of Tariff Nomenclature was also introduced in order to classify imports (MUTRAP, 2007). As of 2004, instead of using two registered codes (one for paying tax and one for customs clearance) each enterprise now used a single code for both tax payment and custom clearance. Since 2004, e-custom procedures were experimentally introduced into major ports around Vietnam. In 2005, a governmental decree was issued to create a legal framework for e-customs

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<sup>61</sup> Under the BTA, Vietnam reserved the right to use quotas on many products such as maize, cotton, animal products and soybean. In 2003, it introduced the WTO's compliance system of tariff rate quotas in 2003 for cotton, tobacco leaf, dairy products, maize, soybean, eggs and salt (Athukorala 2005; Mutrap 2007; Thai, 2005).

<sup>62</sup> The Government demonstrated its commitments on the trading rights for foreign companies in a series of laws and regulations (example: Decree 23/2007/ND-CP for regulation on purchase and sale of goods and related activities by foreign owned enterprises; Decree 90/2007/ND-CP for providing import and export rights of foreign business entities without presence in Vietnam; Decision 10/2007/QD-BTM for a detailed roadmap for implementing regulations and policies; Circular 09/2007/TT-BTM for instruction of implementing these regulations and policies) (Mutrap, 2007).



(MUTRAP, 2007). The WTO accession process completely overhauled the trading regime.

### ***SOEs reforms***

At the 9<sup>th</sup> Congress the General Secretary acknowledged that SOEs reform was “a sensitive political issue, closely related to social and economic stability” (Thayer 2002, p.85). SOEs should “serve as a tool in the hands of the State to regulate the economy, ensure adherence to the socialist path, and maintain political, economic and social stability” (Thayer 2002, p.85). The conflict was between the need for economic growth and maintaining CPV control of the economy. Pressure to reform SOEs coupled with the need to strengthen them to meet the competition from economic integration forced the CPV to bring about changes (Abrami, 2003).

In 2002 the SOEs reform aimed to create a “level playing field for non-state actors” (Abrami, 2003). The Prime Minister, Phan Van Khai, organised and chaired meetings to discuss the need and solutions for accelerating the reforms. A range of policies and measures were introduced to facilitate the SOE restructuring process, including mergers, conversions to limited liability companies, outright sales and liquidation (WB, 2006). In 2004, Government’s Decision 155/2004/QĐ-TTg was issued by Prime Minister to establish the criteria for classification and listing of SOEs’ operations.<sup>63</sup> Firms who did not meet the criteria were forced into equitisation to be Joint Stock Company’s operating under the Enterprise Law (same as private companies) (WB, 2006b). Equitisation is a process of restructuring SOEs, rather than simply privatising, but can include elements of privatisation of SOEs subsidiaries. Decree 187/2004/ND-CP<sup>64</sup> on converting SOEs to joint-stock companies was issued in 2004 to facilitate the equitisation process. It guided the process and emphasised that auctions should be the main mechanism for divestiture with appraisals being conducted by outside evaluators and the sale of shares taking place through auctions at securities

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<sup>63</sup> Regulating which fields and activities were allowed to 100% SOEs operations and reducing the numbers of SOEs

<sup>64</sup> Issued on 16 November 2004 about equitising SOEs into the joint-stock companies

centres for market prices. The stock markets were upgraded, invested and promoted to facilitate the process of SOE's equitisation and restructuring

**Table 4.2: Process of equitised SOEs in Vietnam from 1999 to 2005**

<b>Year</b>	<b>Number of equitised SOEs</b>	<b>Total number of equitised</b>	<b>Year</b>	<b>Number of equitised SOEs</b>	<b>Total number of equitised</b>
<b>1992</b>	Started	0	<b>2000</b>	212	577
<b>1992 – 1995</b>	3	3	<b>2001</b>	149	726
<b>1996</b>	5	8	<b>2002</b>	164	890
<b>1997</b>	7	15	<b>2003</b>	532	1422
<b>1998</b>	100	115	<b>2004</b>	753	2175
<b>1999</b>	250	365	<b>2005</b>	754	2929

Sources: PWC, 2008.

As a result of the Government's drastic measures, the number of SOEs was reduced from more than 5600 in 2001 to below 3,200 in September 2005 and to around 2100 in 2006. Since 2004, the average size of the SOEs being equitised increased, including medium SOEs (WB, 2006).

The rest of SOEs were reformed by two other mechanisms:

1. Increasing competitions in the market and
2. Gradual hardening of the budget constraint to the SOEs (WB, 2006).

A new single Enterprise Law was issued in 2005 to merge different laws for different economic sectors. The Government also stipulated that all SOEs would be operated under the Enterprise Law 2005 by 2010. The new law with clearer articles and easier regulations for establishing private companies provided a more level playing field between sectors and has increased the number of new registered companies significantly, which served as a means to place more market competition on the SOEs. Increasing trade liberalisation increased competitiveness in the market economy, and the Government's efforts to accelerate the WTO accession process helped liberalise the trade and investment regime, further undermining the SOE's monopolies (WB, 2006).

The New Investment Law (2005) had policies for allowing foreign owners up to 49% ownership of equitised SOEs.

### ***Institutional reform***

Rapid development created demands for institutional reforms. Effective institutions were required to reduce transaction costs, condition the market environment and regulate the player's behaviour and operation (Arkadie and Mallon, 2003). Inadequate legal and market institutions for investment in Vietnam greatly inhibited economic development, and the institutions in Vietnam only slowly adjusted to the needs of the market, causing a mismatch between changes in market actor's behaviour and adjustments in the formal institutional framework (Arkadie and Mallon, 2003). Further decentralisation increased the pressures for institutional reform (WB, 2006).

Institutional reforms were essential to the process of accelerated international economic integration (Luong, 2006; 2007; Fforde, 2004). The motivation for accelerated reform was the need for an improved market oriented economic management system in order for the country's deeper integration into the World Economy (Masina, 2006; Fforde, 2004). International commitments, such as, the US-BTA and the WTO, resulted in the urgent need for the Government to accelerate reform in almost all aspects of the legal and administrative framework (WB, 2006b). The national chief negotiator, Khanh (interview, 2012), agreed that "The WTO and BTA agreements had a deep impact; not only on trade policy, but also on many fundamental rules of law and governance, providing a critical benchmark and focus for modernising Vietnam's economic and legal institutions to support the market economy and international integration". The essential impact here was on the granting of Vietnam Most Favoured Nation (MFN) status, which gave open access to US markets. In one year (2002) the exports to the US increased by 128%, while exports of manufactures increased by 'an impressive rate of over 500 percent on an annual basis'. There was an 18 fold increase in clothing exports, a 250 percent increase in electrical appliances and 499 percent increase in furniture (Reidel and Parker, 2003, p.4). A number of major regulations were changed and details of some of the main new laws are given below.

In 2003, the Government proposed an Action Plan for Legislation Reform, which planned to change 31 laws and ordinances by 2007 (Hiep, 2005). The law-making agenda from 2001 reflected the legislative harmonisation required for BTA and WTO accession (Gillespie, 2007).<sup>65</sup> Law making was intensified in 2004 and 2005 in the bid for the WTO accession (WB, 2006).<sup>66</sup> Vietnam revised and modernised almost every law affecting commercial activities in Vietnam in line with the need for supporting a domestic market economy with a growing private sector and for conforming to international standards. These reforms made the business environment more transparent and equal to all economic players (Anh, 2007). The law restrained the Governments' intervention in the market, including intervention on resource allocation, firm's planning and operational processes (Nguyen and Nguyen, 2009).

Judicial reform was accelerated and the National Assembly adopted the Law on the Organisation of the People Courts and the Ordinance on Judges and People's Assessors in 2002, specifying the formal tasks and functions of the Court. The Court system changed its roles toward fostering strict compliance with law and became independent from the political system (WB, 2006; Phuc, 2006). The Supreme Court has also undertaken reform programmes for its management of the courts, and gained independence from the Ministry of Justice (Nghia, 2008; Phuc, 2006; WB, 2006; Nicholson, 2007). With the exception of the Chief Justice and Judges of the Supreme People Court, all judicial appointments, removals and dismissals in provincial and district courts are made by the Chief Justice on the advice of the Judicial Selection Councils. Court budgets are determined by the Standing Committee of the National Assembly on advices of the Chief Justice. Thus, the court system does not need to be dependent on the Ministry of Justice for funds (Phuc, 2006). New laws specified that judges must hold a bachelor of laws degree, have legal experience, and have attended adjudication training for enhancing the profession of the judges. These all contributed to

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<sup>65</sup> For implementation of the USBTA, the Ministry of Justice reviewed 148 legal documents relating directly to the agreement, and it suggested amendments to 24 legal documents, including 8 laws and 3 ordinances, and issued 39 new legal documents including 8 laws and 11 Ordinances (Hiep, 2005). For the WTO accession, 263 legal documents directly related to regulations of the WTO and 52 legal documents including 14 laws and 9 Ordinance, needed amending.

<sup>66</sup> The National Assembly passed 8 laws in 2004 and 22 laws in 2005

the process of making judges and courts at all levels gain more independence from political influence (Nicholson, 2007).

Licenses were abolished for all firms and individuals who had registered import and export functions in their licenses. The new Enterprise Law (2005) and the Investment Law (2005) prohibited discrimination in ownership types and nationality such as state and non-state firms, domestic and foreign firms (WB, 2006). The Competition Law (2005) restrained monopolies to enhance competitive advantages, and the Department of Competition and Council of Competition was established to monitor, investigate and handle all cases relating to competition (Anh, 2007; Nguyen and Nguyen, 2009).

Public administration reform was guided by the need to decrease unnecessary bureaucracy, to combat corruption, and to increase the transparency and effectiveness of the administrative system (ADB, 2003; WB, 2004; Ministry of Home Affairs, 2006). Three major components of the public administrative were:

1. Legal reforms including simplification of administrative procedures, increased legal basis for state activities,
2. Organisational reform including restructuring of central and local governments and some degree of decentralisation of administration, and
3. Reform of human resource management. Functions, responsibilities and mandates of agencies and institutions were defined more clearly (Phuc, 2006; Anh, 2007; Buhmann, 2007).

The Government's decision 136/2001/QD-TTg (2001) adopted the Comprehensive Public Administration Reform Agenda for 2001-2010, with it 'responsive to the needs of the people' (Phuc, 2006). Administrative procedures were simplified, more transparent and open, with streamlining of public administrative procedures into the 'One Stop Shop' (OSS) (WB, 2006). This mechanism helped reduce difficulties for citizens, combat red tape and reduce corruption. E-government was actively promoted to increase efficiency, boost transparency and reduce corruption and inconvenience (WB, 2007).

The number of Government agencies was reduced from 70 in 1986 to 39 in 2006 and then 22 in 2011, of which 18 are ministries and equivalents, and 4 Government affiliated agencies (Office of Government, 2012). The number of provincial departments and equivalents was reduced from 30 to 20-22; at district level, from 16-17 to 12-14 (Phuc, 2006). This helped overcome the problems of overlaps and duplications in terms of functions, tasks, responsibilities, scopes and objects of management among ministries and agencies (Phuc, 2006).

### **4.3 Impacts of WTO accession on the accelerated reform process of Vietnam**

Accession is often considered as a catalyst and guideline for economic reforms towards an accepted level of a market economy (Michalopoulos, 1998; Basu, 2008). WTO accession supported domestic reform of Vietnam by:

1. Creating pressure for reform;
2. Creating a new balance of influences from interest groups on the policy making process;
3. Forcing adjustment of institutions;
4. Influencing the leader's ideology on economic reform (Sally, 2008).

#### **4.3.1 WTO accession process has provided pressure for reforms**

Khanh (interview, 2012), said that “one of the tangible challenges of the WTO accession is the increasing pressure of external competition on domestic production triggered by the opening of the market”. In the negotiation process for accession, Vietnam bilaterally and multilaterally negotiated the levels of its WTO commitments (NCIEC, 2007). Khanh (interview, 2012) suggested “although Vietnam trade accounted for a very small share at the global level, it has been considered as a potential market by its scale of population ranked 13<sup>th</sup> in the world and a young workforce of nearly 40 million. Thus, Vietnam received considerable attention from WTO members during its bid to accede to the WTO”.

**Table 4.3: Nominal and Effective Rate of Protection under the WTO commitments (%)**

<i>Year</i>	<i>Agriculture and seafoods</i>		<i>Mineral, oil and gas</i>		<i>Manufacturing</i>		<i>Whole economy</i>	
	<i>ERP</i>	<i>Tariff</i>	<i>ERP</i>	<i>Tariff</i>	<i>ERP</i>	<i>Tariff</i>	<i>ERP</i>	<i>Tariff</i>
<b>2005</b>	7,40	6,10	4,39	3,85	40,38	19,45	<b>21,43</b>	<b>11,12</b>
<b>2006</b>	6,42	5,37	4,33	3,84	38,93	18,69	<b>20,43</b>	<b>10,53</b>
<b>2007</b>	6,20	5,17	4,38	3,84	31,21	15,25	<b>16,93</b>	<b>9,04</b>
<b>2008</b>	5,50	4,72	4,41	3,84	29,58	14,45	<b>15,97</b>	<b>8,54</b>
<b>2009</b>	5,00	4,39	4,43	3,83	28,00	13,71	<b>15,10</b>	<b>8,11</b>
<b>2010</b>	4,59	4,13	4,45	3,83	26,78	13,14	<b>14,41</b>	<b>7,78</b>
<b>2011</b>	4,20	3,88	4,46	3,83	25,53	12,53	<b>13,72</b>	<b>7,43</b>
<b>2012</b>	3,92	3,72	4,48	3,83	24,57	12,05	<b>13,20</b>	<b>7,18</b>
<b>2013</b>	3,85	3,67	4,49	3,83	24,08	11,80	<b>12,96</b>	<b>7,05</b>
<b>2014</b>	3,85	3,67	4,49	3,83	24,05	11,77	<b>12,95</b>	<b>7,04</b>
<b>2015</b>	3,51	3,25	-0,29	0,17	21,14	10,65	<b>10,57</b>	<b>5,64</b>
<b>2016</b>	3,51	3,25	-0,29	0,17	21,13	10,64	<b>10,56</b>	<b>5,63</b>
<b>2017</b>	3,50	3,25	-0,28	0,17	21,12	10,64	<b>10,56</b>	<b>5,63</b>
<b>2018</b>	3,35	3,11	-0,33	0,13	21,01	10,51	<b>10,44</b>	<b>5,52</b>
<b>2019</b>	3,35	3,11	-0,33	0,13	21,00	10,51	<b>10,44</b>	<b>5,52</b>
<b>2020</b>	3,36	3,11	-0,32	0,13	20,76	10,30	<b>10,34</b>	<b>5,43</b>

Sources: CIEM, 2009

Vietnam's commitments were strong and comprehensive (Mutrap, 2007; NCIEC, 2007). The average simple tariffs were cut down to just 13.4% and all tariffs lines would have only seven years to adjust (Mutrap, 2007; NCIEC, 2007). NIEIC (2007) believed that Vietnam's commitments exceeded China's, even though Vietnam is a much smaller country to China. The average agricultural bound tariff was below the same tariff of neighbouring WTO members such as Thailand and Philippines (WB, 2006b; Mutrap, 2007). Table 4.3 shows that the WTO accession process put direct pressure on many industries that Vietnam had protected for years (NCIEC, 2007).

The pressures for increasing competition and limiting government intervention and protection were high. According to Thanh (interview, 2011), "this expectation of increasing competition was a real motivation for both government and the business communities to think of improving and renovating their business efficiency and competence to cope with future environment. The motivation was actually tense

because many businesses, citizens and even the government agencies had not had a clear idea about the WTO accession”.

All these changes and expectations had significant impact upon the Party-State. Accession meant managing a more diverse and complicated economy. The State’s agencies came under pressure to be more transparent and provide regulatory equity in economic management according to the WTO framework. Accession forced the Party-State to rethink their ideology and economic management (Anh, 2007).

The Government were forced to renovate their public financial management system, improve the business and investment environment and develop the tax collecting system. The shrinking budget prompted the Government to re-consider its levels of subsidy to SOEs (Luong, 2006; Fforde, 2005).

Vietnamese enterprises came under pressure to become more competitive. Chi Lan (interview, 2012) said “many businesses would face challenges in the short-term as they adjusted their business and production operations to the new business environment”. Accession was a real threat to the SOEs, with a wider market opening undermining their monopolies and weakening their financial position through reduced government protection and subsidies (Luong, 2006; 2007; Fforde, 2005).<sup>67</sup> SOEs were using more capital but the factor accumulation did not produce a proportionate increase in output or productivity (WB, 2011). SOEs used several times more capital to produce one unit of output than the industry average (WB, 2011).<sup>68</sup> SOEs were less efficient in their use of fixed assets than the industry average (WB, 2011). Labour productivity growth in SOEs was lower than the rest of the industry. The SOEs had the highest ratio of the debt to assets among all economic actors and the lowest returns on their equity, well below the nominal growth rate of the economy (WB, 2011). The strong WTO’s commitments for opening both goods and services threatened the domination of SOEs

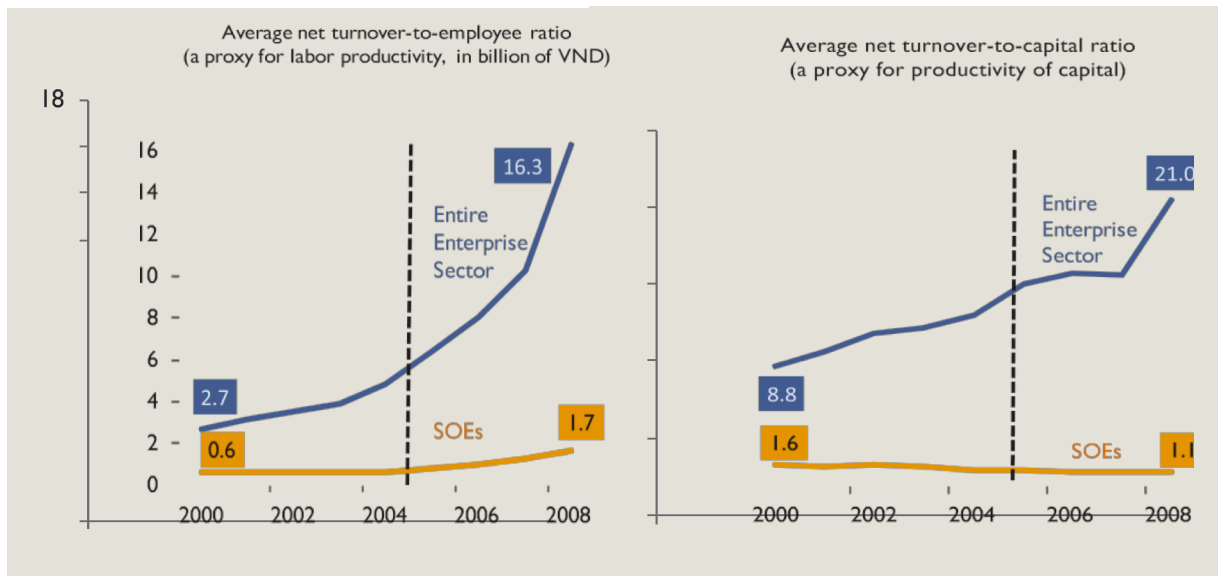
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<sup>67</sup> In 2003, Vietnam still had 4,845 SOEs, accounting for 6.73% of the total enterprises, but producing 29.3% of the industrial output and about 40% of GDP (GSO, 2008).

<sup>68</sup> In 2000, the average ratio of turnover to capital in SOEs was 1.6 compared to 8.8 for the entire enterprise sector, which mean nearly 9 units of capital to produce 1 unit of output (WB, 2011).



in competition and reduction in business privileges. Competition from the foreign companies would increase due to easy and more convenient conditions for trade and investment, which would attract more participation of foreign companies (MUTRAP, 2007; Khanh, interview, 2012). WTO commitments and mechanisms ensured a level playing field for all sectors engaging in trade and investment, reducing the government preferences and subsidies to the SOEs (WB, 2006; MUTRAP, 2007; NCIEC, 2006).



**Figure 4.1: SOEs efficiency of using resources compared with industry average**

Source: WB, 2011

One has to seriously question the real effectiveness of Accession on Vietnam's SOEs. They remain the dominant force through covert means of subsidy (such as the Government transferring funds to Banks that are 'instructed' to loan to SOEs), coupled with almost total monopoly over the tender process (tender processes are carried out but often the participants already know who (the SOE) will get the contract). Government decision-makers were always directly involved in the executive management of SOEs and guaranteed business to SOEs regardless of their levels of inefficiency, lack of productivity and mishandling of capital. Individuals grew constantly richer while their SOEs were bringing the Vietnam economy to even greater levels of collapse.

After 20 years of reforms, Vietnam's economy is still at a low development level. Advantages in export are mostly derived from labour and natural conditions factors, not from on technology and efficiency (Son, 2006). As a result, the export products are often a crude form and at lower value than the same products from other countries (Nguyen, 2008; MUTRAP, 2007). The Vietnamese private sector is still very young, small, scattered and inexperienced in international economic integration; significantly weak in terms of technology, production scale, management skills and access to the market (Son, 2006; Tai, 2006).

With the accelerated WTO accession process, both Government and the business community were aware of the threat of the increasing competition through opening up to international economic integration. Government and business actively tried to improve and renovate to cope with the new challenge to the business environment. Thus, WTO accession acted as force for domestic reform in Vietnam. However, there is little evidence, either then or now, that the Government has really grappled with the dominance of SOEs, and the private sector suffers from an almost total control of the economy by inefficient and virtually bankrupt SOEs. Regardless of private company's increases in productivity, efficiency, quality and good capital management, they still fail to win business in competition with many virtually useless SOEs.

#### **4.3.2 WTO accession process has influenced the political balance of interested groups for reforms**

The process of reform was slow and ineffective in the period 1996-2002. The main reasons were the decline of the momentum for continued reform and concerns for possible instability and derailment of society due to the negative side effects of the market economy (Sidel, 1999; Hung, 2000; Thayer, 2001; 2002). Chi Lan (interview, 2012) suggested that "these concerns created a suitable environment for conservatives to press their prudent view in the process of economic reform". Vietnam's economy entered into a new economic cycle with economic slowdown and reform immobilisation (Sidel, 1999). Chi Lan (interview, 2012) observed "the reform immobilisation did not improve the economic situation or prevent the social instability due to the poor economic performance through only partial reforms". The demand for reforms to stem

the crisis was increasing, but the delays in reform continued to occur. The reforms faced two major challenges. It was different from the previous reforms, as the goals of the second wave of reform affected more interest groups. The economic restructure for more efficient and competitive growth would create losers in the short term during the reform process (Nelson, 1990; Thayer, 2002). Losers in the reform process were motivated to combine to protect their benefits from the status quo and resist reforms. The second wave of reforms was far more technical, which was also challenging for Vietnam. The second reforms were more pertinent to policymaking and legislation to help the economic system develop into a transparent, equal and effective fashion. Thanh (interview, 2011) suggested that “this may require a strong capacity of the government in policy planning and implementation. In many cases, this capacity is lacking in the developing countries”. Reform applied to the private sector and the Government operation at public level, but privately the SOEs were almost immune from pressure to reform (Sidel, 1999, Hung, 2000).

Reform regained momentum in 2002 and this was chiefly due to a combination of pressure from US BTA’s implementation and an accelerated WTO accession process (Luong, 2005; Masina, 2006). The Accession process mandated the trade and investment liberalisation, but also included many behind-border issues such as transparency, uniform and impartial law application, and creating a level playing field. The process widely affected different groups in trade and investment activities, such as protected SOE sectors, redundant labour, private companies, and policy makers and officials in charge of trade and investment (Basu, 2008).

The primary resistant groups to reform were the SOEs and the government functional agencies (Thai, interview, 2012). The need for reform was centralised around the efficient use of resources and the transparency and decentralisation of authority (Thayer, 2002; Chi Lan, interview, 2012). Thai (interview, 2012) said “some groups enjoyed a close relationship with the power structures in Party-State via the ideology of the market economy with socialist orientation”. The CPV’s forced little change in the roles of the SOEs in the economy (Painter, 2005). The CPV wanted to use the SOEs as a main force to implement their ambitious industrialisation process, which was set to be completed in 2020. Through SOEs the CPV was able to closely control industrialisation (Le and Liu, 2006), and thus, SOEs were heavily invested in and protected by CPV

(Masina, 2006). SOEs continue to serve as a tool of CPV, and as the market regulators. The SOE and CPV relationship means that the Government continues to covertly operate a quasi central command system, but instead of doing it through political control, they convert that control into commercial partnership and privilege within the SOEs and prevent the Vietnam economy from opening up to competitive market forces. The very cornerstones of establishing reform in the Vietnam economy are often the main obstacles to that reform. SOE's, although ideal 'agents' of reform for the CPV, they are, instead, often the least capable of change, with many having enjoyed decades of 'business' without 'competition' and subsequently come to enjoy a privileged position that many are resistant against losing. This has been the main shared value of the conservative leaders. They are not only conservative leaders, but often the very business leaders making the large government produced profits from the monopoly position their SOEs hold. Government subsidies provided by Bank 'loans' ensures that 'manufactured' profits are produced, and the immunity from competitive forces means they have little reason to change, while the 'gravity train' continues to run.

Communist ideology and the movement towards a free market economy become entangled in political contradictions. Thai (interview, 2012) suggested that "Whilst realizing that economic prosperity and the future of the economy rely on adoption of free market economic liberalism, and therefore accepting much of the ideology of capitalism, the Communist Party is not unaware that this course contains a 'Trojan' horse that threatens the very basis of power of a one-Party state". Thus, reform itself becomes politically controlled by whatever means that the Party can, and chief among these are controlling the major business actors in the 'business world'. Although much of the cause of economic disaster brought about by their misuse of resources, the levels of inefficiency and bad management, and the refusal to become competitive, SOEs remained largely 'protected' by the Party (Chi Lan, interview, 2012; Thayer, 2002; Painter, 2005). SOEs act as an 'agency' for government rule within the economy, able to control much of domestic business and through 'relationship' assume a role of governance within, and over the business world (WB, 2006; 2012).

In assessing the impact and actual manifestation of ideology upon the Vietnam political, social and economic world it is important to understand what 'communism' is in Vietnam. Relating the 'real' impact of communism and correlating it with Marxist or

Leninist principles quickly brings a realisation that the 'ideals' are adapted in the political and public security fields with some credibility attached to the traditional tenets of the ideology. But economically and socially the Vietnamese system reflects a far higher correlation with capitalism than communism. The health and education system are not free and actually form a very active 'commodity' role in economy. There is little attempt to reduce the poverty gap and there exists a very wide range of divisions between the extremely wealthy and the poorest communities. The land is owned by the State but the 'right to use' element is an extremely competitive market based only on the ability to 'buy' and on 'relationships' to support that purchase. Unionisation is a strongly controlled element that reflects more the Party's rights rather than those of the worker. There is little that can actually be called 'communist' in Vietnam and the ideology is now chiefly controlled by an elite interest group that is firmly in control of both the political and economic system. As McGough (interview, 2012) said 'there is little that can be called communist in Vietnam. The ideology has long become the preserve of an 'elite' who have captured it for personal gain and power'. Vuving (2012, p.2) is clear on his view of the ideology as he declares "the marriage of the communist regime with the capitalist economy in Vietnam's reform era has given rise to a new type of state that is similar to the classic communist state in form but different in substance... [and now has] the ethos of the rent-seeking state, which creates barriers and extracts rents from society...rent seekers have become the dominant force... and are thereby quietly changing the nature of the state they occupy". The thesis case studies show how the operation of this elite/communist synthesis operates a system of wealth building that sees the country raised to middle income status, while the actual economic infrastructure and the lives of the vast majority of people remains in an under developed status.

Thanh (interview, 2011) notes that "another group of interest exists in parallel with SOEs in the reform, and this is advisory bodies and regulators". In a system where the regulators actions are not processed on the basis of transparent regulations, the power of regulators is enormous. Ministry of Trade is responsible for granting import and export quotas for trading companies that for a long time have been based on unclear regulations; or the Ministry of Planning and Investment's licensing procedures for international and State-funded projects; the local governments allocate blocks of land for investors, etc. These special mandates help those institutions possess special powers

and interests, leading to a strong reluctance to reform, and a fear that they will lose their 'privileges' if they do. These groups are the advisors to senior leaders, so they trigger a strong setback against progressive policies (Thai, interview, 2012; Chi Lan, interview, 2012). Thai (interview, 2012) suggested that "SOEs are favourably treated and its reform is often slow as it's attached to interests relevant to Ministries/agencies and local authorities". The relevant agencies establish policies and mechanisms for the operations of companies. On the other hand, they are also the regulators of the companies in their own fields (Painter, 2005). The reform of SOEs hurts the economic interests of regulators and localities. Thai (interview, 2012) mentioned that "Through such companies, the line Ministries/agencies and localities accumulate economic benefits for their own institutions or as individuals". Chi Lan, (interview, 2012) commented that "the influence of SOEs and advisory bodies on reform policy is tremendous, it is not only aligned to material benefits, but also political links". In this covert and almost total control of the economy, the SOE and regulator relationship is built on mutual benefits that neither wanted to lose, but are more often than not corrupt, and completely against the spirit and intent of WTO accession and membership.

Unemployed labour after the SOEs' restructure was a 'loser' group in the reform process that strongly protested against accelerated reforms. Before the reform, SOEs did not operate under the pressure for profit making and were labour intensive (Le and Liu, 2006). Employment in the SOEs was (and is) considered an 'ideal' job with long term contracts and better-paid employment than other sectors (Le and Liu, 2006; Arkadie and Mallon, 2003). Thus, when the SOEs restructured, the first impact was dramatic reductions in labour (Le and Liu 2006; Thuong and Hung, 2010). Unemployment surged and employees at SOEs often strongly opposed the government's plan to privatise or restructure the enterprises. Middle aged workers at SOEs had a strong voice and were respected due to their long years of service in the enterprises (Thai, interview, 2012), but "the concern of this group is often expressed in forms of unorganised activities such as protests and social problems, thus utilised thoroughly by the conservatives and press to support their advocate for slower reforms" (Khanh, interview, 2012).

Protectionism for SOEs also meant others had limited opportunities to access the sources of other economic sectors, especially in the strengths of Vietnam such as

agriculture, light and labour-intensive industries including textiles and garments, footwear, etc (Le and Liu, 2006). Advantages of agriculture have been long confirmed since the early days of Vietnam's integration, namely its high ranking in rice export and in other items as well, such as sea foods, coffee, pepper, cashew etc (Son, 2006; Le and Liu, 2006; Nguyen and Hoang, 2010). Son (interview, 2010) suggested that "rural areas are disadvantaged compared with urban, specifically in terms of social conditions. The concentration on industrial development, which heavily depended on SOEs, had absorbed most of the domestic and external resources. FDI inflows and technology were steered into capital-intensive industries". Yet the absence of priorities to agriculture led to the shortage of workforce in this sector as the youths migrated from rural to urban areas (Tu, 2008; Bich, 2007; Nguyen and Hoang, 2010). Industrial expansion claimed agricultural land, depriving the farmers of accumulation possibilities to invest in the quality and efficiency of farming (Son, 2006).

A similar outcome occurred in labour-intensive light industries in Vietnam. These advantageous sectors of Vietnam also faced difficulties similar to the agriculture sector. Light industries consume less capital and technology, so they are open to private companies to engage in (WB, 2006; 2011). As a result of the broad participation of the private sector, subsidies for protectionism are fairly limited. According to Tuat (interview, 2011), "Private companies coped with challenges like ownership of land and capital. Lack of large areas of land for establishment of big facilities of private companies is one of the difficulties. In this connection, large and favourable pieces of land are often reserved for SOEs". The biggest hurdle to the private companies is the access to capital (Hakkala and Kokko, 2007, WB, 2011; Sjöholm, 2006). Tuat (interview, 2012) suggested that "without property, these companies found it very hard to borrow money off the banks due to the requirement for the property ownership papers". On the other hand, as capital was mainly put into SOEs, credit for these sectors are also very limited in terms of quantity and repayment periods, coupled with strict borrowing and mortgage conditions (WB, 2006). In calling for foreign investment or establishment of joint ventures, these areas are not keen on the investment sources as they have no preferential duties and no land to contribute to the business partnership. Tuat (interview, 2011) suggested "so such facilities often operate at a small scale, less than 300 workers and, as a result, the private sector and exports sector were unable to absorb the unemployed labour during the economic restructuring".

The WTO accession process plays an important role in reducing the power of some interest groups in order to maintain reform. It also elevates the political voice of the groups benefiting from economic reform and integration, especially the Vietnam competitive industries such as agriculture and light industries, as well as the private sector (MUTRAP, 2007). WTO accession generates motivations for relevant groups in international trade and investment to struggle for their own interests. Admission to WTO helps open up opportunities of market access and expansion for consumption and bring about greater equality in the international trade. Before joining the WTO, Vietnam engaged in the regional FTAs like AFTA and BTA, bringing great benefits to the economy and advantageous areas of Vietnam, opening up markets through bilateral or regional FTAs, Vietnamese exports attained a higher ranking (Chuc, 2009).

Admission to WTO ensured greater equality for trade. Previously, Vietnamese exports were often levied high tariffs and discriminated against (MUTRAP, 2007). Khanh (2010) mentioned “Many countries sometimes use the non-tariff measures such as quota, technical and SPS standards without a well-founded ground, as barriers to prevent the import of Vietnamese goods. So many Vietnamese items were undervalued, repatriated or levied high taxes”. Some exports were refused because of allegedly low quality and chemicals residuals. Many measures to limit Vietnamese exports are groundless (Son, 2006; Nguyen and Hoang, 2010). With the potential competition in terms of price, it is certain that they will have more and more sophisticated barriers in the future. Khanh (interview, 2012) suggested that “the WTO is a helpful track for Vietnam to safeguard its legitimate rights of trade in a more equal manner”.

Accession liberalised the industrial sector towards a level playing field for competition and helped reduce the pressure of interest groups opposed to reform (MUTRAP, 2007). Vietnam’s duty system substantially changed. The effective rate of protection came down significantly after the WTO accession. Most of the reductions were attributed to the reduction of the effective rate of protection in the manufacturing sector (CIEM, 2009; 2010; Tuyen et al, 2011). This reduction in import tariffs helped decrease protectionism in the domestic market and also meant promoting economic restructuring toward greater efficiency of resources distribution, enhancing



specialisation and large-scale production (MUTRAP, 2007; NCIEC, 2007). Because of the reduced effective rate of protection, the attraction of protected areas went down, and resources were transferred to other more efficient sectors.

Vietnam must ensure a level of uniformity in its application of policies established during the GATT rounds (MUTRAP, 2007). The increased level of the uniformity reduces rent seeking behaviour (Olson, 2000; McMenamin, 2002, Kostecki, 2007; MUTRAP, 2007). As a result, the State owned sector should lose its previous privileges. During the negotiations, “many members were concerned about the existence and function of the SOEs in Vietnam, which is a transition country and has been ruled by a communist party. They required detailed information on the policies and practices of the SOEs in the economy”, Khanh (interview, 2012). Although the WTO does not prevent the existence and operation of the SOEs in the member states, it requests these companies to operate under two basic conditions:

1. Commercial-based and non-discriminative business, and
2. Transparency in export and import (MUTRAP, 2007; NCIEC, 2007).

Under the Unified Enterprises Law (2005), the aim was to officially eliminate discrimination among economic sectors. A list of sectors that enabled 100% of State ownership was published, leading to equitisation of enterprises not included in the list. This is an important change as it marked the point where instead of the Government naming those industries that could be privatised; they named those that could not, meaning that all other areas of the sectors could correctly assume a *carte blanche* agreement on them being able to change ownership. As a result, the number of equitised SOEs surged since 2004 (WB, 2006; Sjoholm, 2006; Hakkala and Kokko, 2007).

However, there is a need to be far more critical in this area of SOE reform. Although the surface research shows impressive efforts to end the monopolies of SOEs and their use as Government controlled and financed entities in the national economy, the reality is far different. In fact, the Party control of many SOEs of a number of sectors, such as construction, insurance, oil and gas, has never been stronger. SOEs are virtually immune from the competitive forces of the market and chiefly protected through back door subsidisation that include government loans directed through banks,

opaque tender processes that guarantee SOEs contracts and freedom from the threat of economic collapse through inefficiency, low profits and low productivity, by constant access to government support. In such an environment the reality of the situation is that the 'free market' economy and its forces of conditioning how business is conducted rarely applies to SOEs. Vietnam has not actually adapted to the free market economy, but instead created a market where SOEs operate exactly as they did in a command economy and through that power, centrally controlling the whole Vietnam economy.

WTO accession did help reduce the pressure for slowing down the reform from the ministries and local governments. The WTO requires acceding countries to review and revise their existing laws to make sure the law and regulations are consistent and equal to all economic sectors in the economy (MUTRAP, 2007). The accession process also required Vietnam to make this law (and apply it) in an impartial and transparent manner. Thus, the legal system has had to improve to meet the requirements. This process helped to limit the power of the ministries and local government, who used to get their power and benefits from the vagueness of the previous laws and regulations or from the administrative control of economic activities (MUTRAP, 2007; WB, 2006). A new feature of the Vietnamese legal system was the ability to appeal against State administrative decisions and in the process make the Party-State more answerable for their decisions (MUTRAP, 2007; Phong, 2009).

The accession process also weakens the interest groups formed by local governments. According to Hakkala and Kokko (2007), the local governments have little interests in reforming the SOEs and acted as interest groups against this process. More than half of the SOEs are actually under the control of the local government (WB, 2011). However, up to late 1990s, the funds raised by the SOEs equitisation were controlled by the central government, and gave local government little incentive to equitise their SOEs. Later, the local government had the rights to control the funds from the equitisation process of their SOEs and use for their investment in local development projects (Hakkala and Kokko 2007). However, decentralisation in managing the SOEs equitisation was also damaged by the lack of capacity in implementing the privatisation process and using the funds. Due to lacks in capacity, transparency and supervision, corruptions or taking advantage of the positions in this process often occurred, and this led to the loss of funds, which were transferred illegally into private hands. Many

individuals were able to gain from assets of SOEs sold at outrageously low prices after they were equitised. McGough (interview, 2012) declared ‘in one major deal in the North, the land was valued at 10,000,000VND per metre, but local officials and investors acquired it for 2,000,000VND and immediately sold it on in a pre-arranged deal to international investors. This is a regular occurrence in which original capital outlay is quickly returned 5 even 10 fold in a very short space of time. The deals always involve local officials or higher and SOE executives’. The new ‘private’ entities enjoying all the same privileges as before, but now with capital and profits diverted into a few individuals private hands. Thus, the pressing problems of corruption and the widening gap between rich and poor were causing many social problems (Luong, 2007; 2006; Fforde, 2005; Hakkala and Kokko, 2007). Stronger Central controls of local government since 2005 have actually further weakened the incentives for equitisation (Hakkala and Kokko, 2007). This is different from the China case, where the local governments actively pushed forward the process of equitisation (Le and Liu, 2006). The SOEs equitisation process must now be planned with definite roadmaps and reviewed annually. The Central Government needs to control and eventually eliminate the objections of local government against equitisation (MUTRAP, 2007).

There was still a strong opposition from conservatives who were concerned about the role of the private sector. Tuan<sup>69</sup> (2006, p.79) said “the development of the private sector should not be judged as the creation factors for the recent increasing social problems such as exploitation, competition and corruption. There should not be the prejudice to see these problems as the nature of the private sector which cannot be overcome”. Despite this, the top leadership still fear that Party control may be weakened by the increasing roles of the private sector (Forsyth, 1997; Masina, 2006; Painter, 2005; Sjöholm, 2006). The Party-State has been to some extent disingenuous in its privatisation policy. The creation within the private sector of quasi government equitised SOEs which maintain all the same privileges and government benefits, falsely inflates the ‘private’ sector appearance, making it look as if there is significant growth and freedom in the sector, but it is actually a sector dominated by Government ‘Trojan’ horses that are nothing more than a ‘privatised’ version of the SOEs.

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<sup>69</sup> A member of Advisory Board of Prime Minister and assistant to the Prime Minister,

The export sector, including the private sector, continued to prove its dynamic potential under the US BTA (CIEM and USAid, 2007). Khanh (interview, 2012) said “The signing and implementation of the BTA was one step closer in preparation for the WTO accession of Vietnam. Without the US BTA, the US and other big trading partners would not negotiate seriously the terms and conditions for the WTO accession of Vietnam”.<sup>70</sup> The success of the US BTA implementation boosted the confidence of the private and export sectors of Vietnam, causing further economic liberalisation and integration. The process also generated millions of jobs and raised the income of the Vietnam economy (CIEM and US Aid, 2007).

Khanh (interview, 2012) notes “The incentives for the further reform in the business environment and a level playing field among different economic sectors has not only come from the improved business environment due to the WTO accession process, but also the from the business opportunities from improved non-discriminating market access by the WTO accession”. The WTO accession would provide full and permanent MFN treatments by other WTO members as well as reducing the lingering non-tariff protections and procedures for export of goods and services (MUTRAP, 2007). Thus, Accession provided opportunities for securing market expansion and improvement of the economic reform process.

The WTO accession process promised fairer market access for the Vietnamese producers under the WTO mechanism for dispute settlement and for collective negotiation of reducing trade protectionist barriers (MUTRAP, 2007). These mechanisms are crucial for Vietnam producers because they are increasingly confronted with anti-dumping cases involving labour and natural intensive products. Khanh (interview, 2012) commented that “increasing anti-dumping cases against Vietnam export products might also be one of the major reasons for the Government to accelerate the WTO accession process to avoid trade protectionism on Vietnam’s products”. The

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<sup>70</sup> Vietnam exports to the US reached 5.276 billion USD in 2004 compared to 0.82 billion USD in 2000. Most products exported to the US were manufacturing products. The garment industry accounted for over 50% of the total export to US since 2003

WTO accession provided increasing opportunities for private and export sectors to raise their voice to the policy makers, and shift the political balance away from the protectionists (MUTRAP, 2007).

Accession played an important role in influencing the conservatives. One of their concerns was the influence of the external forces to weaken the roles of the Party (CPV, 2006). A National Congress political report (2006) declared that “the hostile forces are continuing keenly to implement the ‘peaceful revolution’ plot, to make riots for overthrowing the CPV, to use the card of ‘democratic’, ‘human rights’, ‘ethnic’, and ‘religion’ aiming to overthrow the political authority of Vietnam” (CPV 2006, p.22). This vigilance towards the threat to the political regime has been pointed out in every political report of CPV to date. Fear was greater at the end of the 1990s, when the normalisation process with the US began and many considered it a covert channel for anti-CPV forces, both in Vietnam and abroad, to attempt a ‘backdoor’ revolution through the undermining of the authority and power of the CPV (Hung, 2001). One senior diplomat had commented “the core objective of the US BTA was to have Vietnam collapse and overcome the Communist leadership” (as cited in Sidel 1999, p. 97). Many leaders believed the relationship with the US always to be a cautious ‘carrot and stick’ approach that has extremely negative objectives towards the Communist party (Hung, 2000). It was true in the Vietnam case with a range of issues raised by US, such as human rights, labour rights, religious freedom, ethnic minorities as well as democracy issues (Sidel, 1999; Hung, 2000). Thayer (2002, p.88) suggested that “CPV conservatives, however, view the BTA as the Trojan house designed to undermine socialism in Vietnam”. The leadership of Vietnam had learned from past experiences not to rely on one source of economics and politics for the development (Chuc, 2009). Chi Lan has mentioned “the CPV did not feel secure for the growing ties in trade with the US”. Khanh (2012) said “the doubt in opening policies with the US was strong in Vietnam from leadership, business, to the people, due to the previous war’s history and memory”. This feeling was strengthened by a series of the anti-dumping case against Vietnam export by the US (Masina, 2006).

Chi Lan (interview, 2012) said “one of reasons to accelerate the WTO accession process in Vietnam is to balance the dependence of the Vietnam economy on the US market. WTO accession was trying to broaden the market access for the Vietnamese

products. The leadership hoped to use this multilateral trade to balance the pressure from bilateral trade with the US. This was especially the intention of many conservative leaders". WTO accession process played a role in maintaining the independence and self-determination of Vietnam, and provides more balance of demand and pressure for economic reforms and performance.

The CPV conservative's fear of the Accession process and the US-BTA being little more than a camouflage for the political overthrow of communism was a strong influence and may go a long way to explaining why the SOEs have actually failed to reform in any real and effective way. The opening up to the free market was an acceptance of the ideological failure of communism in the economic sphere. Yet communism is inextricably linked to economic determinism and political ideology, with the very basis of the politics founded on control of the economy for the interests of the 'People', the Proletariat. To expect the Party to loosen completely the political central control of the economy was over ambitious, and the expectation that they would remain in the dominant economic role by directing their control through the SOEs and the so called 'privatised' SOEs was one that should have been expected. To date, the economy of Vietnam is still largely directed and controlled by the Party-State, and this control is concentrated in the SOEs and the now 'privatised' SOEs. Control of the economy is overtly operated through licenses, permissions, rules and regulations, but even stronger control is enacted through 'relationships' involving any enterprise only able to operate effectively if they have the right relations with the Government and/or their officials. But this has also created the ideal recipe for corruption, with the opportunities for individuals at the top of business and in Government to gain great wealth that is too attractive for many to resist. An example is the recent VINASHIN (a Vietnam Shipbuilding State-owned Economic Group) scandal, with it running up debts of \$4.11 billion and eight defendants (senior executives in the company) receiving \$43 million of fines, which reflected the belief in the levels of private rewards the defendant had accumulated (Thanh, 2012). The economic system means that this kind of debt or personal rewards could not have been possible without high level 'relationships' involved and yet, the scandal has successfully been limited to but a few senior executives.

### **4.3.3 WTO accession process has guided the institution reform**

WTO commitments target the decisions and policy making of the Government in accordance with:

1. State's decisions and policies must be transparent and equal, prioritizing enforcement of clauses within international commitments;
2. Vietnam must apply regulations consistently across the country. Laws, sub-laws and other measures including regulations and solutions of the local government must comply with WTO rules;
3. Judicial bodies shall have an independent and objective status when dealing with administrative decisions under the WTO regulations (MUTRAP, 2007; CIEM, 2010).

WTO rules request members to assure stability, transparency and predictability in international trade policy and activity. They comply with the 'rule of law' promoted by developed countries in promoting their institutional and legal systems. According to Article X of GATT 1994, Article III of GATS and other requirements of policy transparency, all policies, laws, regulation, legal or administrative decisions pertinent to international trade must be published by all means to keep the Governments and businesses of other members apprised. Vietnam must commit to building an information centre to provide information of national laws and regulations on goods trade and services to meet the demand for information of other members (MUTRAP, 2007; Basu, 2008) WTO also requests Vietnam to amend its regulations and laws related to investment, including the licensing and investment conditions, issues pertinent to IPRs, trade services, etc (MUTRAP, 2007).

In 2005-2006 when Vietnam actively prepared for the admission to WTO, the institutional and legal reforms were robustly carried out (MUTRAP, 2007; CIEM, 2010; Tuyen et al, 2011). However, although the laws and regulations are in place, the actual enforcement of them is almost totally ineffective. Institutional and regulatory compliance procedures are inefficient and full of unnecessary delays, to a point where any sensible business person will often find the 'backdoor' method not only open, but

necessary in order to conduct good business. This is a situation, which actively encourages corruption as a 'normal' practice, in order to achieve profitably in the economy.

#### **4.3.4 WTO accession process has influenced the ideology for economic reforms**

The process and speed of reform heavily depended on decisions and guidelines of the CPV (McCarty, 2006). Thai (interview, 2012) commented that “the CPV is characterised by the principles of centralized democracy, so real power belongs to the senior cadres of the Party, specifically the Central Committee and Politburo”. Yet, the decision-making process is not simple. Within the CPV, the struggle between reformers and conservatives is constant (Thayer, 2002; Phong, 2009). The conservative group always stressed the uncertainty and out-of-control developments in the course of reform. This group is often sceptical and hesitant about ideas of reform including the reduced roles of the government, increasing roles of private sectors, impacts of international economic integration on the sovereignty and security of Vietnam, etc (Phong, 2009). In contrast, the reform group tends to take strong and positive actions when it comes to reform. Therefore, the reform in Vietnam is always represented by contradictions among the thoughts of reform, stability and prudence in the socio-economic development and politics of the country. Apart from these two groups, there is a middle ground groups, choosing to support either reformers or conservatives in a sometimes arbitrary and unpredictable fashion (McCarty, 2006). The CPV leaders, according to Thai (interview, 2012), “mediate between a variety of different and competing thoughts to reach the final consensus, best fitting the national socio-economic development at a specific time. The speed of reform therefore primarily relies on the situation and willingness of senior leaders, particularly the Politburos”.

There remain significant questions as to the viability of maintaining a communist ideology in a free market economy. The experience of China and Vietnam is but a few decades old and any certainty of its permanence as an economic model is far from certain. A factor further complicated in Vietnam by the position of SOEs. The SOEs remain reliant on support and capitalisation by the Government; they remain inefficient, and protected from the reality of the free market by a number of means,



which is further aggravated by the wholesale opportunities for rent-seeking and corruption that allows individuals the chance to accumulate vast private wealth and divert badly needed resources into their own private domains (ex-the VINASHIN scandal). Clearly in Vietnam today, many of the SOEs if not already bankrupt are on the verge of bankruptcy. Reuters reported in 2012, that even EVN- the Vietnam Electricity Group, which “builds apartments, runs a bank, oversees stock brokerage, provides electrical power to millions of homes and employs over 100,000 people” is a ‘state behemoth’ that “symbolises the decline of the country” (Grudgings, 2012, p.1). An EVN official declared “debt is... hundreds of trillions of Dong”. The problem of many SOEs is ‘cronyism and muddled priorities that have allowed the 100 largest state-owned enterprises (SOEs) to run up debts of US\$50 billion- equal to nearly half Vietnam’s annual economic output in 2010’ and they have no way of servicing the debt (Grudging, 2012, p.1). Despite revenues of \$5 billion a year, EVN is at least \$11.5 billion in debt, as the SOEs went on a massive spending spree over the last decade and as Nguyen Duc Kien, the Deputy Head of the National Assembly said ‘they attached personal interests to investment decisions...there was corruption’ (Grudging, 2012, p.2). The Party’s survival is dependent on its economic control through totally inadequate SOE enterprises that have proven they are unsuitable for trade in a competitive market. Whilst conservatives and reformers within the party are in a contest to reform or not, both sides are often directly involved with SOEs and both are reluctant to bar the SOEs from the advantages of Government capitalisation, support and relations, and in the process throw them into a market where they must invest profits in long term planning, human resource training, higher salaries, better management training and pursue higher productivity and more efficiency. However, the power to reform is not solely political as all reforms require some form of economic power. Often, that power lies with reformers only when their businesses and business interests are firmly based in the SOE sector or in a now ‘privatised’ SOE. The contradiction is that only by being involved, and therefore supporting the Government and SOE relationship do reformers gain the influence to change things; which mean changing the very basis of their own power.

The WTO accession was considered to play an important role in advancing the reform process in Vietnam. Indeed, the practices of integration have proven to be a reliable policy for Vietnam development despite believing it was a ‘tool’ of the Western countries to sabotage the domestic economy (Masina, 2006). Thai (interview, 2012) said

“previous integration into the ASEAN with the AFTA has proven that Vietnam gained more in terms of social and economic development than it lost in economic and sovereignty terms. The success of ASEAN integration removed all the CPV doubts on loss of sovereignty and control of the Party”. He also mentioned that “the US-BTA, was more influential on the leaderships thought and ideology and on economic reforms and the international integration than the WTO. The US market is much larger than ASEAN”.

Khanh (interview, 2012) said “the benefits of the US-BTA have reduced the doubts over social stability in reform and integration at the top leadership. This gave enough weight for the reformers to push further reforms under the WTO accession”. The promulgation of Resolution 07-NQ/2003/TW (2003) on international economic integration by the Politburo has been the example of the change in ideology and thought over the international integration and reforms (Luong 2005; 2006). This Resolution affirmed and defined the process of active and proactive international economic integration and preparedness for WTO membership as soon as possible (Thuong and Hung, 2010). Khanh (interview, 2012) said “This resolution was a real milestone change for the integration process and economic reforms as the negotiators had had for the first time a compass and umbrella for their active involvement and preparation for the WTO accession and other international integrations. From that point the real negotiation for WTO accession process started”.

#### **4.4 Economic reforms after the WTO accession**

Khanh (interview, 2012) suggested that “the momentum for reform created by the WTO accession process is still effective due the nature of the commitments in the WTO. Many of the commitments are to be implemented in a period of 7 years, so they are still forces for the domestic reform complying with these commitments. However the pace and intensity of reform was not as fast and strong as during the period for accelerated accession. The reform process has been affected by the two major factors, the reform fatigue of the accession process and market opening and the impacts of the global financial crisis and recession”.

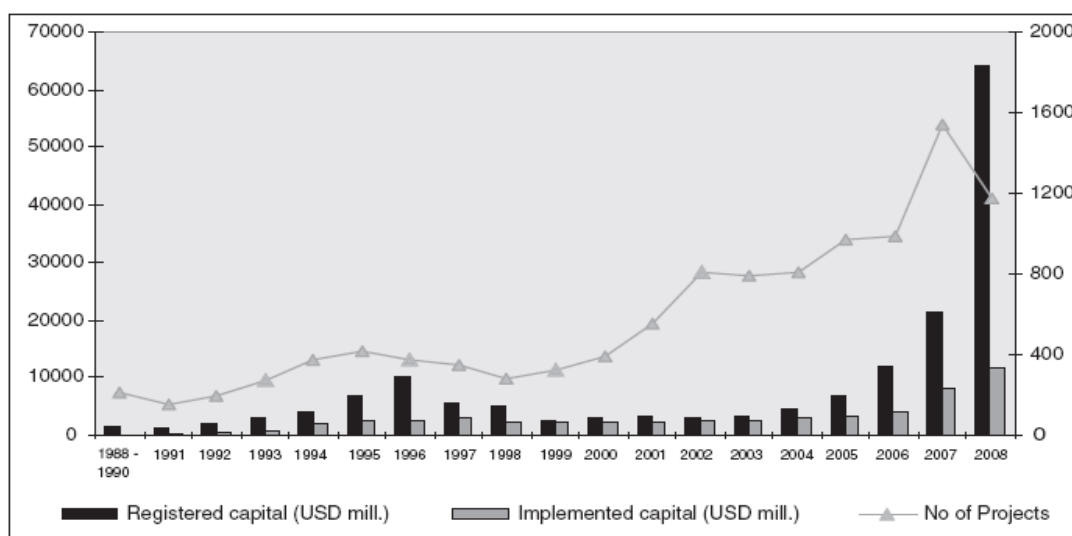
According to Khanh (interview, 2012), Vietnam has strictly implemented tariff cuts laid out in WTO commitments.<sup>71</sup> Vietnam engaged in several regional FTA's under the ASEAN integration such as ASEAN China FTA, ASEAN-Korea, ASEAN-Japan, ASEAN-Australia/New Zealand. Most of them are beginning in 2015 with 0% tariff for many goods. Thus, there is an expectation that the pressure from tariff cuts is still paramount in the manufacturing sector. More effort from both government and enterprises is needed to conduct further reform and renovation of policies and operations (Tuyen et al, 2011; CIEM, 2007). According to Khanh (interview, 2012), "this pressure is at the right level for Vietnam industries because the tariff cuts are gradual and take place in several years. These provide enough time for enterprises and the government to react and prepare for the changes". CIEM (2010, p.4) stressed that "the government roadmap for tariff reductions since mid-2007 has been significantly faster than that in the WTO commitments". Vietnam government fully implemented the tariff quote rate for the products allowed under the WTO commitments and removed all the remaining quotas and removed all agricultural subsidies (CIEM, 2010).

Vietnam has a high level of market opening, with the volume of imports and exports exceeding 1.7 times of the GDP (WB, 2011). As a result, Vietnam is highly sensitive and vulnerable to external shocks, such as the fluctuation of world prices, economic situation of the main trading partners as well as the world economic situation (CIEM, 2010; Anh, 2012a). The current global financial crisis was the vivid example of the implications. The GDP has fallen down to lowest point of 5.3% since 1999 (Anh, 2012a). So there is pressure for the government to continue their reforms and to coordinate the macroeconomic policies for a more stable and growth supported economy (Anh, 2012a). The Prime Minister confirmed that with the limited resources, inadequate legal system, lack of the experience in market economy operation, there is a big challenge of the government in running a stable macro-economy, having capacity in

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<sup>71</sup> The average EPR for the whole economy has dropped 2.1 times from 21.4% in 2005 to 10,3 % in 2020. The nominal average tariffs also reduce 2 times from 11.1% in 2005 to 5.4% in 2020 (CIEM, 2007). Indeed, actual EPR may be lower due to the possibility of lower actual tariff (Tuyen et al, 2011). Thus, the pressure from the WTO accession is still high for the Vietnam producers. Manufacturing has the highest reduction rate from 40.4% in 2006 to 20.8% in 2020 (CIEM, 2007).

planning and forecasting as well as appropriating managing mechanisms for coping with the changing environment of the international market (Government Online, 2006).



**Figure 4.2: FDI inflow in Vietnam from 1988-2008**

Source: WB, 2011

The benefits of the WTO accession are in terms of the opportunities, which need conditions for realising them in order to make real gains for the economy (Tuyen et al, 2011). Table 4.2 shows that the FDI commitments have continuously reached new high records since 2006.<sup>72</sup> Foreign Indirect Investment also increased significantly since 2006 (CIEM, 2010). However, the Vietnam economy soon exposed its limits in absorbing the strong dose of investment flow, when the economy became macro economically unstable, with high inflation rates (CIEM, 2010; Anh, 2011a). CIEM (2010) judged that macroeconomic instability showed that the administration was not up to meeting the rapid and strong impacts of the economic integration. Moreover, this also proved that several bottlenecks in the economy still need to be addressed. These are the low quality and high cost of the infrastructure, the lack of skilled labour, low productivity, ineffective investment, etc (CIEM, 2010). There are real pressures on the government to maintain reforms and for overcoming such limitations in government

<sup>72</sup> In 2006, the FDI commitments reached USD 12 billion, which increased 75% of that in previous year. In 2008, this figure was USD 71 billions in 2008, which was 4 times higher than that in 2006 (GSO, 2009).

capacities, the administration, mechanism, the infrastructure and productivity (CIEM, 2010).

The WTO accession process is still continuing to play an important role on changing the interest balancing favouring the economic reforms. Firstly, Chi Lan (interview, 2012) said “most of the government’s objectives of the WTO accession have been achieved in the first few years of the process”. This was a big boost for the reformers to expand their influence. The economy had achieved a record high growth rate of 8.5% in 2006 and the highest rate since 1997 (GSO, 2010). The structure of the economy has also changed, with an increasing proportion of manufacturing and construction and decreasing proportion of agriculture (CIEM, 2010). According to CIEM (2010), manufacturing and service industries achieved high growth rates above the increase of the GDP. The exports also gained benefits from the WTO accession, which contributed significantly into the growth of GDP (CIEM, 2010).<sup>73</sup> As a result of the WTO accession, the trade barriers in the WTO trading members were significantly reduced (CIEM, 2010).<sup>74</sup> However, the WTO accession is also associated with a huge trade deficit of 14.1 billion USD in 2007 (CIEM, 2010). The volume of imports also rocketed to 62.7 billion USD in 2007, which was an increase of 39.6% of that in 2006. The imports were mostly the input for the production and export, however, increasingly included consumer goods (CIEM, 2010). In 2007, the total investments hit a record high due to the sharp increase of FDI and of the State sector investment (CIEM, 2010).<sup>75</sup> The sharp increase in the FDI might be the result of the WTO accession, which might show the improvement of the legal system and business environment and the potential of the market (Luong, 2007; CIEM, 2010). Moreover, Khanh (interview, 2012) mentioned that “the WTO accession also helped to diversify the export products of Vietnam. The

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<sup>73</sup> The volume of export reached USD 48.6 billion in 2007, which increased 21.9% of that in 2006 (GSO, 2009).

<sup>74</sup> The Volume of non-oil export was increased 27% in 2007 and 30.6% in 2008 (MPI, 2010), in which agricultural such as coffee, rice, and cashew and textiles and garments products had high growth rates (GSO, 2010).

<sup>75</sup> The total investment of the whole economy was 521.7 billion VND in 2007, which was equivalent to 45.6% GDP. In 2008, the investment was equivalent to 43.1% GDP (MPI, 2010). The registered FDI was 21.3 billion USD and unexpectedly high at 71 billion USD in 2008 (GSO, 2010).

export structure is also moving towards having more exports from manufacturing”. He also stressed that “US-BTA has brought a significant change in the market access for Vietnam products”. CIEM (2012) reckoned that the WTO accession has enhanced Vietnam’s image in foreign affairs. Since the WTO accession, Vietnam has actively broadened its involvement in foreign affairs and increased its diplomatic recognition around the work with bilateral and multilateral efforts. These processes have gained many successes for Vietnam in the both economic and diplomatic fields (Han, 2008).

**Table 4.4: FDI, Export and import value after the WTO accession (billion USD)**

<i>Years</i>	<i>2005</i>	<i>2006</i>	<i>2007</i>	<i>2008</i>	<i>2009</i>	<i>2010</i>
<b>FDI Commitments</b>	6.83	12	21.34	71.7	21.1	18.6
<b>Implemented FDI</b>	3.31	4.1	8.03	11.5	10	11
<b>Total export value</b>	32.44	39.82	48.56	62.69	57.1	72.23
<b>% Increase</b>		22.74	21.93	29.09	-8.92	26.52
<b>Total import value</b>	36.76	44.89	62.77	80.71	69.95	84.84
<b>% Increase</b>		22.12	39.82	28.60	-13.34	21.29

Source: GSO, 2010; 2011.

However, economic performance has deteriorated since 2008. Macroeconomic instability has persisted with high inflation, a large trade deficit and low GDP growth (Han, 2009; CIEM, 2010; WB, 2010). Since 2008, the inflation has been troubling the economy, with the highest rate of 28% in 2008 (Tuyen et al, 2011). GDP growth dropped dramatically from 8.5% in 2007 to the lowest rate of 5.3% in 2009 since 1999, and while also showing that the GDP growth has improved, it is still low and unstable (GSO, 2011).

As the economy liberalised under the WTO accession, it was greatly affected by external shocks from the global economic crisis such as price fluctuations, economic

health of trading partners, etc (Tuyen et al, 2011). Another factor was the high price of imports and this bringing a higher trade deficit into Vietnam (CIEM, 2010; Tuyen et al, 2011). Easy and cheaper imported products due to WTO trade liberalisation increased domestic consumption (Tuyen et al, 2011; CIEM, 2010). Vietnam's experts have not seen this as the primary cause of Vietnam's economic problems and instead point to the Government's mismanagement of the macroeconomic and the partial reforms that have led to an economic slowdown and instability over the last 3 years (CIEM, 2010; Tuyen et al, 2011; Han, 2008; 2009; Fforde, 2012). Government policy has failed to handle adequately the macroeconomic instability, which led to negative impacts on growth and inflation. The State Bank increased the money supply to purchase back foreign currencies. The Bank also fixed a rigid exchange rate, which resulted in import inflation problems caused by rising world prices (CIEM, 2010). The main reasons for the economic instability of Vietnam in 2008 were domestic policies, which put a heavy weight onto high economic growth and were based on investments, especially the State investment (CIEM, 2010; Amer, 2010; Han, 2009; Fforde, 2012; Tuyen et al, 2011). Excessive state investment placed pressure on the budget deficit and economic instability (CIEM, 2010). The coordination between monetary policies and the fiscal policies was not in harmony as tight monetary and fiscal policies were aimed at achieving continuously high growth (CIEM, 2010). The Government did not plan the price liberalisation well. Maintaining high economic growth is one of important goals of the Party-State as this helps to ensure the leading role of the CPV in the society and the ideology of the "market economy with socialist orientation" is still the magnetic needle for economic development of Vietnam. Although WTO accession helped to speed up the level playing field for all economic sectors in the economy, the state sector plays a leading role in central tasks of economic development (CPV, 2011, p.35). The core and central commanding units are the State Economic Groups and Corporations (Chi Lan, interview, 2012; Thai, interview, 2012; WB, 2011; Anh, 2012a). After WTO accession, the process of SOEs equitisation and reform increased its pace and the number of 100% SOEs has been reduced from 3800 SOEs in 2005 to about 1400 SOEs in 2008 and to 1309 enterprises in 10/2011 (Government Office, 2011). Chi Lan (interview, 2012) said on the SOEs reform "this does not tell the real pictures of the SOEs reforms". The Party and Government believed the consequence of the WTO accession would be fierce competition by many international corporations. The principle of the market economy is the 'survival of the fittest', thus the domestic economy needs its strong 'steel' fists for coping with this competition. The SOEs were entrusted to play this role in keeping the

market economy and balancing the competition of the foreign companies. The government has paid attention to promoting the SOEs and placing them in a restructuring process. However, the SOEs promotion could not be done formally, but has been realised through a series of industrial policies including steel, cement, ship building etc. Industrial policies are targeted to promote capital-intensive industries. These industries need huge resource investments and capacities, which were out of the reach of the private sector. As a result, the SOEs were the sole participants of the programme and were also responsible for strategic development for their industries. The central part of the plans was to get huge government investments into the SOEs to make them large-scale enterprises in the industries.

The SOEs privatisation before the WTO accession satisfied WTO's members (MUTRAP, 2007). However, this has not reflected the real picture of the SOEs reforms (Thanh, interview, 2011). Although the speed and number of the SOEs privatisation was quick and large, the capitals of the privatised SOEs were less than 10% of the total capital of the SOEs. The Prime Minister set new targets for SOE privatisation process in 2006, but less than 30% of the target was achieved every year since 2006 (Chi Lan, interview, 2011).

The Government has experimented on the transformation of the large SOEs and State General Corporations' into holding-subidiaries and to establish State-owned Economic Groups (SOEG) (Thanh, 2011). The SOEGs are groups of enterprises each with distinct legal status, which are gathered together through mutual investment, capital contributions and other forms of affiliation (WB, 2008). They are organised under the 100% state owned parent limited companies or limited holding companies, who share long term economic interests. These subsidiary companies may be joint stock companies or 100% state owned companies (WB, 2008). This experiment has aimed to change ideas on the role of Government in ownership of the SOEs. The Government, instead of investing and managing the enterprises can now limit this to having shares in the enterprises. However, McGough (interview, 2012), a political policy expert to the Vietnam government noted "the relationship between shareholders and senior executives in Vietnam is somewhat complicated, but basically it is beyond the owners' capability to release power to second parties. Owners and executives are nearly always one and the same, and both major day to day decisions and the overall business strategy



is concentrated in the hands of the main shareholders”. Thus, Government ownership means they are still making all of the major decisions. Thai (interview, 2012) said that “Two State Owned Economic Groups (SOEG) were established for the experiment just before the WTO accession, which were the Vietnam Coal Groups in 8/2005 (which later become Vietnam Coal and Mineral Group (VINACOMIN) in 12/2005) and VINATEX in 2005. These two groups both have been upgraded from the two existing corporations”. Thanh (interview, 2011) suggested “the model was expanded in 2006 and after four years of experiment, there were 12 SOEGs in operation”. The model increased the size and power of the enterprises as it integrated the vertical production chain into one big economic group. Many of them even have their own banks or they have financial and securities subsidiary companies”. Chi Lan (interview, 2012) was concerned that “rapid expansion of the SOEGs is not only leading to concern over their size and monopoly power in the market, but also generated concerns on the process of SOE restructuring and privatisation. These economic groups are acting as an umbrella for the small and medium SOEs to avoid the privatisation process when they become members of the group”. As a result, the number of SOEs was reduced, but they have not disappeared. For examples, VINASHIN has 454 subsidiary enterprises. These groups become a closed circle of a business empire including providing services such as financial and distribution services. In 2008, most of these economic groups have diversified their core business to many other areas. With their concentration of capital and vertical integration, these Economic Groups are powerful economic entities. They further enjoyed the government’s connections and resources invested in them by their plan for the industry’s development. Fforde (2012) suggested that the SOEGs are also organised around family and relationship connections. These not only distort the market but also erode the disciplines of the market. This also facilitates the corruption epidemic in the country. People also complained that the government money invested in SOEGs for the industry’ developments have been extracted for the personal wealth rather than for the development of the industry. With these assets and connections, the SOEGs are making money for their own personal wealth but leaving the consequences for the government. The VINASHIN case was an example of the situation. It was established for the development of the shipping industry of Vietnam. The government guaranteed an international loan valued at 700 million USD for VINASHIN. However, VINASHIN was soon in debt and economic losses without any paying back capacity, due to its inefficient operation, wrong investment and corruption. The debt of the VINASHIN was recorded at over 4 billion USD in 2010. Although there has been high public attention to

the case, the Party and the state still concluded that it is not their fault in managing this EG and all responsibility rests on the Chairman and Director of the VINASHIN.

Chi Lan (interview, 2012) has mentioned “the boom of the SOEG establishment has indeed reduced the ability of the government to conduct reforms following the WTO accession.<sup>76</sup> The reforms have succeeded in several fronts such as trade, investment and legal framework, but the reforms for less intervention of the government into the economy through state investment and commands for better business environment has not succeeded. The current business environment is even more distorted, because the SOEGs have become very strong interest groups that obstructed reforms”. In the 3<sup>rd</sup> Central Committee Meeting in 2010, the Party recognised interest groups in the economy for the first time. This recognition of the Party is at a time that the corruption and SOEG’s are causing unacceptable losses (Fforde, 2012). Thai (interview, 2012) mentioned, “SOEGs are gaining greater powers and connections, which can influence the policy decision-making. Through personal connection they can influence directly the persons who are making the decisions and be able to by-pass the executives in charge of the decision-making preparation.” Chi Lan (interview, 2012) further stressed “SOEGs can lobby through various channels including the personal channels directly to the top leadership. With this great economic power, these groups can by-pass the Ministry in forming policies and regulations by approaching directly to government leadership. SOEGs are established by the decision of the Prime Minister, thus many of them even ignore the control and management of the Ministries”. Fforde (2012, p.183) found that “politics has changed, capitalism has been established and the Party is finding ways to make money from the political system”. As a result, Chi Lan (interview, 2012) and Tuyen (interview, 2012) believe that “the expected benefits of the WTO accession in regard to the SOEs and market reform have not been fully achieved”.

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<sup>76</sup> Only two SOEGs were experimentally established in 2005. Without a proper evaluation and end of the experiment scheme, the number of SOEGs was increased sharply to 13 SOEGs in 2010. Most of the largest State Owned Corporations were upgraded to Economic Groups within 4 years since 2006.

## **Shareholding, SOEGs and Equitisation: Solution or a deepening of the problems?**

Despite warnings of the inadequate, and to some extent, false equitisation process in Vietnam, the Party continues a policy of cosmetic privatisation (Sjoholm, 2006, p.2). SOE's in Vietnam are plagued by a 'complex maze of cross-subsidization and indebtedness' (Sjoholm, 2006, p.3). WTO accession was an overt acceptance that SOE's needed to privatise or equitise and that the private sector needed to be encouraged and supported. Yet, the Party's covert approach has been a superficial approach and commitment to privatisation, accompanied by the adaptation of a corporate Party strategy involving the Party switching from State controlled status to a 'private' entrepreneurial role that maintains political authority, even oligarchy, over the economic system (Sjoholm, 2006, p.17). The State's actual dominance and control of the economy has remained constant, which is in a stark contrast to China's record. The statistics show significant drops in the numbers of SOE's, but this is accounted for by a large number of small SOE privatisations, while the large SOE's have increased their size and monopolies of markets. State control is hidden behind the shareholding structure, where the Party maintains their interests through manipulation of shareholding control in foreign joint ventures and Stock companies (Sjoholm, 2006, p.17-18). Painter (2005, p.267) notes that Vietnam SOE's strengthened their economic monopolies through a lack of effective Government controls, with regulation left to 'a highly centralised, fragmented and sometimes incoherent set of state institutions'. The confusing and uncoordinated controls meant that 'private actors' in powerful political positions and the SOE sector are able to divert benefits given or created by SOE's into their own 'pockets'. This has been the primary foundation of the creation of an elite interest group, who can now be seen as the prominent political force in Vietnam.

When equitised, the shareholding shape is questionable at best and fraudulent at worst. On average, the State retains 46% of shares, while workers have 29% and 'outside' investors 24%. Even in this overt format the State retains sufficient ownership in the Vietnam shares structure and regulations to maintain overall control. However, the reality is worse, with the workers share having very little influence or power over decision-making, and the 'outsiders' share often involving a sharing out of holdings to Party connected friends and family'. These are often still left as 'votes' of an individual,

but disguised by being held in the names of family or friends. The situation grows worse as the divesting of multiple holdings of shares to one person is made possible through the ‘borrowing’ of family and friend’s names and signatures or the invention of non-existent individuals (Nghia, interview, 2011). The availability of shares is increased by a tendency for workers to divest their holdings of shares very quickly after taking possession and earning the ‘quick profit’. As Fforde (2003, p.21) notes, ‘in Vietnam, the private is not entirely private, and the public is not entirely public’. Foreign investment in the shares is minimal, with for example, only 25 privatisations/equitisations out of 2600 (up to 2006) being allowed to offer shares to foreigners and shareholding limited to a point where foreign ownership is virtually without decision-making powers at any level (Sjoholm, 2006, p.23). Coupled with bad accounting standards, a still weak stock market and the embedded practice of providing false statistics and evaluations, the privatisation process is impossible to accurately assess or to evaluate against WTO commitments. However, it is fair to declare that equitisation/privatisation of large SOEs is virtually non-existent and ‘the State maintains control of the economy’ (Sjoholm, 2006, p.29). The system clearly allows the ‘elite’ political-business interest group a means to monopolise finances and resources and divert them to SOEs and State owned ‘private’ companies, which are then re-directed into their own ‘pockets’. The lack of an efficient institutional and regulatory system to enforce laws provides this elite interest group with even further opportunities for individualistic wealth and power creation.

Although there have been significant improvements in the institutional reforms since the WTO accession, there are still many complaints about the reforms. Tuyen (interview, 2012) mentioned that “the process of institutional reforms have been short of the expectation for the impacts of the WTO accession on the speeding up of the institutional reforms. The CPV resolution mentioned that the WTO accession process might be a catalyst for speeding up the reform process. Apart from many improvements, there are still many shortages in the reforms of the roles of the government, the level playing field between economic sectors, the public administration, the transparency etc”. The CIEM (2010) believe that the quality of some legal documents is not high, comprehensive and clear enough, causing inconsistent understanding, arbitrary enforcement and corruption. Thus, many legal documents are unsuitable for a modern economy. Many also complained about the overlapping mandate of laws and regulation. For example, contracts are under jurisdiction of many laws and regulations such as Civil

Code 2005, Ordinance of Economic contracts, Trade Law, and other laws in different related areas (CIEM, 2010).

A concern is the level of law enforcement, which is still a problem after the WTO accession. The WTO accession process has imposed remarkable improvements in the legal framework and the operation of the institutions (CIEM, 2010; WB, 2011; MUTRAP, 2007). However, Thanh (interview, 2011) criticised that “enforcements of these good improved laws and regulation are still a big problem. When they come into force, the enforcement is shambolic and the laws and regulations lose their affect.” Aggregate institution indicators are still at a very low rate and have not really improved since the WTO accession. The rule of law is improved, but is insufficient in the context of increasing quality of regulatory compliance and accountability, and this suggests that the laws and regulations are not effectively enforced. The control of corruption has been significantly improved but is also now in decline. This also suggests that the decline in enforcement of the rule of law can be correlated with the decline in the controls of corruption. Indeed, the corruption has been considered as a growing epidemic of the society, which has gradually eroded the control and credibility of the Party-State (Fforde, 2012). The corruption is now the highest concern in the society and the Party introduced new laws on anti-corruption and, this has been highly welcomed by the society, but it still needs time to see how it is actually realised in the current situation. Many believe that it will again be a case of a good law but absolutely minimal enforcement, which does little more than make the Party-State now seem ineffective, or even active and willing participants in the corruption.

#### **4.5 Conclusion**

The positive results of the US-BTA and the accelerated effort to join WTO contributed to a change of the views and thoughts of the CPV leaders on economic integration and reforms. Reforms brought a better environment for investment and business and helped towards creating a better society, which could only benefit the future position of the CPV. Support for development through ‘import substitution industries’ declined and was replaced by the strategy of investing and producing the competitive goods and services for the international markets.

The WTO accession acted as a measure to empower the reformers and give them an enhanced political basis for locking-in the progress of the reforms. However, although we have seen in this chapter how WTO and the USBTA helped structure and drive through a reform process, confidence in the future of the economy cannot be high as serious questions need to be asked. Central to these is the clear indication that a socialist oriented free market economy has come to be seen by many on the reformer and conservative side as some form of integrated and interdependent model of economics with a mixture of free market and central command features. There are no previous models to gauge or evaluate the present attempts by China and Vietnam to retain communist political control and ideology in a fast developing free market economy. Free market economics is the very core of the capitalist ideology with Adam Smith's 'hidden hand' of the free market as much a political statement as an economic one. A belief that the two ideologies, Capitalism and Communism can be merged into a hybrid model is the very foundation and justification of the continuing authority of Vietnam's CPV. But this may be an impossible dream unless the negative impacts and problems of its operation are not tackled by the Party.

Vietnam's economy has operated for centuries on a Confucius basis, where relationship and friendship are the paramount forces of successful business. Whether French or Chinese colonialism, American occupation or Communist Single Party rule, the strength of the business world has been its continued reliance on 'relationships' as the basis for 'doing business'. The relationship model is a product of Asian culture, colonialist history, the fights for independence and Communist Single Party rule, which also now imprints free market economics upon the society and country. But it is clear that this has often only served the interests of individuals and individualism. The VINASHIN scandal may merely be the 'tip of the iceberg' and beneath the surface SOEs, 'privatised' SOEs and the 'relationship' culture have meant that the economy suffers from a dramatic drain on its resources by individuals who are amassing gigantic fortunes at the expense of the country and its people. VINASHIN were able to corruptly subvert over \$4 billion dollars and merely a fraction of that amount was handed out in fines (\$143 million) to the convicted perpetrators of the crime. That \$4 billion also has to be understood in relative terms, as Vietnam is a developing country and \$4 billion in economic and political power terms is comparatively equivalent to 10 times that amount

in the Western economies. But the real problem was a system that enabled this type of corruption to take place. SOEs are remaining as chiefly political forces to maintain Central control over the economy and in the process are freed from the pressures of a competitive and free market system, whilst also stifling the incentives for truly 'privatised' and competitive businesses to expand and profit from a open market system.

Although the hybrid model of communist political control in a free market economic model, would seem a contradiction that is ideologically impossible to sustain, the development of a socialist based capitalism, similar to for instance to the Scandinavian countries is possible, and the future rule of a Single Party system is also thus possible, retaining its Communist ideology through the particular Ho Chi Minh morals and values being applied to the society and economy as a whole. The legitimacy of that model would have to rest on providing the benefits of development to all of society and not having them chiefly left in the hands of individuals who grow daily richer at the expense of the rest of society. WTO and the US-BTA have provided the means and opportunity to enter and compete in the global economy, but its future success will depend on factors such as attracting more FDI and welcoming foreign businesses on the basis of their efficiency, high productivity, capital soundness and benefits to Vietnam, and not on whether they are partnered with a particularly powerful SOE, or on relationships, or on a willingness to feed the system of corruption and rent-seeking.

Reforms and change would have appeared to only accelerate when Vietnam reached a critical point in any crisis. The WTO and the US-BTA would then appear to be the 'tools' to actually force through and manage these changes and reforms. This changes our concept of these Agreements as the initiator and cause of these reforms, and in Vietnam, move more towards understanding them as a means to an end, rather than the definer of what that end is or its cause. The imposition of the WTO model on Vietnam for instance, has been redesigned as hybrid political experiment in Single Party Socialist rule in a free market economy; something that the original creators of the WTO would have felt an impossible contradiction. The impact and strategies for coping with crisis in Vietnam need to be understood from both a cultural and behavioural perspective, with change the result of the pressure of impending catastrophe and the

only real means to bring about reform in Vietnam. Set against this society wide aversion to change, and a belief in ‘better the devil you know than the one you don’t’ the movement of Vietnam to free market economics is truly a giant step into the unknown, and much of the reforms might then been seen as reactive, rather than planned.

There is the possibility of developing a hybrid ideological model that involves Party power remaining, but only by the Party becoming the facilitator of the economic system whilst also ameliorating the negatives impacts such as unemployment and poverty. The WTO can remain as the means to support this, with Government providing guidance and power to establish a society of high morals and values based on Communist communitarianism and opposed to individualism, whilst maintaining a free economic market system that provides the financial wealth to further improve the economy and society through free education and health, and efficient and sufficiently rewarded administrative and legal systems that discourage corruption, rather than benefit from it. In this thesis it is vital to understand that in contrast to other countries that have gained accession to the WTO, China and Vietnam are aiming to maintain the basic ideology of Communism, while applying the economics of Capitalism. Success in this could further confirm Deng Xiaoping’s famous quote that “do not care if the cat is black or white, what matters is it catches mice” and prove that Communist ideology and single Party rule can continue as long as society as a whole benefits from its success.

In order to further understand how WTO accession influenced the process of economic reform in Vietnam, the next three case studies are providing more details of the reforms under the WTO accession in three different industries: textile and garment, banking and agricultural industries. Each industry is representing a different interest group that has been affected by the WTO accession.



## **CHAPTER 5      CASE STUDY: THE AGRICULTURAL SECTOR'S REFORMS**

Vietnam implemented numerous economic and political reforms on the road to developing a market economy. The agricultural sector plays a vital role in the Vietnam economy and society. Commitments of WTO reform focused to a large extent on the agricultural sector, which came under extreme pressure as Vietnam converted from a chiefly rural economy, to a modern urban industrial economy. The impact has created both pressure groups strongly supporting the Accession process and staunch opponents to it, which have even resulted in violent protests and fears for the stability of the country and the rule of the Party.

Accession accelerates the process of reform, provides opportunities for market expansion, and helps in adjusting the political and legal framework and better preparation for integration into the global economy (Tu, 2008). The reality of reforms and the reaction to them provides a clear picture of how WTO accession and the reform process are interlinked. It is clear that the liberalisation of trade provided numerous new opportunities for the expansion of agricultural markets and has resulted in vast new inputs of wealth and opportunity for the agricultural sector. However, a major concern is that the actual producers of agricultural goods (the farmers, seafood producers, etc) have been denied many of the benefits. Most producers remain on a subsistence farming level and have enjoyed few of the rewards of a rich and rewarding growth in agricultural exports. The benefits have largely gone to SOEs who have become vital 'middle men'. They act as the 'agents' between the international markets and the producers, amalgamating the profits and rewards of impressive levels of growth in exports and improving them by providing the producers with limits to prices that are more of the reflection of the past central controls of quotas and prices, than the delivery of new opportunities. Thus, producers, such as farmers, have seen little reason for celebration of WTO accession and instead find their opportunities for development stultified by prevention of direct access to their markets, and domestically limited by archaic regulation of ownership of land, limitation of investment and generally a wholesale denial of their ability to progress to an economically and politically powerful

force for change and development. This chapter will show that this is a deliberate and conscious policy and intended to ensure that agricultural producers/peasants do not become a powerful voice for reform at the lowest level of subsistence. This chapter will examine how the current development of the agricultural sector has progressed, the reforms undertaken in the last 20 years and the impacts of the WTO on the reform process.

## **5.1 Overview of the Agricultural sector and policies**

Agriculture plays an important role in the political, economic and social development of Vietnam. More than 70% of its population live in rural areas, with the vast majority dependent on the agricultural sector (Son, 2006; Bich, 2007; Nguyen and Hoang, 2012).<sup>77</sup> Agriculture provides inputs for processing and is vital to exports. It is one of the major political forces in the country and its influence is the very foundation for stable politics and society (Son, 2006; Nguyen and Hoang, 2010; Son, 2008b; Tu, 2008).

Since 1986, Vietnam's agricultural sector has developed and contributed remarkably to the economy (Le and Liu, 2006). The agriculture sector has maintained rapid growth with an average of 5.8% a year (Tu, 2008). This growth rate is not as high as in the industry and service sectors, but is much higher than the average rate of many other parts of the world (Son, 2008). The contribution share of the agricultural sector to the GDP has decreased over time, owing to the more dynamic sectors of the economy (MUTRAP, 2008; GSO, 2012).<sup>78</sup> The structure of the agricultural sector has also moving towards modernisation (Son, 2008).<sup>79</sup> The agricultural sector has not only

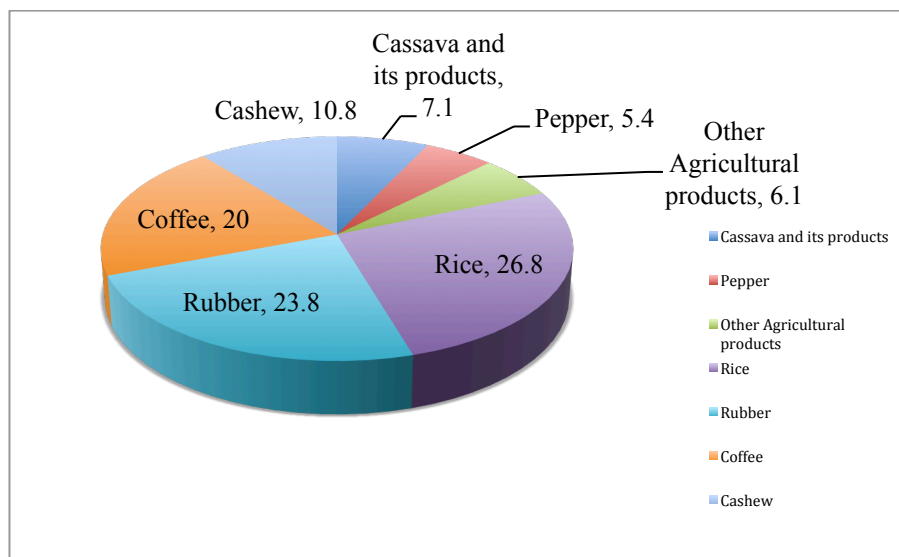
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<sup>77</sup> Seventy one per cent work in the agriculture sector (10.46 million households). Its most important role is to ensure food security for the nation. Eighty eight million require food and the population increases by 1.2 million every year.

<sup>78</sup> The share of agriculture in the national economy accounted for around 20.58% in 2010, falling from 27% in 1995

<sup>79</sup> Agricultural cultivation has reduced gradually from 78.1% in 1995 to 72.1% in 2011. The proportion of livestock farming increased from 18.9% in 1995 to 26.5 in 2011 (GSO, 2012).

guaranteed the steady provision of foods for the country's industrialisation process but also contributed greatly into the state budget by its growing exports (Son, 2008; Nguyen and Hoang, 2010).



**Figure 5.1: Export share of the major agricultural products**

Source: Custom News, 2012

Before economic reforms, Vietnam imported more than 500 million tons of foods every year. Since 1988, Vietnam has produced enough foods for their large and increasing population and become the biggest rice exporter in the world. Many other agricultural products have achieved leading world market shares (Son, 2008).<sup>80</sup> Agricultural exports are a major source of foreign exchange earnings for Vietnam.

Agriculture is not an attractive sector for investment (Son, 2006; 2008).<sup>81</sup> In the period of 2004-2010, public investment for agriculture just accounted for around 7% of

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<sup>80</sup> In 2011, the export value of the agricultural products including forestry and fishery reached 16.8 billion USD, which accounted for 23.3% of the total exports (GSO, 2012) and is 28% higher than the previous year (GSO, 2012). In 2008, Vietnam also imported 4.5 billion USD of foods, foodstuff and live animals, which was up by 38% compared to the previous year (GSO, 2010).

<sup>81</sup> Private investment just made up 13-15% in the total amount of annual investments.

the total state investment (GSO, 2012; 2009). Son<sup>82</sup> (interview, 2010) noted that “the industrialisation process has also attracted young labour out of the rural and agriculture areas and into the cities, which has further forced agriculture into more difficult circumstances”. Thus, agriculture is currently facing many difficulties.

## **5.2 Agricultural Sector Reform**

Agricultural reform was in three major phases; from 1986 to 1995, as agricultural production develops in compliance with market demands; from 1996 to 2002 with reform in terms of production structure and enhanced export capacity to keep up with the international economic integration since 2002 (Son, 2008; Bich, 2007). The third phase started from the time of Vietnam’s accession to the WTO.

### **5.2.1 Agricultural shift to an export-oriented economy from 1986-1998**

Agriculture was one of the first sectors to carry out reforms. Since 1979, “fence breaking” activities were spontaneously and secretly done in several local government areas. Farmers were contracted to collectives to take production responsibilities for a stage of production, then later for land and equipment (Phong, 2009). The difficulty in producing foods for the nation meant the success of these fence-breaking activities (with higher productivity and more foods supplied to the local people) led to the CPV’s informal acceptance of using these methods in the collectives from 1981. This was the first reform of the CPV under the pressure of the food shortages. However, this partial reform was soon exhausted in 1984, when the lands and equipment still belonged to the collectives and the returns to the collectives under the plan were increasingly high for the farmers (Phong, 2009; Bich, 2007). From 1984, the country again fell into a food shortage crisis, leading to wholesale famine in 1987 (Bich, 2007).

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<sup>82</sup> Dr. Nguyen Kim Son is the Director of Institute of Policy and Strategy for Agriculture and Rural Development.

The 6<sup>th</sup> National Party Congress (1986) concluded that “the centrally planned mechanism no longer creates momentum for development, weakens the economy, generates barriers to production, reduces productivity and product quality and places circulation of goods in chaos” (CPV, 2004, p.23). The Congress officially announced economic reforms, recognising the existence and role of a multi-sector economy in Vietnam and the free flow of goods in the market. Congress announced the shift in focusing on heavy industry to producing agricultural and consumer products (Phong, 2009). In Decree 10-NQ/TW (1988) on management reform in the agricultural economy, farmers were allowed to lease the lands from collectives for durable contracts up to 15 years. They could own the means of production or contract the facilities from collectives for undertaking cultivation. Contracted households would complete targets for the State and then could decide on the remainder of production and conduct trade with collectives and State-owned institutions on the basis of equality and price negotiation (Phong, 2009). ‘Contract 10’ was a milestone for the development of the market economy and the agricultural sector, ending collective works and ‘liberalising’ the resources from these collectives to put them into individual households. They became key economic entities in agricultural production, working for the benefits of themselves and free to decide the methods and investment of productions and distribution of the output (Phong, 2009; Bich, 2007). State-owned agricultural and forest farms moved their focus to providing services and technology for the overall agricultural sector instead of just for large production units. The scale of agricultural and forestry farms were restructured according to their suitability in regard to their facilities, technology and managerial expertise. Redundant land was returned to local governments for handing over to households or leased to its members under the contract system (Bich, 2007). However, land ownership law in Vietnam remains to this day complicated, with only the ability to lease the ‘use’ of land. Land is owned constitutionally by the “People” and administrated on their behalf by the Party and Government. There are no freehold hold ownership rights and the major ‘possession right’ is a ‘red book’. The red book is a certificate of land *use* and not ‘ownership’ but permission to use the land for a fixed length of time.

Reform took effect immediately with food production scaled up to provide adequate food for the nation. The liberalisation in the production and distribution of agricultural products helped increase the productivity and provided incentives for

production. Vietnam was able to enjoy a new abundance of rice at low costs and exported rice for the first time in 1989. This ended the period of food shortages and of dependence on imported foods (Phong, 2009).

At the 7<sup>th</sup> National Party Congress (1990), the Party Central Committee fleshed out the continued reforms and acceleration of socio-economic development in rural areas, which focused on the following points:

1. Rural development moves toward commodities production as the top priority in the course of industrialisation;
2. Implementation of a consistent policy on a multi-sector economy in agriculture and the rural economy, and;
3. Expanding production in parallel with a broader market and encouraging application of technology and properly protecting domestic production (Bich, 2007, p. 298).

A series of legal documents were released to create a framework for agricultural development (Bich, 2007; Son, 2006). The Land Law (1993) affirmed the long-term right to land use for the farmers. Households were authorised with the right to land use from 20 to 50 years on the basis of land type (Le and Liu, 2006). The Law regulated 5 fundamental rights of households including inheritance, transfer, transform, leasing and mortgage. Many legal documents were issued to re-enforce the State's policy such as the Law on Taxes on Use of Agricultural Land, the Law on Foreign Investment Incentives, the Law on Collective land, serving as legal platforms for mass production and agricultural economic reform, reform of State-owned agricultural and forestry farms. Re-organisation and reform of management mechanisms in SOEs created a legal frame for the development of a multi-player and market-regulated economy (Bich, 2007).

Vietnam's agricultural sector recorded fast growth and increased exports (Nguyen and Le, 2010). International trade helped this sector shift its production structure (Tu, 2008; Son, 2008; Bich, 2007). The reforms enabled agriculture to develop specialised areas, for instance rice bowls in Mekong Delta region, tea production in the

Northern upland, rubber and fruit crops in the Southeast, Mekong and Red River areas, sugar cane in the Central area, etc (Nguyen and Hoang, 2010; Tu, 2008; Son, 2008). Agricultural products became staples for export such as coffee, rubber, cashew and pepper, etc. (Tu, 2008; Bich, 2007). The export value of agro-forestry-fishery products accounts for 38-40% of the total export revenue per year (Tu, 2008; Son, 2008).

From 1989 to 1999, agricultural production and fisheries grew by 4.3% and 5% per year respectively. People's lives have been remarkably improved and the poverty rate has reduced by 2% per year. Agricultural development has substantially contributed to macroeconomic and social stability (Son, 2006; 2008).

Weaknesses in the agricultural sector also became apparent, as it struggled to fully integrate with the international markets. Vietnam experienced a boom in food production, but such progress is mainly attributed to the lifting of regulations constraining production during the command economy period. Farmer households still used inefficient methods that affected the quality of products and services. Although sufficient for the domestic market, they were unsuitable to the demand and quality requirements of foreign consumers. Low-quality products are often purchased at low prices while exports are mainly unprocessed products (Tu, 2008; Nguyen and Hoang, 2010; Son, 2006; 2008; 2008b). Vietnamese rice, in spite of its second rank in the world, is purchased at the lowest price among rice exporting countries, even lower than the rice of Thailand, and with Vietnam rice at US\$ 40 per ton, compared to the US\$ 300 of Australia, the profit margins are extremely low. As for coffee, pepper and rubber, the price is usually much lower than that of other countries. Initial challenges in the integration process revealed the numerous weaknesses of Vietnam's agriculture (Tu, 2008; Son, 2006; 2008; 2008b; Nguyen and Hoang, 2010; Bich, 2007).

### **5.2.2 Reform problems and slowdown: 1996-2002**

Despite the State's good intentions, agriculture has failed to solve its weaknesses. Policies are slowly implemented and often unsuitable to the reality. Son (interview, 2010) suggested that "agricultural development is facing increasing difficulties in a competitive environment, leading to negative impacts in rural areas such

as abandoned land, migration to the city, unemployment and poverty, causing political instability” and unrest in several provinces such as the Thai Binh and Central Highlands protests (Nguyen and Hoang, 2010; Kerkvliet, 2001). It faces limitations in trade and investment, institutional reform, and slow agricultural development.

**Table 5.1: NRP and ERP estimate of Vietnam tariff from 1997-2003**

	1997		2001		2003	
	NRP	ERP	NRP	ERP	NRP	ERP
<b>Weighted average</b>						
<b>Agriculture</b>	8.12	<b>7.74</b>	6.28	<b>7.43</b>	11.06	<b>12.52</b>
<b>Mining</b>	9.42	<b>6.05</b>	8.91	<b>16.39</b>	3.55	<b>-0.03</b>
<b>Manufacturing</b>	30.63	<b>121.47</b>	25.28	<b>95.97</b>	29.23	<b>43.94</b>
<b>Total tradable</b>	20.95	<b>72.22</b>	17.92	<b>58.46</b>	18.2	<b>24.87</b>
<b>Simple average</b>	23.32	<b>59.54</b>	20.14	<b>54.1</b>	19.98	<b>26.23</b>
<b>CV</b>	133.81	<b>156.01</b>	149.9	<b>172.34</b>	106.51	<b>134.93</b>

Source: Athukorala, 2005

Son (interview, 2010) noted that “Trade and investment policies were biased towards industry, where the Government advocated industrialisation and modernisation, at the expense of agricultural development”. The Government focused on promoting industrial policies that benefited import substitution industries and SOEs. Table 5.1 showed that trade and investment were highly protected industries, and diverted resources from agriculture to industry (Son 2006; Nguyen and Hoang, 2010). For Athukorala (2005), the systems of export and import tariffs of Vietnam before the acceleration process of WTO negotiations in 1997-2003 had discriminatory treatment against potential exporters (Athukorala, 2005).<sup>83</sup> The 2003 increase was mainly caused by rising tariffs levied on outputs (Tu, 2008; Son, 2006). Vietnamese industry was only able to supply about 25% of tractors and machinery required for the agriculture sector.<sup>84</sup> Most chemical fertilisers, pesticides, veterinary medicine and plant seeds had to

<sup>83</sup> Effective protection rates for agriculture were lower than that of industry (7.74% in 1997; 7.43% in 2001; 12.52% in 2003) (Athukorala, 2005).

<sup>84</sup> In 2001, economic units in rural areas possessed nearly 1.3 million water pumps, which increased to 1.9 million in 2006. From 2001 to 2006, the domestic industry produced just 44,000 of these water pumps, accounting for around for only 7.5% of water pumps in the rural area and demonstrated the very low capacity of the industry to serve the domestic needs (Tu, 2008; Son, 2008; Nguyen and Hoang, 2010).



be imported. Every year, material demands for the husbandry industry are worth nearly US\$ 1 billion (Tu, 2008; Son, 2008). Son (interview, 2010) mentioned “whenever protection appears, farmers and agriculture have suffered losses from these protections. They have to buy products at a high price regardless of its origin”.

An industry-biased trade policy widened the price gap between manufacturing goods and services and agricultural ones (Tu, 2008). The situation of ‘price scissors’ brought about adverse impacts on agriculture for years.<sup>85</sup> Agricultural competitiveness was declining and the difference between price increases of agricultural products and its inputs increasing (Dinh, 2010). In provinces like Thai Binh, Hai Duong, farmers gave up their land or no longer cultivated due to high production costs and losses (Dinh, 2010).

Agriculture has low returns and protection and is a risky business, thus, unattractive for both domestic and foreign investment inflows (Son, 2006). Investments are often diverted to high protection areas such as the automobile, motorbike, electronics industries, etc (Tu, 2008; Son, 2008). The lack of investment leads to low development in capital, science and technology growth and weakened the application of science and technology. Public investment showed the bias against agriculture<sup>86</sup> (Dinh, 2010; Nguyen and Hoang, 2010; Son, 2008). In contrast, investment in industry was increasing (Tu, 2008; Son, 2008).<sup>87</sup> The ratio of public investment in agriculture to GDP is much lower than that of other developing countries. The State has not encouraged

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The supply of trucks and tractors was just 28% of the additional increase required to meet the demand of the rural area (Tu, 2008; Nguyen and Hoang, 2010).

<sup>85</sup> From 1989 to 2000, the growth of agricultural competitiveness was 7.3% per year, increases in agricultural products were 14.3% per year, and the increase in the price of inputs was 19.9% per year. From 2000 to date, that figure was 0.9%, 4.2% and 10% respectively (Nguyen and Hoang, 2010; Tu, 2008; Son, 2006).

<sup>86</sup> Percentages of public investment in agriculture just accounted for 7% of the total State’s investment in the period of 2000-2006. Total social investment in agriculture was only 13.8% in 2000 while FDI inflows are only 3-4%

<sup>87</sup> The total social investment in industry rose from 28% in 2000, while public investment in industry also stood at 23% from 2000

timely and effective policies for producers to upgrade their facilities and production scale, and this has delayed economic re-structuring of rural areas (Son, 2006; Nguyen and Hoang, 2010). Agriculture remains out-dated and the rural economy is coping with poor competitiveness and lack of links between production establishments and the market. It was fundamentally dependent on plantation and rice cultivation without low technology application (Nguyen and Hoang, 2010).

Son (interview, 2010) suggested “the priorities for industrialisation and urbanisation have continually seen agricultural land turned over to industry, and this at a time when there already exists insufficient agricultural land.<sup>88</sup> Industrial zones are a major conversion from fertile land”. An additional problem created by this is that the previous system was based on integrated irrigation systems and the piecemeal conversion of plots of land means the system has provided more problems to farmers (Bich, 2008; Tu, 2008). No industrial zone or locality has generated adequate employment for the local population whose land they occupied. This growing poor rural unemployed are becoming a social and economic burden that threatens future political stability of the Party. With reference to Deng Xiaoping’s cats theory, it appears the cat is beginning to fail to catch mice.

SOEs still have a lion’s share of agriculture as they possess most of the land, but consume lot of resources.<sup>89</sup> The right to management of natural resources is unclear. Although the Land Law is revised, it is still not suitable to the real demand and is unable to generate a strong market (Son, 2006; 2008). Activities of trading land use rights,

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<sup>88</sup> Between 2001-2005, the country had 366,000 ha of agricultural land transferred over to other purposes, with 6,124 ha in Ha Noi, 5,017 ha in Hai Phong, 2,287 ha in Ha Tay, 1,049 ha in Hung Yen, 1,200 ha in Hai Duong, 1,200 ha in Vinh Phuc, 3,087 ha in Bac Ninh and 16,627.5 ha in Binh Duong, etc (Son, 2008).

<sup>89</sup> In 2001, agricultural SOEs accounted for 24.5% of 3600 enterprises operating in Agricultural sector. However, the state owned farms had managed a huge land resource of 700,000 ha agricultural land. State Owned afforestation farms also managed nearly 5 million ha of land, which included 3.5 million ha of forest (Son, 2006). On the other hand, the private agricultural companies were using only 23,600 ha of agricultural land (Son, 2006; Bich, 2007).

financing joint ventures and taking land for public goals are still limited (Nguyen and Hoang, 2010).

Reform has been very slow since domestic food security was achieved. Though a lot of guidelines for development of this sector were put in place, they are still only on paper and very few successfully implemented.

### **5.2.3 Reforms during the accelerated WTO accession process (2002-2006)**

CPV issued Special Resolution 06-NQ/TW (1998), recognising weaknesses of agriculture in initial integration, and highlighting reform towards large-scale and modern production systems. It encouraged private and public capitals to invest in agriculture (Bich, 2008). Resolution 03/2000/NQ-CP (2000) declared that the farming economy was yet to meet expectations, in spite of its enormous potentials and, presented unified policies to mobilise development resources for the farming economy, like leasing land on a long term basis, providing credit and assistance for farming. The Government's decree ensured that legal property of farms would not be expropriated or confiscated by administrative measures. It focused upon market policy, including business orientation in line with the market to grasp market information and development.

The 9<sup>th</sup> National Party Congress (2001) set out the building of a unified institution for the socialist-oriented market economy and strengthening of industrialisation and modernisation (CPV, 2001). Modernisation and industrialisation focused on the agricultural shift toward mass production, aligning the processing industry with the market; applying technology and science in agriculture to enhance productivity and competitiveness; increasing values of industrial products and labour in the rural economic structure and reducing percentages of agricultural products and labour; building socio-economic infrastructure, undertaking rural planning, protecting the environment; reorganising production and developing a rural area of democracy, equality, advanced society and continually improving spiritual and material life of the population in rural areas (CPV, 2001).

Import and export activities were liberalised, including the fertiliser and rice industries (Son, 2006). The non-tariff measures such as quotas or licenses were gradually abolished and replaced by tariff measures to meet the requirements of international economic integration (Son, 2006; Bich, 2007).

SOEs restructuring was very slow and the Government instructed the MOARD to restructure and consolidate its SOEs (Son, 2006). From 2000-2004, the MOARD restructured 155 out of 352 enterprises under the Ministry control, accounting for 44% in total<sup>90</sup> (Son, 2006; MOARD, 2010). These SOEs often operated inefficiently and were small in scale.<sup>91</sup> Son (2011), complained that “the process of privatisation and restructuring was behind the schedule of the original plan. SOEs were still believed to be forms of business and production representing the socialist production relations”. Many SOEs were restructured to become big Corporations and the main economic powers in their industry (Chi Lan, interview, 2012). Many used the capital very inefficiently, or corruptly and continue now to operate more as quasi state owned enterprises, retaining many of the disadvantages and faults of the command economy enterprises and chiefly immune from the competitive market forces of the free market economy (Nguyen and Hoang, 2010; Son, 2006). The leaders of SOEs and State management agencies still wanted to maintain the mechanism of some government control and in the process enjoyed monopoly positions and protected through supporting policies such as: monopoly in export-import, quota policies, focal points, interest subsidies, etc or priority positions in funding and investing in facilities, land, winning contracts for State invested projects, having debt frozen or supported when suffering losses. The Government gave vocal support to privatising the enterprises and opening up the market, but in reality did little more than create state monopolies that even when privatised were private entities in name only. The Vietnam economy stands on the brink of yet another financial and economic crisis as the debt of these companies grows to

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<sup>90</sup> In the process, 105 out of 164 enterprises were equitised. The Ministry of Fisheries equitised 12 out of 43 SOEs (Son, 2006).

<sup>91</sup> The loss making SOEs accounted for 27% of a total 880 enterprises in 2000. The profit was only 488.2 billion VND (40 million USD) while losses were 339.1 billion VND (28.6 million USD) (Son, 2006).

levels impossible to service or control. Meanwhile the companies continue to operate at appalling levels of efficiency, safe in the knowledge that the Government will continue to provide support whenever they fail.

By 2003, there were 314 national farms in the country. Pham Quoc Doanh<sup>92</sup> (interview, 2010) mentioned that “many farms didn't find ways to do business effectively. This was a waste, because the farms held a huge area of land, and inherited much from the infrastructure investment for many years”. The land use efficiency of the farms was very poor and the cumbersome management systems and the obsolete infrastructures resulted in poor labour productivity (Bich, 2007; Son, 2006).

The law and mechanisms for agricultural development were improved. The rights and obligations of the farmers and for the Government were clarified. But, controversially, the Government retained overall stewardship of the land and the farmers, as ‘users’ had little rights or control of the requisitioning of the land by the Government and aggravated the situation by being able to set prices themselves and leaving no room for the negotiation of price compensation. Doanh (interview, 2010) suggested that “the farmer was limited to using the land for agricultural purposes and banned from using it for any other purpose. The rights for use of land were limited to 30-50 year terms and the regulated price for land was equal to the market price in normal conditions. The Government autocratically set prices and maintained a monopoly over its use and control”. Thus, farmers and investors are less willing to invest capital on the land, and such conditions mean sufficient development is extremely unlikely to occur.

Agriculture remains a means for well-positioned people in the Government to personally benefit from such things as land priced well below market value (Son, 2006; 2008). Other laws, such as the FDI law and the Domestic Investment Law, stipulated that investment in the agricultural sector is prioritised with special terms for providing lands with concession rent and reduced taxes, but this has less impact if the basic

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<sup>92</sup> Pham Quoc Doanh is the Director of Industrial Economics Department, Office of the Government

problem is that the law deters investment, rather than promotes it (Nguyen and Hoang, 2010). The Government is more often than not trying to achieve mass production while maintaining uncompetitive and unattractive control over it. By clearly offering land ‘use’ rather than land ‘ownership’ the Government makes large-scale investment and the introduction of technology, etc, almost an impossible task (Nguyen and Hoang, 2010).

Special credit policies were also created for the agricultural sector and the Government requested commercial banks lend money to farmers to invest. The Government also subsidised the farmers and businesses involved in the exporting of agricultural products. Since 2002, these policies were revised in order to meet international standards. ‘Policy’ loans were provided by ‘Policy Lending Banks’, not by Commercial Banks. Special banks for social policies were established, especially for projects resulting in poverty eradication. In 2002, new credit policies were also introduced to remove the mortgages for farmers lending small amounts, and to provide loans for businesses in the agricultural sector and rural loans for establishing or upgrading farmhouses (Nguyen and Hoang, 2010).

The Government provided incentives such as tax grants or incentives to carry out research and development agencies to cooperate with farmers to improve the productivity in the agricultural sector. A new program of cooperation between farmers, business people, scientists, and the Government was created for them to work together to transfer technology and promote agricultural products on the markets (Nguyen and Hoang, 2010; Bich, 2007).

There were some significant changes of attitude and funding for the development of the agricultural sector, but they were still limited in the policy implementation process. The Party and Government developed progressive and important new policies, with good intentions. But, the virtual absence of any mechanisms or willingness to apply or enforce the new laws made their existence superfluous (Son, 2006; 2008). The agriculture sector is expected to improve only through the personal efforts and investments of the farmers themselves, and this promises only further hardship and under development for the agricultural industry and

the high levels of resistance to reform is to be expected. Farmers have no reason to reform, or support national reform when the only outcome is further hardship for themselves and very little rewards for the agricultural industry (Son, 2008; Bich, 2007). Farmers were a major resistant to WTO accession and most remain opposed now that Vietnam is a member. Their lack of development is creating a serious crisis, with subsistence farming remaining and the farms themselves run on out-dated technology and little mechanisation. The weaknesses found in the period of 1995-2002 remain or have improved very little (Nguyen and Hoang, 2010). Laws and policies changed in line with WTO accession procedures, but practices and conditions remained the same. There is a need to address the almost wholesale refusal of those responsible for application of Government policy to actually implement reforms. With the added problems only being able to 'use' and not own land the prospects for development are poor and the likelihood is that not only will they continue to resist reform they are likely to become the very core of social instability and unrest.

### **5.3 Impact of the WTO's accession process on the reform of agricultural sector**

#### **5.3.1 Vietnam's agricultural commitments to WTO membership**

Vietnam observed the WTO Agreement on Agriculture, which regulates commercial agriculture in three areas: market access, domestic support and export subsidy (MUTRAP, 2007).

*Opening of the market:* Committed tariff reduction is 10.6% compared with the current MFN tariff (determined by out-quota tariffs), a decrease of 20% of agricultural products against current MFN tariff (from 23.5% to nearly 20% - in-quota tariffs) (NCIEC, 2007).

Quota limitations were removed, except for; eggs, sugar, tobacco and salt. Trading rights were also liberalised and foreign companies were allowed to trade in agricultural products, except rice. Vietnam committed to removing all export subsidies after joining the WTO (NCIEC, 2007). It fully observed the SPS Agreement without a

transitional period and has committed to transparency of all policies on food safety and hygiene. But even a cursory evaluation of this would show that while rules and regulations have been changed the actual standards are still closer to the old ways than they are to international standards (NCIEC, 2007).

Vietnam WTO's commitments are not considered as strong as the Chinese. The average tariff in agriculture is higher and dropped slower than those in China (NCIEC, 2007). Vietnam also committed less than China in several non-tariff and institutional issues in agriculture, such as the number of goods entitled for tariff rate quota and of state trading (NCIEC, 2006). However, Khanh (interview, 2012) said "the commitments on agriculture of Vietnam are appraised as strong and adequate for the Vietnam future development and reforms". The Vietnam economy is much smaller in scale and has a lower foundation and conditions for economic development than the Chinese economy. Taking into consideration these issues, the commitments of Vietnam is high and strong its level of development (NCIEC, 2007; MUTRAP, 2007).

### **5.3.2 WTO's accession process has provided pressure on economic reform in agriculture**

In theory, Vietnam's agriculture with favourable conditions is the most likely beneficiary of economic integration. Agriculture has affirmed its competitiveness throughout integration at regional level.<sup>93</sup> However, WTO integration is on a larger scale and provides tougher competition compared with other trade liberalisation agreements and was a challenge to agriculture as it increased the competition from both domestic and international markets (MUTRAP, 2007)

One of the predicted challenges in the run up to WTO admission was strong competition both at home and abroad (Tu, 2008; Son, 2008). WTO commitments would provide more favourable conditions for foreign companies to penetrate into Vietnam's

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<sup>93</sup> Such as AFTA since 1996, BTA and ASEAN- China Liberalisation Agreement, in which tariffs of many unprocessed agricultural products are reduced to 0%.



market, thus putting enormous pressure onto the domestic producers (Oxfam, 2004). In both the domestic and foreign markets, competition is high. Many competitors are already large and competitive exporters of agricultural products, such as China, the US, Australia, and Thailand (Son, 2008).<sup>94</sup>

Vietnam's agriculture is still exposed to a lack of capacity and competitiveness, and it is in slow development with low productivity, high costs and scientific and technological application is still limited (Son, 2008; Nguyen and Hoang, 2010; Tu, 2008). The major driver of agricultural development is increases in area, materials and labour, even in highly competitive crops like rice (Tu, 2008; Son, 2008). As a result, "Vietnam's rice productivity is only about 65% of China's and Indonesia; rubber productivity is just about 50% of Malaysia, Thailand and vegetable productivity is lower than the average of regional countries" (Tu 2008, p. 140).<sup>95</sup>

The cost of agricultural production is high due to the country's low level of development (Tu, 2008; Son, 2008). The price of domestically-produced feed is higher than that of foreign countries-about 20-30% (Tu, 2008).<sup>96</sup> Industrial inputs for agriculture like tractors, fertilisers and chemicals are scarce and expensive (Tu, 2008, Son, 2008; Nguyen and Hoang, 2010). Production costs are fairly high, for example the price of Vietnam's processed sugar is US\$ 220 per ton while that of Thailand, Australia and India is US\$ 72, US\$ 78 and US\$ 118 respectively (Tu, 2008). Vietnam's agriculture is yet to achieve sustainable development. Production services like veterinary, forest protection, flood prevention and environmental protection are underdeveloped. Natural resources are exploited haphazardly and inefficiently,

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<sup>94</sup> For instance, the US export of agricultural products reached 77.5 billion, in which they exported 380 million USD of agricultural goods to Vietnam, mainly wooden products, cattle feed, milk and milk related products (Tu, 2008; Son, 2008). China exported 1.1 billion USD of agricultural products and material for agriculture to Vietnam (Dinh, 2010). In 2007, Thailand exported 307 million USD to Vietnam in agricultural and its related products (Tu, 2008).

<sup>95</sup> Pineapple productivity is 13 tons per ha and that of Thailand is 24.5 tons/ha. Tomato productivity of Vietnam is just 15-20 tons/ha while that of the world is 50 tons/ha.

<sup>96</sup> For examples, the price of maize in the world is just US\$ 84 per ton and that of Vietnam is about US\$ 160 per ton.

threatening the long-term development of agriculture (Son, 2008). This demonstrates the seriousness of the situation and it's aggravated by an almost institutionalised refusal to change. The industry suffers from high levels of rent-seeking and corruption that promises to eventually place Vietnam into yet another economic crisis, but this time there will be no WTO accession, or Trade Agreement to offset the losses borne from a refusal to change and develop.

Rural business has expanded rapidly and is considered as the driving force for growth in the rural areas; but is still very small in size and quantity. In the Agricultural sector, household businesses are the majority (Nguyen and Hoang, 2010).<sup>97</sup> They lack financial capacity and production management, are of limited scope and efficiency in production, produce poor quality products, as well as suffering from shortage of links in terms of trade, production technology and services (Tu, 2008, Son, 2006; 2008; Nguyen and Hoang, 2010). State Owned Enterprises, cooperatives and farms are in persistent difficulties (Son, 2006). The relationship between producers and businesses remains far from being a large-scale industrialisation form (Nguyen and Hoang, 2010). Although there have been several large-scale clusters of rural commodities production, they are not enough to create a fundamental change in the production nature of the agricultural sector (Son, 2006). Investment and technological application in enterprises are limited due to the risks and low profits of agriculture.

Son (interview, 2010) mentioned that “managerial expertise in the agricultural business is limited, agricultural products are often monotone, inflexible and inappropriate for the international market given the fluctuations of the global agriculture market, processed items are still very few and mostly raw materials for simple processing, thus reducing export prices”. The information about markets is not developed and often untimely and inaccurate, particularly long-term forecasts. The Trade promotion network is ineffective. The policy on labelling and trademarks has not been established (Tu, 2008; Son, 2006; 2008). Farmers are yet to be equipped with adequate sources and skills to take advantage of international integration (Tu, 2008;

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<sup>97</sup> Vietnam currently has 13 million rural households with average agricultural land area of 0.7 ha per household, which is scattered in nearly 100 million small fields.

Son, 2008; Nguyen and Hoang, 2010). Enterprises in rural areas are striving to grasp and master WTO rules. The lack of knowledge brings difficulties to many companies and high costs result (Son, 2008).

WTO membership was a challenge for agriculture, which stemmed from a pressure for more reforms and investment in agriculture (Son, 2006; 2008; Tu, 2008, Nguyen and Hoang, 2010; MUTRAP, 2007). Agricultural production within WTO markets required large-scale production to take advantage of production scope and businesses must be able to compete in terms of market share and communication, ensure good packaging and quality of products, etc (Son, 2006; 2008; Tu, 2008). Vietnamese agricultural would appear to have failed to meet the challenge of reform. Son (interview, 2010) said “Internal shortcomings of agriculture have constituted pressure on policy makers in order to come up with stronger reform to adapt to WTO membership”.

### **5.3.3 WTO accession process has influenced the balance of politics to support the agricultural sector**

During wars of resistance, peasants played strategic roles in amassing the whole people in the struggles for revolutionary victories (Son, 2006; Nguyen and Hoang, 2010). In the post-reform period, agriculture has seen some developments and growth, but, innovation and investment for agriculture have shown signs of slowdown following those successes. State policies have transferred resources to industries through state investments and trade protection. Protected sectors are usually industries requiring extensive capital with few natural competitive advantages (Nguyen and Hoang, 2010). Son (interview, 2009) said “Policy has resulted in slow and out-dated growth for the agricultural sector as well as disagreements between urban and rural areas... reforms have been hampered and realized very slowly due to the huge localised interests from industrial investment and protection activities”.

Direct interest groups in the agricultural reform process include industrial, agricultural interest groups and relevant State agencies. These interest groups have

conflicting interests when the state changes economic policies (Nguyen and Hoang, 2010; Tu, 2008; Dinh, 2010).

Although agricultural interests are heavily impacted by state economic policies, they are not politically strong enough to assemble forces and demand their interests (Nguyen and Hoang, 2010; Dinh, 2010). Farmers and small and medium agricultural enterprises, are inadequate at binding together to raise their voices against state economic policies. There are three causes for this scattered interest (Nguyen and Hoang, 2010; Dinh, 2010). First, the more developed a society becomes, the lesser the role of agriculture in the economy (Son, 2006).<sup>98</sup> Second, although farmers are an important political force, farming households are usually small production units, mainly producing on a self-sufficient basis (Nguyen and Hoang, 2010; Bich, 2007). Third, farmers have low incomes and savings and do not have much potential for development due to low knowledge levels and non-professional training. Son (interview, 2010) noted that “the interests of farmers are only seen in the short term, they are venture-shy, and are mainly occupied with how to make ends meet. Their political awareness and cohesion are not very high”.<sup>99</sup> Farmers view socio-political organizations as leader-exclusive and therefore have not realized the importance of standing together to protect group interests. Despite the existence of many vocational associations in rural areas, mainly State Owned Enterprises are taking part (Nguyen and Hoang, 2010). Farmers’ voices are barely heard during the policy making process (Bich, 2007; Nguyen and Hoang, 2010; Dinh, 2010). The Party are aware of the social unrest that can be borne from the disenfranchisement of such a large group as ‘the farmers’ and although farmers have few avenues for impacting upon the political decision-making process, that very lack of access has caused serious and violent protests in the past (Dinh, 2010). Farmers are suffering negative consequences from WTO reform.

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<sup>98</sup> In Vietnam, the ratio of agricultural contribution to GDP has been largely reduced from 38.6% in 1986 down to 20.91% in 2009 (GSO, 2010). Agriculture growth is considerably slower than industry and service, averaging 4% as compared to 10% and 8% respectively (GSO, 2010).

<sup>99</sup> According to a report of the MOLISA in 2005, non-professionally trained labourers accounted for about 83.12% of the labour force, while this ratio in urban areas reached only 49.3% (Nguyen and Hoang, 2010).

Doanh (interview, 2010) suggested that “From the history of feudal dynasty to the struggle for independence and unification recently, realities have shown that rural stability is the foundation for political and social stability of Vietnam”. Thus with WTO accession challenges, Vietnam’s agriculture has been able to attract more attentions from the Party-State for priority development policies and reforms. This is a good opportunity for the agriculture sector to express its view in the policy reform process of Vietnam, particularly in land, capital, trade liberalisation issues (Nguyen and Hoang, 2010; Son, 2008; Bich, 2007).

On the other hand, WTO accession will help reduce protectionist pressure from industrial interest groups since WTO requirements enforce development towards a more transparent and balanced commercial environment (Mutrap, 2007). This will reduce preferences in trade and investment policies that the government is reserving for industries, bringing industries down to a more level playing field and freeing resources from industries for Vietnamese sectors with more natural competitive advantages like agriculture (Mutrap 2007). During WTO accession, Viet Nam’s custom and duty systems have experienced fundamental changes. Table 5.1 showed that the real protectionist trend in industries decreased drastically from 121.47% in 1997 down to 95.97% in 2000 and 43.94% in 2003. According to Athukorala (2005), this strong decrease is the result of significant reductions of import tax for industrial inputs, which will lead to a gradual decrease of the attraction of protected sectors and resources will instead be diverted to sectors with export advantages. This will in turn reduce production costs and improve competitiveness. Moreover, the real protection for agriculture increased markedly from 7.74 in 1997 to 7.43 in 2001 and reached 12.52% in 2003. Thus, agriculture has enjoyed a more suitable protectionist scheme, which encourages more investment in the sector. MFN customs for finished and by-products, inputs in agriculture were reduced to 25% in 2005, and following WTO accession, down to 20.9%. Almost 100% of agricultural produce falls under this MFN tax line (NCIEC, 2007).

WTO accession requires Vietnam to realise non-tariff commitments in trade. Non-tariff trade barriers distort trade and lead to losses for agriculture. These policies were designed to protect agriculture sectors but in fact are catering to the interests of an interest group in charge of permits, specifically the MOARD. Since 2002, Vietnam

abolished all forms of import bans in agriculture, except for temporary bans for health reasons such as the SARS epidemic. Import permits for many agricultural goods were lifted or simplified including plant genes, veterinarian drugs, pesticides, livestock feed and inputs and new fertilizers (Nguyen and Hoang, 2010; Dieu et al, 2007). WTO accession negotiations also changed many customs regulations, facilitating easier import/export activities such as lifting pricing controls and imposed tax calculations of the past (MUTRAP, 2007). In the past, imported fertilisers must all be subject to 3-5% additional import duties. Since 2002, these additional duties have gradually been phased out. Minimum pricing was also lifted for import/export goods not on the Government taxing list prior to 2002. Prior to WTO accession, Vietnam was still subsidising exports and domestic production. These regulations were in contradiction of WTO regulations and therefore, during 2003-2006, Vietnam gradually restructured these subsidies into preferential loans or guaranteed loans. Loan recipients were also expanded to include any companies' importing/exporting goods eligible for loans. Vietnam reserves almost no subsidies that are contrary to WTO regulations concerning domestic production; most subsidies are in the green box (NCIEC, 2007). Khanh (interview, 2012) suggested that "WTO accession has helped orient non-tariff policies towards international standards and promoted removals of inappropriate non-tariff barriers".

Agricultural export amounts to US\$ 6.9 billion in 2006, a double increase against 2001. During 2004-2006, agricultural and forestry export grew by 23% on average (Tu, 2008).<sup>100</sup> WTO membership promises new market openings for agriculture. Agricultural enterprises wanted greater market access. Vietnam agricultural products were subject to discrimination caused by sophisticated trade barriers like technical standards or dumping taxes.<sup>101</sup> WTO membership is an effective channel for

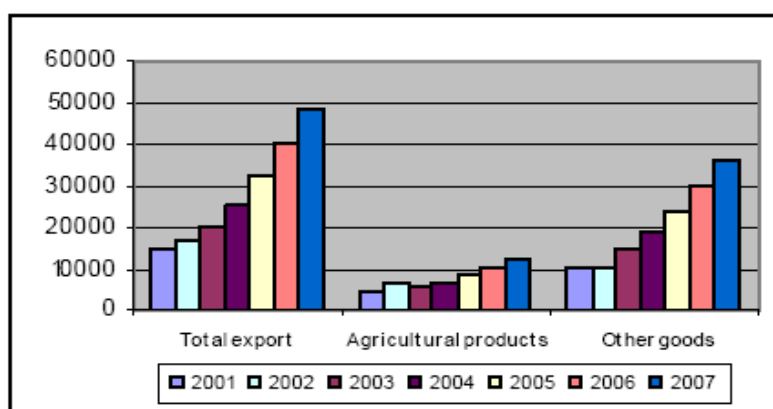
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<sup>100</sup> It is noted that the growth by 47% in 2002 is the result of Vietnam–US Bilateral Trade Agreement that removed US barriers against Vietnamese agricultural products

<sup>101</sup> For instance, Belgium and the EU refused to import 600.000 coffee bags from Vietnam and a huge amount of coffee from UK ports in 2006, accounting for around 72% of Vietnam's coffee export due to low quality and ruined coffee beans compared with international standards. They demanded the return to Vietnam of that coffee or sell at low price, causing massive losses to coffee producers in Vietnam (Tu, 2008; Son, 2008). In 2007, Vietnamese tea was also returned by Taiwan as the residuals of insecticides exceeded acceptable norms. By the end of 2007, Taiwan proposed imposing dumping taxes on Vietnamese tea as import of tea from Vietnam was skyrocketing (Son, 2008; Tu, 2008). Other incidents

Vietnam to defend its legitimate trade rights in a more equitable manner or dispute settlement by the WTO, instead of stand-alone negotiations with importing countries.

The Special Safeguard mechanism under the Agreement on Agriculture enables developing countries to protect domestic producers with a sudden increase in imports of some special products related to food security (Tuoc, 2007; Cordella, 2007). For Vietnam, sensitive products like sugarcane, maize, husbandry products and cassava are staples of the poor and most disadvantaged areas in Vietnam. In addition, maize and cassava are also feeds for husbandry industry, and if they are competing with low-cost and subsidised products of other countries, negative impacts on agricultural producers and the poor in disadvantaged areas are obvious (Nguyen and Hoang, 2010; Bich, 2007; Son, 2008).



**Figure 5.2: Import and export of agricultural products of Vietnam**

Source: Son, 2008; GSO, 2008

### **5.3.4 WTO accession process has guided the institutional reforms in agricultural sector**

The most visible impact on economic reform is amendment of laws and localisation of WTO regulations. In acceleration of WTO membership from 2002 to

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related to Vietnamese livestock industry such as rice export to Russia in 2005, poultry export to China, Cambodia and the EU (Son, 2008; Tu, 2008).

2006, Vietnam has released, amended and supplemented a number of relevant laws and policies related to agriculture in order to meet integration and international commitments. First, is the amendment of laws and policies to create a level playing field for all stakeholders in agriculture and this is included in the Law on Enterprises (2005). The Law unified relevant laws on different type of enterprises and regulated all players (Nguyen and Hoang, 2010). WTO membership helped adjust most of the regulations on domestic subsidies in compliance with the Green Box of WTO (NCIEC, 2007; Nguyen and Le, 2010). By 2006, Vietnam complied with 60% of codex standards related to foodstuffs.

The WTO accession required the acceding country to provide a level playing field for all economic sectors, good trading practices and public transparency in the macroeconomic management of the state (NCIEC, 2007). WTO commitments help the Vietnamese Government rebalance the policy towards greater neutrality. The tax cuts on finished products help reduce the protectionist barriers held by SOEs and lead to better competition (MUTRAP, 2007; NCIEC, 2007).

In 2001, SOEs in agriculture accounted for 24.5% of 3,600 enterprises operating in agriculture, forestry and fishery with the total State-owned capital of US\$ 470 mn. SOEs controlled activities related to export and import, supply of fertilizers, export of rice, rubber, coffee, tea, vegetable and fruit (Son, 2006).<sup>102</sup> Son (interview, 2010) suggested that “SOEs are still weak in terms of its management, bulky apparatus, limited production and business efficiency”.

The Politburo issued Resolution 28-NQ/TW (2003) on the reorganization and reform of national agro-forestry farms (Son, 2006). In 2005, the reorganization and reform of state-owned farms started to be implemented (Son, 2006).<sup>103</sup>

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<sup>102</sup> Those companies are mostly under the management of the Ministry of Agriculture and Rural Development (463 companies) and the State-owned Corporations under auspices of the Government and Ministries (155 business of 4 Corporations 91 and 255 businesses of 15 Corporations 90 (Son, 2006).

<sup>103</sup> The national agro-forestry farms were sorted into 107 agricultural enterprises operating under the Law on State Enterprises, 16 one-member limited companies, 1 two-member limited liability company, 25



### **5.3.5 WTO accession process has influenced the economic development ideology of the agricultural sector**

In the early years of reform, agriculture created momentum for more reform. Internal strength of agriculture held back during central planning economy was released and generated strong production for foods, which helped to stabilise the social and economic situation (Phong, 2009). In the 6<sup>th</sup> Party Congress, food production topped its agenda with the request for adequate food and a food reserve (Phong, 2009; Le and Liu, 2006). There was a remarkable increase in food production, which not only provided sufficient food for consumption but also exported rice for the first time in 1989 after years of starvation and rice import (Phong, 2009; Bich, 2007). At the 7<sup>th</sup> Party Congress (1991), a more comprehensive direction and policy for the agricultural sector and rural economy were formed by the CPV resolution on “continued reform for strong socio-economic development in rural areas” embracing the promotion of development of mass production and a multi-sector policy in the agricultural sector (Bich, 2007, p.298). A major goal of the CPV resolution was confined to production development aimed at meeting domestic demand and dealing with food shortages, not paying attention to promotion of a competitive agriculture in the international market (Bich, 2007).

The real change in the CPV awareness on the potentials of agricultural was started by the process of international integration (Tu, 2008). Although many of the agricultural products were quickly gaining the world top position for market shares, they still suffer losses in terms of prices and preference in comparison with the same products from other countries. Many of them cannot be sold in the international market due to failures in meeting standards of the international markets (Tu, 2008; Son, 2008).

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joint stock companies operating under the Enterprise Law; one joint-venture company and 24 dissolved national agro-forestry farms. The national agro-forestry farms were arranged as the Forestry companies (136 companies) and three joint-stock companies operating under the Enterprise Law; 14 one-member limited liability companies, 68 national agro-forestry farms were converted into revenue-generating units which were the Forest management units; 28 new forest management units were established based on the separation of the protection forest areas from the national agro-forestry farms, 14 dissolved national agro-forestry farms (Son, 2006)

The realities had alerted the CPV to the problems of the Vietnam agricultural industry (Bich, 2007; Tu, 2008). This changed the CPV's thought on the scale and professional production of the agricultural sector. Resolution 06-NQ/TW (1998) emphasised the importance of mass production, increasing the percentage of industry and services in the agricultural structures and stimulating agricultural exports (Bich, 2007).

At the 9<sup>th</sup> Congress (2000), its socio-economic development report continued to stress on the building of a mass production and market based agriculture (Bich, 2007). However, policy on development of a modern and large-scale agriculture was not implemented as expected. The thoughts on rapid industrialisation and import substitution have been the rationale of delayed implementation of State's policy, in which there was the underestimation of agriculture and more attention to industry to create shortcuts to industrialisation (Son, 2006; Nguyen and Hoang, 2010). Son (interview, 2010) suggested that "WTO accession process played a very important role on reminding the CPV to continue to transform the sector to be modern large commodity industry and redefining the importance of the agriculture in the economy".

Doanh (interview, 2010) agreed that "the positive results of the agricultural sector during the early integration have confirmed the determination and trust of the CPV in economic liberalisation and integration". The WTO has a huge 5 bn consumers and 95% of global trade and import value up to US\$ 635 bn per year. It's a good opportunity for Vietnamese agriculture to continue to expand and increase market share (Tu, 2008; Son, 2008).

Chi Lan (interview, 2012) said "the WTO accession means the acceptance of the market economy with fair competitions and rules of games of the international markets". This indirectly influenced the CPV's attention to the agricultural sector as this sector often plays a role as a buffer in turbulent economic times. Unemployed workers from other industry may go back home to rural areas and carry on their agricultural jobs, until difficult times are over and they can find new jobs again. The CPV attention helped reduce the tension and gap between the urban and rural areas in terms of living conditions and development (Tu, 2008; Son, 2006; Nguyen and Hoang, 2010)

#### **5.4 Reforms after the WTO accession**

Khanh (interview, 2012) said “WTO commitments have their implementation period from 5-7 years, and are still providing momentum for the domestic reforms”. For agricultural products, the implementation period was from 3-5 years (Tuoc, 2007; Cordella, 2007). The pressure for reforms is still very strong. The average nominal tariff of the agricultural sector has been reduced rapidly during 2005 to 2012. The low nominal tariff rates also come with the low EPR rate, which showed that this sector is relatively free of protection (CIEM, 2010).

Applied tariffs have reduced faster and lower than the scheduled and committed level, such as in fresh and frozen meats, seafood etc (CIEM, 2010). Due to the opening of the domestic market, several highly protected agricultural products have faced difficulties in competing with the imported products, such as sugar, cotton, tropical vegetables. However, the pressure of the competition has led to the increase of several tariffs to protect the domestic industry, such as poultry and meats.

The good performance of agriculture, during and after the WTO accession, has helped to elevate the position of the agricultural sector and farmers in rural areas (CPV, 2008). According to Chi Lan (interview, 2012), “a goal of the WTO accession set by the government is the increasing of the market access for export products of Vietnam, and it has been successfully achieved. Although many are concerned about the competition pressure to the sector, it is still doing well and gaining the most benefit”. In 2009, the country was in recession, but the agriculture is still maintaining its growth (CIEM, 2010). The growth rate of agricultural exports has increased remarkably and the agricultural sector is one of the rare industries that can produce a trade surplus for Vietnam (CIEM, 2010). As a result, the political voice from agriculture for its own development has been listened to more carefully (CIEM, 2010; Thai, interview, 2012).

**Table 5.2: Total investment and its growth on extended agriculture products over the year**

<i>Year</i>	<i>2000</i>	<i>2004</i>	<i>2005</i>	<i>2006</i>	<i>2007</i>	<i>2008</i>	<i>2009</i>	<i>2010</i>
<b>Agriculture, forestry and aquatic</b>	20933	22963	25715	30087	33907	39697	44309	51071
<b>% Change year by year</b>			11.98	17.00	12.70	17.08	11.62	15.26

Sources: GSO 2008; 2009; 2012.

**Table 5.3: FDI in agricultural and aquatic products since WTO accession**

<i>Year</i>	<i>2007</i>	<i>2008</i>	<i>2009</i>	<i>2010</i>
<b>No. of project</b>	16	23	29	12
<b>Registered capital</b>	58.6	223.5	134.5	36.2

Source: GSO, 2012.

The CPV's Central Committee set up a special session in 2008 for discussing the development of agriculture, rural areas and farmers. The session ended with the Resolution 26-NQ/TW to establish a special scheme for development of the agriculture, rural areas and farmers to 2020, aiming to enhance the living standards of the farmers and rural people; develop a large, sustainable, high quality and effective industry, and a highly competitive multi-sector commodity industry; ensuring national foods security; enhance the human resource capacity for the rural, and enhance the strength of Party control in the rural areas (CPV, 2008). A list of measures was recommended and put into implementation for the development of the agriculture and rural economy such as attracting more resources, implementing industrialisation, building the large and modern commodity industry with high quality, efficient and competitive entities, increasing value added into the products, linking the infrastructure of rural to urban, equality between regions, etc (CPV, 2008). There have been changing priorities and thoughts of

the leadership on the development of the agriculture. A range of the policies has been issued to implement the Politburo scheme to boost the development of agriculture and the rural economy (Bich, 2008; Nguyen and Hoang, 2010).

Parallel with the change in the Government thought on the role of the agriculture, SOEs reforms in the agricultural sector progressed and by 2010, the MOARD only managed 112 SOEs (MOARD, 2011).<sup>104</sup> The restructuring process has helped enterprises reduce costs, and increase their scale and business efficiency. However, the process has been slow and most of the privatised companies were small companies only. SOEs are still holding critical positions in the industry (Tuoc, 2007; Cordella, 2007; Vinafood 2, 2011).<sup>105</sup>

One of the most concerning issues on the institutional reforms of the agriculture is the matter of land ownership (Coxhead et al, 2010). The CPV has stressed one important task of the reforms in the agricultural is to transform the sector from small scale and self-reliant sector to a large commodity production sector (Son, 2006; Bich, 2007; Nguyen and Hoang, 2010). In order to realise this task, the land use right and land ownership for the production process issue needs resolving. Land reforms in the past were the motivation and catalyst for the remarkable agricultural growth in Vietnam (Ravallion and Walle, 2008; Coxhead, 2010). Land is a vital issue because it is not only the input of the production process but also the assets and wealth for long terms investments. The Law on Land (2003) allowed the farmer to lease the land from the Government. The law shows several shortcomings for the new development of Vietnam. The land limitation per household has been a long pressing issue for the investment into the agriculture. Currently, each household or individual can have land

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<sup>104</sup> These include 5 independent enterprises under the Ministry, 68 enterprises which were the members of 1 Economic Group and 3 Corporations 91; 14 Corporation 90; and 38 100% SOE limited companies with the capital of VND 14,054.5 billion (USD700 million), 168% higher compared to 2001. The number of employees in these units was 107,207 people, 23% down compared with 2001. The revenues of these enterprises reached USD 1.2 billion and 145 million of profit (MOARD, 2011).

<sup>105</sup> For example, in the exporting of rice and some other products, Corporation 91 Vinafood 1 (Northern) and Vinafood 2 (South) are the two major stakeholders for rice exporting, although there about more than 150 others rice exporters (Vinafood 2, 2011).

use rights for a maximum of only three hectare of agricultural and forest planting lands. Lands for other purposes such as long-term agriculture plants can be allowed for 10-30 ha depended on the regions. The land right also has its own maximum expiry date of 20 years for yearly agricultural and fishery lands and 50 years for long-term forestlands. Thus, the Law of Land has not provided enough incentives and legal rights for large-scale commodity productions. With limited lands and time of rights, few are willing to make long term investment. Moreover, the Law on Land also stipulates two types of land use right withdrawal. One is done by the Government for the national or local projects and the other is done by the enterprises. The first withdrawal of right to use the land is often done with fixed compensation based on the Government prices on lands, while the enterprises must negotiate with the users about their compensation (Law on Land 2003). Thus, this law creates a loophole for SOEs and private enterprises using the Government projects names to confiscate the land with much cheaper value. These often create protests and complaints focused on land disputes (Coxhead, 2010). The law has been subject to several changes since 2006, however, for many reasons the changes have not been ratified by the National Assembly. In 2012 there were increased demands for change following violence resistance of the land users to confiscation of their lands, with one mass demonstration in Hai Phong illustrating the depth of protest against the Government and regular street protests in Hanoi by farmers from the countryside around the city.

In 2007 a Government plan of action was released, emphasising the tasks to review the existing legal system, remove overlapping and inappropriate regulations, promulgate legal documents, mechanisms and policies, supplement and issue new documents and abolish documents unsuitable to the WTO mechanism and regulation (Dieu et al, 2007). In the MOARD, the review of all legal documents in the areas of agriculture is relevant to four important agreements in agriculture, the AOA, SPS, TBT and the TRIPS.<sup>106</sup> From this review, the MOARD has revised the regulations and

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<sup>106</sup> A total of 116 legal documents and policies had been reviewed and 73 documents were in accordance with WTO regulations, accounting for 63% of the total revised documents; 29 documents need to be amended, making up 25%; 7 documents were abolished, accounting for 6% and 8 documents need to be promulgated. About 31% of documents do not comply with WTO regulations, mostly in TBT and AOA (Dieu et al, 2007).

procedures for complying with the WTO agreements as well as removed the overlapping regulation and procedures for easing the administration procedures (Dieu et al, 2007).

## **5.5 Conclusion**

Agricultural reform was carried out rapidly and strongly in the beginning of reform, transforming agriculture into the free production and market-oriented sector. Being liberated from the constrained mechanism agriculture advanced into being an important economic sector and involved deeply into the international economic integration process. Achievements gained in the agricultural reform laid the firm foundation for the national industrialisation and modernisation. Unfortunately, after periods of sustainable development, agriculture gradually suffered from discrimination compared to other services and industries sectors through trade and investment measures. With the majority of resources diverted to the industry sector, the agricultural sector was not paid enough attention to and left behind other economic sectors. Agriculture remained the small-scale production sector with low competitiveness and unstable developments. Direct producers only gained small benefits from agriculture, thus leading to the increasing gap between the rich and the poor in the rural and urban areas and more serious social conflicts and tension.

Despite the Government's acknowledgement on the inadequacies in agricultural development, the implementation of the agricultural policies remained slow. The roots of these inadequacies lay in the development ideology and agricultural protectionism. With the market-oriented economy model, the State-Owned Enterprises were given the leading roles in the economic development process. Industrialisation and modernisation were also considered the immediate goals of the national development process. Given such ideas, the majority of the SOEs were operating in the industry-related areas, which required a huge amount of capital and technologies. Moreover, the subsidised industries and enterprises also benefited mostly from the State's investment and protection. Therefore, these beneficiary groups would protest any policy changes that were unfavourable to them (Son, 2006).

The State's decision to expedite the WTO negotiation process in 2003 happened when the Government carried out the comprehensive economic structural reform. The WTO negotiations had huge impacts on the agricultural reform in Vietnam, helping the Government balance its priorities for agricultural development and promote the agricultural reform process. Despite the constant trade surplus, challenges on the severe competition from other agricultural markets when joining the WTO were quite visible. This created the impetus to review the agricultural policies and further promote the agricultural reform process. During the WTO process, Vietnam also gradually adjusted its investment and trade policies in compliance with the WTO regulations. This process resulted in the decrease of State's interventions and subsidies granted to the protected industries and SOEs. Commitments to the WTO and the policy amendments helped mitigate the impacts of the subsidised sectors and State-Owned Enterprises.

The improvements in agriculture due to WTO accession appear impressive with for example, 2009 seeing agriculture account for 22.1 percent of GDP, 13 percent of export revenue and creating employment for 61 percent of the labour force (Khai and Yabe, 2012, p.333). The agricultural-forestry-fisheries sector grew at an average rate of 3.4 percent over the 2007-2011 period, which was 0.4 percent above expectations (VNS, 2012a). However, by 2013 growth fell to 2.4 percent, the lowest rise in 10 years (Vietnam News, 2013). By 2012, Agriculture, Forestry and Fisheries (AFF) reached a production value of 173.7 trillion dong and nearly 9 million households by 2011 relied on agriculture as their main income source. By 2011 Vietnam's AFF reached 42.3 million tonnes of rice output, maintaining its self-sufficiency in meeting domestic demand and continuing its position as the leading global rice exporter (GSO, 2012). A worrying aspect is that despite the growth during WTO accession, a comparison with the 2002-2006 period shows that agriculture recorded better growth pre-accession, with the average then reaching 4.2% (GSO, 2012). In addition, the main benefits of export remain with the 'agent' (usually SOEs) while only 4% of farmers have actual direct relationships with foreign importers (Le, 2012, p.4).

The integration process showed that although the competition capacity of Vietnamese agricultural sector was limited, its development potentials were enormous. The agriculture sector always enjoyed a trade surplus and was an important source of foreign currency for the country. Therefore, the successes in the agricultural



international trade activities were viewed as the motivation for the policy-makers to have more open-minded views on opening up the market and free competition. Accession facilitated economic reform through perfecting the institutions and legal systems, and towards creating a more transparent and just business environment. Vietnamese legal documents were reviewed and adjusted to be more suitable to the WTO requirements. WTO negotiations also forced the State to speed up its State-Owned Enterprises' restructuring process. WTO commitments helped the Government balance its trade and investment policies to be more neutral and allocate more reasonable resources into the sectors that Vietnam had the advantages, such as agriculture.

Vietnam also made concrete commitments to WTO in the field of State-Owned Enterprises, in which they were requested to operate on the commercial basis. The State was not allowed to have direct or indirect interventions into the SOEs' activities and SOEs' procurements were not considered the Government's procurements. In its commitments, Vietnam also pledged to report annually about the SOEs' equitisation process. In fact, the agricultural policies were constantly adjusted during the WTO accession. The enduring issues in the agricultural sector such as land, credits, investment and SOEs reform were tackled more intensively. These efforts were clearly demonstrated in the 10<sup>th</sup> Party Congress (2006) and in the Resolution 26-NQ/TW of the Politburo (2008) on the comprehensive agricultural, farmers and rural development. WTO accession created enormous pressure on the agricultural sector of Vietnam.

Accession and membership has established frameworks for reform that accelerate the development of agriculture to becoming a competitive industry. Severe food shortages in the past caused mass starvation and the focus of reforms was first making Vietnam self sufficient in food supplies. Nevertheless, in order to move from stability in domestic food supply, the agriculture industry needed to be assisted in transforming to a modern, mass production system that could compete with international producers. Despite the successes the process of reform has also demonstrated the massive problems with the industry. Not least is its appalling record on productivity compared to international competitors, but also the transparency of these problems has come with WTO accession, as the Government and business have been forced to reveal a number of practices that were harming the industry. These

practices continue with corruption and discrimination in land use rights leading to increasingly violent protests and clear evidence that dramatic changes need to be enacted on land ownership rights. There have been negative and positive consequences of using the WTO accession process as a driver of reform in agriculture, with the difficulties creating the right incentives for growing opposition to reform from groups affected in a negative way. Continued reform, backed up by WTO membership promises further reforms but could result in even greater and possibly more violent protests.

Communist revolutions are often predicated on amassing support of the vast agrarian population and identifying the 'elite' Marxist elements with the 'peasants', to create a 'single' revolutionary class. Nevertheless, the ascending 'rulers' of a communist state often then fear the 'counter-revolution' and see the 'peasants' as its most sensitive source. This elemental fear is highly prevalent in the Vietnam Communist Party, creating a duality of crisis conditions. The CPV curbs the means for the Vietnam farmers/producers to become a powerful political force, restricting their type, level and size of land possession and barring them from direct communication and trading with the major buyers of their produce. This has placed farmers in a permanent state of crisis, reliant on barely enough 'profits' to survive and ensuring they have little opportunity to develop as an independent force in Vietnam. For example, the original distribution of land by the Party involved the issuing of land use rights and leases in 1993 to millions of farmers, limiting them to only 7.4 acres of land and the Government retaining the right to re-possess the land in 2013. This left the farmers little incentive to invest in long term plans involving cultivating the land and investing in costly modernisation and mechanisation strategies. This led to protests in 2012/13 such as Doan Van Vuon and his family who refused re-possession demands and resisted military and police occupation through use of handmade land mines and guns. He was arrested and tried for attempted murder, but has become a 'model' in the minds of many farmers. In the major Ecopark project near Hanoi, with chiefly illegal moves to re-possess the land for developers with Government's relationships, it required the use of 3000 military and police personnel, who brutally suppressed local farmers protesting for their rights. These and many other major incidents have become the subject of deep concern in US-Vietnam relations and in accusations of infringing international human rights laws (Hiebert and Nguyen, 2012, p.1).

Farmers are instinctive and reactive in how they manage their agricultural businesses, deepening the problems of a lack of sustainable development of their businesses and ensuring that they remain in a state of permanent crisis. This is compounded by low levels of education and skills training, restriction of development of economies of scale and little opportunities or abilities to form collective groups, Unions or associations. The agricultural sector stays in a permanent level of crisis, despite widening markets and higher profits as the benefits are retained at middle management (SOE) levels, and the overall mechanisation and modernisation of the industry remains impossible as Party/State strategies are focused more on retaining their avenues into enjoying the benefits while also constraining any opportunities for the farmers to become an effective and united political force for change and reform.

A central issue is the influence of ideology and institutional reforms. The 'ideology' of the Party is concentrated on its own power and constrains incentives for actually improving the independent power and wealth of the farmers, while institutional reforms are based on restricting the growth of political power in the 'masses' involved in the agricultural sector. These almost elemental influences means that the Agricultural sector is divided into major 'winners' and 'losers' in the process of WTO led reforms, with farmers actually seeing the WTO reforms as part of the problem, rather than one of the solutions. Profits are accumulated in 'rent-seeking' conditions and benefit few of the 'masses'; investment is directed towards the 'middle-management levels; and regulation and institutional reform avoids creating independence, entrepreneurship and influence amongst the millions of 'producers', concentrating instead on providing them with a 'glass ceiling' between them and the rewards of WTO accession and membership.

The agricultural sector has the appearance and statistical evidence to generally be listed as beneficiaries of WTO led reform and a winner in the efforts to bring economic reform, re-structuring and financial success. Yet, beneath the perceptions of success is a 'real' story of growing instability, increasing political and violent unrest and the threat of a return to poverty levels of past ages for the vast majority of people involved in the industry. Many farmers can justifiably point to WTO accession and membership as a failure, although it is a failure of the Party/Government, rather than of

the WTO. That ‘failure’ is never more evident than in the Banking sector, where the influence of CPV ideas and the inappropriate and even criminal impact of vested interests has led Vietnam to the very edge of financial crisis. The following chapter describes how the WTO accession process helped structure the system into one that is based on elite interest group control, debt, corruption and the deepening of political and economic bonds, rather than a western liberal and capitalist separation of the two.

## **CHAPTER 6      CASE STUDY: THE BANKING SECTOR'S REFORMS**

The banking and financial services industry has benefited from accession and entry into the WTO. The financial services, especially the banking sector, have played important roles in the economy. It ensures not only the provision of capital resources flows in the whole economy, but also acts as filters of the economy to select effective and potential investment opportunities (Rostowski, 2006; Dung and Hung, 2010). But in this chapter we learn that the reality is far more complicated and involves the realisation that although the US-BTA and WTO accession are steps on the development of Vietnam as a free market economy, the actual situation is proof that the system remains under politically directed central command control. Banks have been the major mechanism in this policy and the Party and Government have used it as a means to maintain control of the economy through the financing of SOEs via Bank loans. Inevitably, the Banking sector has become trapped in a debt cycle, where it has been forced to loan, sometimes at great risk and often to an end where bankruptcy and collapse has led to debt failure. Although laws and regulations have changed in order to meet WTO commitments, this has merely been a camouflage for a system where enforcement is almost non-existent and Banks themselves and their owners have become a central part of the corruption.

Banking needed to reform in order to escape the failures of the past and create a new level of financial stability commiserates with membership of the global economy. Ideas and ideologies needed to change and incorporate a level of economic independence that allowed financial institutions to develop into market driven entities. The vast 'cash' benefits ensuing from foreign investment, new levels of profits and continually increasing access to wider markets needed to be directed and controlled by stronger and more effective regulations and institutions. In all these areas, the conclusion is not whether accession reforms were successful or a failure, but more accurately, how deep are the failures and to what extent can (if possible now) they be reversed by the Party. The thesis finds that the banking sector is quite possibly in a state of critical collapse and will be the start point for the eventual fall into the most serious

economic crisis possible, and the political upheaval that will almost certainly accompany that.

This chapter will examine the impact of reform through the pressure of the WTO accession, but will finish on an evaluation of the present situation and how that affects our evaluation of the impact of WTO accession.

## **6.1 Overview of the Banking Sector**

The Vietnam economy has encountered difficulties in recent years. Fforde (2012) suggested that the macroeconomic imbalances have returned since 2007 after nearly two decades' of good performances. Rising inflation together with high loan growth and increased borrowing costs are threatening to undermine the credit quality of many banks. In addition, a number of large SOEGs have gone bankrupt or performed badly, with further problems with the credit quality of banks (Reuter, 2012; Economist, 2012). The present crisis is believed to be far worse than any previous crisis (Fforde, 2012). Vietnam's banking sector stands on the brink of disaster and yet, the accession to the WTO promised far better outcomes.<sup>107</sup> Banks are struggling to manage NPLs and liquidity problems (Fforde, 2012). In 2012, the Government introduced a scheme for restructuring the banking sector (Decision 254/QD-TTg) and save the banks from systemic risks and to develop a capable and healthy banking system from 2012 to 2020 (Gafin.vn, 2011; SBV, 2010). Many experts believed that the banking sector problem is in a critical situation and on the edge of collapse, with the Government hesitating to conduct fast and costly reforms (Reuter, 2012).

The last 20 years of economic reform has vastly improved the banking sector (Anh, 2012b). The growth of the sector has been represented in the increase of the chartered capitals of Banks.<sup>108</sup> This has been together with the fast growth of M2, which

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<sup>107</sup> WB, 2011; Brummitt, 2012; Bland, 2012

<sup>108</sup> The total equity of the banking sector has increased from 8.35 billion USD in 2008 to 13.7 billion USD in 2010 (Stoxplus, 2011).The total assets of banking sector have doubled from 52.4 billion USD in

registered an average level of 29.19% during 2005-2010 (Linh, 2011). The growth of the credit and the M2 have contributed positively to the high growth of the economy but also created an asset bubble in risky areas such as in the stock exchange and real estate markets (Linh, 2011). In 2011, the banking sector is able to provide credit for the whole economy at 135% of GDP (Thang, 2012).

By the end of 2011, the system of credit institutions in Vietnam consisted of 101 banks and foreign branches.<sup>109</sup> The number of banks has increased from 78 banks in 2006 (Linh, 2011). Small banks account for a large proportion of the banking sector (WB, 2011; Linh, 2011). Linh (2011) reported that 11 out of 43 domestic banks, account for 25.6% of chartered capital with USD 250 million or above. Many small banks have just been upgraded from rural banks to national banks and their expansion has been swift in order to meet the conditions for upgrade, but at the risk of poor quality management and operations (Linh, 2011). The main dominators of the banking sector are still the SOCBs as they have the chief advantages of having large capital assets. Several SOCBs have been equitised, but the Government has retained the largest proportion of shares (Linh, 2011). In 2010, four large SOCBs had a total chartered capital of 3.2 billion USD. Their traditional customers are often the SOEs (FRB of San Francisco, 2011). These customers have been posing both business opportunities and risks. They were big customers and ‘safe’ due to the government back up but also most risky for exposure to NPL risks (Linh, 2011; WB, 2012; Parker, 2012).<sup>110</sup>

Private Banks under joint stock or joint venture forms account for most of the other banks, are often small in size and have low chartered capital. Most of them have a chartered capital under 150 million USD. Their customers are often the SMEs (Linh,

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2007 to 128.7 billion USD in 2010 (FRB of of San Francisco, 2011). The average growth was 31.55% for credit and 28.91% for deposits during the period of 2000-2010. The rates reached its peak of 53.89% and 47.64% in the boom year of 2007 (FRB of of San Francisco, 2011; Linh, 2011).

<sup>109</sup> Including 5 state-owned commercial banks, 1 social policy bank, 1 development bank, 35 joint stock commercial banks, 50 branches of foreign banks, 4 joint venture banks, 5 100% foreign-owned banks; 49 representative offices of foreign banks; 49 financial companies; 12 leasing companies; and about 1000 people’s credit funds with a network of postal saving funds (SBV, 2012).

<sup>110</sup> SOEs have about 60% share of the NPLs of the sector

2010; WB, 2012; MPI, 2006; CIEM and UNDP, 2004; FRB of San Francisco, 2011). The SOCBs still dominate the banking market. Five SOCBs accounted for 49.3% of total loans, compared to 37.1% by the Joint stock commercial banks. However, this role has significantly reduced since 2005 and the SOCBs's deposit market share also declined from 74.2% in 2005 to 47.7% in 2010 (Linh, 2011; WB, 2012).

The younger players of the sector are the joint venture and foreign banks, which are quickly expanding their business activities, holding competitive advantages through sophisticated and high quality services as well as greater management expertise. Since 2007, 100% foreign owned banks have been allowed to operate in Vietnam. Due to the limits on fund mobilisation based on the capital fund of their mother banks, their market share is still limited to 8.9% for deposits and 13.6% for credits. But their market share is expecting to rise because under the WTO commitments, these banks should enjoy the same opportunities in banking services as Vietnamese banks (WB, 2012; NCIEC, 2007; Tran, 2007; Linh, 2011).

Banks have developed in number and size, and provide new services like ATM and Internet banking (Cong, 2010; Linh, 2011; Hong-Dung, 2012). Banking brands also have been upgraded with new technology and expansion throughout the country (Linh, 2011). Thus the sector is able to provide more services and options for customers, which were not in existence in banking sector just 10 years ago (Hong-Dung, 2012).

Despite significant progress the banking sector still suffers many problems and weaknesses, especially with loan quality. Many scandals in banking have been revealed in 2012, such as the higher real NPLs of 9% rather than the reported 3% and money circulating around banks rather than being distributed to the businesses or lenders (The Economist, 2012; Parker, 2012). Experts often express the sceptical view of the stability and possible collapse of the banking system (Parker, 2012; Brummit, 2012; Nguyen, 2007). These problems have proved a pressing need for further strong reforms of the bank's governances and SBV's supervision roles as well as of the SOEs (The Economist, 2012; Mui, 2007).



## **6.2 Banking reform process since 1986**

### **6.2.1 Banking industry before Doi Moi**

After national reunification the old banking systems in the two regions were unified (North and South) into a national central command system (Phong, 2009). A new currency was issued by the State Bank of Vietnam to replace the separate North and South currencies (Phong, 2009; SBV, 2010). The new banking system was structured into a one-tier system, with the typical characteristics of a centrally planned economy banking system (Phong, 2009; Arkadie and Mallon, 2003). Such a system embraced the State Bank and specialised banks including the Investment and Construction Bank, Foreign Trade Bank and Socialist Saving Fund. The State Bank at that time operated as an issuing bank, which was responsible for drafting and implementing the plans for cash and credit, supplying credits and loans (Phong, 2009; Le and Liu, 2006; Cong, 2010). The banking system basically functioned as an instrument of the State budget and was yet to conduct monetary business in compliance with market rules (Cong, 2010; Phong, 2009; Arkadie and Mallon, 2003).

### **6.2.2 Establishment of market-oriented banking system from 1988-1997**

Degree 53/HDBT (1988) had two major implications:

1. Separating the state budget divisions out of the State Bank to establish the State Treasury for managing the State budget, and
2. Establishing special functioning State Owned Banks in order to remove certain business functions from the control of the SBV (Cong, 2010).

This is the first important step in banking reform, which initially separated the business functions and management functions of the SBV (Kovsted et al, 2005; Cong, 2010). In 1990, two government ordinances on SBV (37-LCT/HDNN8) and on banks and credit institutions (38-LCT/HDNN8) were issued, which marked the official turn of the banking operating mechanism from a one-tier system into a two-tier format. The

mandates and goals of each tier were legally separated (Cong, 2010). The State Bank acted as a Central Bank with the Bank limited to printing money and macro-economic management of the system. It managed monetary policy including the forex rate management and supervision of the second-tier banks (Cong, 2010; Arkadie and Mallon, 2003). SBV was established as a regulator of the money market and monetary policy (Cong, 2010).

**Table 6.1: Number of Commercial Banks established from 1991 to 1999**

	1991	1992	1993	1994	1995	1996	1997	1998	1999
<b>SOCBs</b>	4	4	4	4	4	4	5	5	5
<b>Urban Joint Stock Banks</b>	4	16	25	29	29	31	31	31	28
<b>Joint Venture Banks</b>	1	2	3	3	4	4	4	4	5
<b>Foreign Banks Branches</b>	0	5	8	9	18	22	24	25	26

Sources: Kovsted et al, 2002

The Commercial banks, financial and non-banking institutions were concerned with money circulation, credit, payment, forex and banking services throughout the whole economy (Cong, 2010). Four major specialised State-owned Commercial Banks were founded.<sup>111</sup> These banks were responsible for their own financial operation and control (Kosvsted et al, 2005; Arkadie and Mallon, 2003; Cong, 2010; Phong, 2009). The Ordinance on Banks and Credit Institutions (38-LCT/HDNN8) lifted the ban on establishment of new commercial banks and private ownership of banks. Joint Ventures and Joint Stock Banks as well as the representatives and branch offices of foreign banks were established and developed shown as in table 6.1 (Kovsted et al, 2005). Nghia (interview, 2011) suggested that “as the reforms had just started, the private sector was very small and developed openly. Thus, although joint-stock banks represented private owners, their largest shareholders were often the State owned Commercial Banks. The private sector simply did not have the capacity or was not encouraged to do so”. Several joint venture banks were established between the State-owned commercial banks and

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<sup>111</sup> The Agricultural Bank, Investment and Development Bank, Trade and Industry Bank and Foreign Trade Bank.

foreign banks.<sup>112</sup> The number of foreign banks opening branches in Vietnam increased rapidly with 22 foreign branches launched in 1996 and engaging in activities related to financing trade, providing letters of credit for export and import, and transferring forex payments. These branches faced limitations in terms of operation such as operation time, licence time, capital mobilisation etc (WB, 2002; Ninh, 2003; Arkadie and Mallon, 2003; Le and Liu, 2006; Cong, 2010; Phong, 2009).<sup>113</sup>

Alongside commercial banks, credit funds played a role as a major institution in the banking sector. They mushroomed on a small scale following reform and then promptly collapsed in 1990 due to lack of managerial capacity and market volatilities.<sup>114</sup> The Government also tasked the SBV to rebuild a credit system at local levels by developing a new system of ‘People’s Credit Funds’ with three levels: central, regional and local.<sup>115</sup> By late 90s around 950 local credit funds were established (Le and Liu, 2006; Phong, 2009).

The reform in the banking industry was further consolidated by the adoption of new Laws on SBV and the Law on Credit Institutions by the National Assembly in 1997. The law stipulated that the SBV performed functions of state management on monetary issues and banking activities, as well as the independent supervision function of SBV over the financial system (Kovsted et al, 2005). The Department of Financial Supervision under the SBV was given the mandate to advise the Governor of the Bank to realise managerial mandates and functions of the Central Bank. Yet this Department is to some extent independent from SBV as the Director General of this Department is appointed by the Prime Minister as recommended by the Governor and the Chief of State Inspectorate (McCarty, 2002; Arkadie and Mallon, 2003; Tran, 2007). This was

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<sup>112</sup> Bank Dagang National Indonesia, Public Bank of Malaysia, Korea First Bank etc

<sup>113</sup> The banks only have trade rights in 20 years, and are allowed to mobilise at maximum US\$ 1.5 mn and to lend 10% of their capital (Ninh, 2003).

<sup>114</sup> More than 7,000 credit funds were bankrupted and only 160 credit funds operated

<sup>115</sup> First tier is the Local Credit Fund (LCF), providing credit to SMEs and households. Second tier is regional credit funds, managing regional credit funds. Third tier is central credit fund, supplying and balancing capital for regional funds. If the distance from local funds to regional funds is too far, local funds would be under direct management of SBV.

the first step of the process to legally separate the SBV from the political system (Kovsted et al, 2005). Nghia (interview, 2010), Vice Director of National Financial Supervisory Commission, commented that “the Law also states that SBV is not the ultimate institution making final decisions on monetary policy. SBV only advises the Government and final decisions belong to the National Assembly”.

The Law on Bank and Credit Institution stipulated the legal independence of SBV against commercial banks. By law, interventions in operation of credit organisations are prohibited (Tran, 2007). The Law further confirmed the legal rights of the establishment and operation of private banks, representative offices of foreign banks by law, and provided the legal framework for a more level playing field for different ownerships of banks (Cong, 2010; Kovsted et al, 2005). The law specified the services and products that banks can provide, while new services and products were required to have a license from the SBV.

### **Regulation and supervision**

Decision 55-CT and Decision 39-HĐBT (1989) stipulated that the real interest must be positive and adjusted following the market’s CPI, and paid for all loans and deposits (Cong, 2010). The policy on positive rates broke the stagnation in channels to absorb money and contributed to the success of inflation control in the subsequent years (Phong, 2009; Kovsted et al, 2005). However, the borrowing rate was still controlled by the SBV to set it lower than the mobilisation rate to support enterprises to move onto a market economy platform. This interfered with the normal operations of the banks and forced the banks to frequently receive assistance from the State (Kovsted et al, 2005).

Since 1992, the Government has pursued more prudent monetary and fiscal policies with the aim of controlling inflation (Cong, 2010; Arkadie and Mallon, 2003; Kovsted et al, 2005). Following the ordinance of the SBV in 1990, the SBV’s operation has changed by gradually using the monetary policy instruments to control the market. The Bank’s started to liberalise the interest rates of commercial banks. It requested the average lending rate to be higher than average interest rate and set the interest framework for the economy (Cong, 2010). Since 1996, SBV has lifted the interest rate

floor and only regulated interest rate ceilings for lending with the difference of 0.35% per month (Cong, 2010). The National Assembly of Vietnam has also removed revenue taxes on the banks, helping curb business costs and reduce the average interest rate (Cong, 2010).

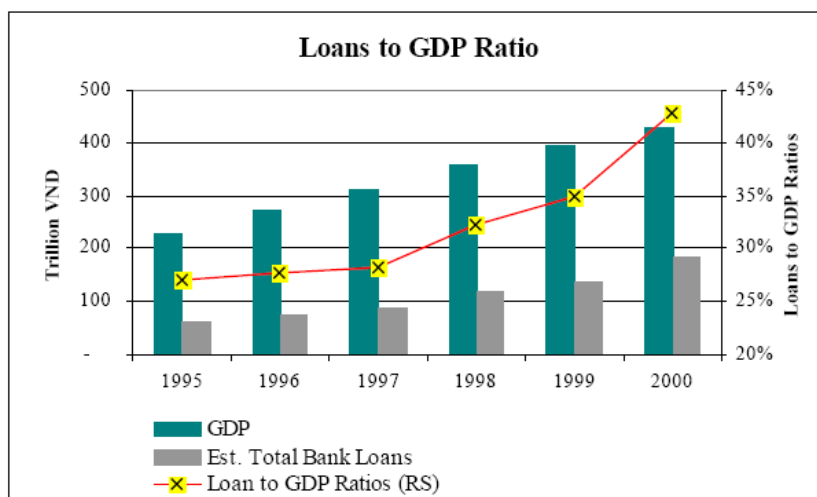
Since 1989, the management mechanism for exchange rates was also reformed. The multi-level exchange rate of the command economy was replaced with a unified USD rate. VND was substantially depreciated to engage in trade payments beyond the State plan (Kovsted et al, 2005; Cong, 2010). The rate was managed and adjusted gradually based on market signals, and SBV announced official exchange rates and adjusted this rate based on inflation, interest rates, payment balances and fluctuations of exchange rates in the market (Cong, 2010). In early 1990, two forex trading centres were established in Ho Chi Minh Cities and Ha Noi and were platforms for the inter-bank forex market; maintain supply and demand of foreign currency to adjust forex policy in tune with market signals and the goals of the macro-economy (Cong, 2010). The Official forex was identified on the basis of trading sessions of the Centres, better reflecting the relations between demand and supply of foreign currency in the forex market, and narrowing the gap between formal and informal forex rates (Cong, 2010).

Since 1990, the SBV also started to use the compulsory reserve rate for commercial banks as stipulated by the Banking Ordinance. Since 1992, the rate was fixed by the SBV at 10% on all the deposits of a bank. It was then relaxed in 1994 to be different for different types of deposit, which was enabling commercial banks to utilise effectively its capital (Cong, 2010). In Decision 261/QĐ-NH1 (1995), the compulsory reserve rate of credit organisations was adjusted to 10% of the Bank's average balance of all VND and USD deposits and borrowings for less than 12 months (Cong, 2010; Kovsted et al, 2005).

In 1995, a new development of the financial market in Vietnam introduced bidding treasure trusts, which was a significant institutional reform of the banking sector. This allowed SBV to manage the monetary policy by the open market derivative instruments, in which banks and other credit institution can participate to bid for the treasury trust and bonds (Cong, 2010). New interbank markets have been developed for

VND and USD. New forms of capital mobilisation have also developed including government bonds, commercial bank bonds, savings for long terms investment such as housing building, etc (Cong, 2010). All these developments helped to increase the mobilised capital of commercial banks and to reduce re-capitalised borrowing from the SBV.

The evolution of monetisation in the Vietnamese economy sharply increased from 13% of GDP in 1990 to 27% in 1995 and 44% in 2000 (WB, 2002). The Government has stabilised the macro economy with a prudent policy to curb inflation and commit to building a multi-player banking system, resulting in increased monetisation, showcasing enhanced trust for the banking system (WB, 2002).



**Figure 6.1: Credit ration to GDP**

Source: WB, 2002.

### 6.2.3 Limitations and slowdown of the reforms in the initial stages

In spite of encouraging progress, the fledgling banking sector was still showing many shortcomings in the system. The banking sector is still fragile in terms of financial capacity and management expertise, as well as limitations of mechanism for development of a sustainable banking sector (WB, 2002; Vo and Le, 2004). The low ratio of the banking sector in GDP reflects limited distribution and financial circulation

of the banks compared to that in other countries (Kovsted et al, 2005; Vo and Le, 2004; WB, 2002).

**Table 6.2: Percentage of circulated money in GDP of Vietnam and other countries**

Item	Viet Nam	Japan	Hong Kong, China	Singapore	Republic of Korea	People's Republic of China	Thailand	Indonesia	Malaysia
M2/GDP	27.6	143.8	205.7	93.1	48.3	119.6	89.9	57.0	116.9
Deposits/GDP	10.0	103.7	165.0	85.0	46.8	88.5	82.8	40.8	100.5
Currency/Deposit	42.7	11.8	3.7	9.5	7.8	15.1	8.4	12.1	8.5

Source: IMF, International Financial Statistics (tape). World Bank in Viet Nam Website and country sources (downloaded from ADB, SDBS).

### *The SBV*

The SBV is an advisory body of the Government on monetary policy to be submitted to the National Assembly for approval (Kovsted et al, 2005). SBV lacks tools to intervene into the market and relies on administrative measures to regulate the market, for instance requesting the banks to implement the Government's orders or fixing the rate floor for deposit rates (Kovsted et al, 2005; Arkadie and Mallon, 2003). Weak banking institutions have led to a loss of control of the banking system, and an abundance of risks in operation. For example, banks are not requested to submit its reports to independent auditors. Accounting standards were indeed unsuitable to international benchmarks so assessment of the financial capacity of the borrowers through the Bank balance sheet is extremely difficult (Vo and Le, 2004). There is limited supervision of the Bank, and a command economy mindset. SBV often abuse their administrative powers in managing banks and credit institutions, intent only on surviving daily challenges rather than actually dealing with long-term problems (WB, 2002).

The capacity of SBV is a major problem in its operations. Nghia (interview, 2010) suggested that "there is a shortage of experienced and trained staffs for managing newly transformed banking and financial sectors moving towards the market oriented sector, despite a large number of staff being employed. Thus the capability to oversee banking activities and discover abnormalities and work out solutions to avoid risks is

still limited. International standards in accounting, supervision and preventing risks are yet to be applicable in the Vietnam banking system”.

SBV still manages interest rates by approving interest rate ceilings and rate bands. The Lending interest rate ceiling is used based on lending terms (Cong, 2010).<sup>116</sup> Special projects and programmes are able to borrow at a preferential rate based on the policy, and not subject to market-based decisions. The control of the lending interest rate is aimed at primarily supporting the SOEs, giving them access to larger loans without investment efficiency. The State narrows interest rate bands, making the banks shrink their profits and produce no momentum for growth (WB, 2002; Kovsted et al, 2005).

### **Commercial banks**

State-owned Commercial Banks (SOCBs) still retain a monopoly in the banking system, accounting for more than 70% of commercial activities and 75% of total assets. SOEs are their main clients and they receive support from the State in terms of capital, ensuring a stable market share with less competition (Oh, 2002).

Non-State-owned banks compete with each other in the remaining part of the market. Their clients are mainly the SMEs. Thus, they are difficult to develop and invest in, or to operate on a larger scale (WB, 2002). There is a clear difference between domestic and foreign banks and this is reflected by strict regulations in mobilising capital, opening branches and using land use rights for mortgage (WB, 2002).

Vietnam’s economy was adversely affected by the Asian financial crisis in 1999. The sluggish economic growth due to the diminished FDI inflows and decline in exports directly hit the SOEs (Kovsted et al, 2005; Masina, 2006). The Government used the

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<sup>116</sup> The highest lending rate is set at 1.2% per month (14.4% per year) for short-term loans and 1.25% per month (15% per annum) for long-term loans.



banking system as a tool to stabilise the situation and assist the SOEs by means of direct interest subsidies, debt rescheduling or lower criteria for loans to SOEs (Kovsted et al, 2005).<sup>117</sup> As the loans were given under the directives of the Government and without undergoing any standard risk assessment or risk prevention methods, NPLs accumulated to dangerous levels in the banking system (WB, 2002; Oh, 2002).<sup>118</sup> Capital mobilisation scaled down, due to the lack of confidence in the banking system, forcing the banks to opt for short-term mobilisation to make up for the long-term, and this led to an inappropriate ratio of asset/liability of several banks. Chi Lan (interview, 2012) commented that “the situation in 2000 was so common among the banks that the entire system was facing a threat of collapsing”.

The legal environment had many shortcomings, troubling the development and operation of the banking sector. The laws on ownership, transfer of property and inheritance were still ambiguous, making the real estate market enormously risky (WB, 2002). The mortgage law was not unified as borrowing agreements are considered as civil or economic contracts, making it difficult for the banks to use the court as the arbitrator of mortgage disputes (WB, 2002). The Law on Bankruptcy in 1993 did not clearly regulate the bankruptcy of financial institutions, thus creating difficulties for restructuring, purchasing or merging the banks (Kovsted et al, 2005).

#### **6.2.4 Reforms restarted from 2000-2004**

By 2000, the Asian Financial Crisis negatively affected FDI and reduced exports. Economic growth slowed and the Government decided to prioritise political and economic stability instead of continued reforms (Oh, 2002; Cong, 2010). ‘Stimulus’

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<sup>117</sup> The assistance to the SOEs included the following measures (Kovsted et al, 2005):

- Remove the requirements on collateral of SOEs for loans from SOCBs. This meant that the SOCBs were allowed to give loans even to the SOEs suffering losses as long as the SOEs had developed their business plans,
- Lower lending interest rates for SOEs, and
- Allow rescheduling the loans to SOEs experiencing difficulties, from 1-3 years up to 1-5 years term. The NPLs of some SOEs were written off.

<sup>118</sup> In 2001, the official number of NPLs under the Vietnamese standards was published at about 14.7%, but the international banks circulated a much higher figure of about 30% (Kovsted et al, 2005; Oh, 2002).

packages containing credits were given to SOEs to ease their difficulties, and in consequence the Vietnamese banking system became weaker. The financial situation of the commercial banks of Vietnam became insecure and highly dangerous (Masina, 2006; Hung, 2000; Nghia, 2010)

SBV took steps to restructure the SOCBs to avoid a collapse (WB, 2002; Kovsted et al, 2002; Cong, 2010). According to Nghia (interview, 2010), “The SOCBs restructuring plans, which were drafted by the SBV, contained two fundamental tasks, i.e., to raise the financial capacities and re-organise the operations of the banks. The first task mainly involved dealing with the NPLs of the SOCBs, while the second task included banking administration, risk administration and development of new services. The plan was amended in 2000, embracing nine points: (1) financial solutions, (2) banking governance, (3) organisational restructuring, (4) risk prevention, (5) internal auditing, (6) system safety, (7) MIS, (8) development of new services, and (9) equitisation”.

Nghia (interview, 2010), who was in charge of the 9-point plan implementation, said that “the process had been progressing slowly with various difficulties, and that success was not seen across all fields. The slow progress was attributable to the technical difficulties within the reforms, the financial constraints of the Government and the protests from interest groups. Reform of financial settlement systems, bank administration, and restructuring was supported by the Government but in other areas such as risk management, internal auditing, system safety, and equitisation reform was slow due to the foreseen reduction of the credit institutions. They were focused only on short-sighted benefits”.

The financial settlement was placed at the core of the banking reforms plan. The SOCBs were restructured by pumping more charter capital in, to attain the minimum capital safety ratio (CAR) of 8% under international norms (Oh, 2002; CIEM, 2004; MPI and UNDP, 2006). The SOCBs also sought to resolve the NPLs and reduce the growing overdue loans. Most of these debts were from SOEs, and were thus removed or rescheduled (CIEM, 2004; MPI, 2006; Lam, 2006). By 2002, the five SOCBs were recapitalized with nearly 330 million USD, and over 43% of the outstanding loans

were resolved and the rate of overdue loans declined from 13.2% in 1999 down to 8% and about 6% in 2001 and 2002, respectively (CIEM, 2004; Lam, 2006). Along with the SOCBs, the JSBs were also restructured by means of Merger and Acquisition (M&A).<sup>119</sup> Regulations and requirements for the establishment of new JSBs were also revised to enhance conditions for establishment of new banks. Several banks that did not meet the criteria, were ordered to close (Kovsted et al, 2005; MPI and UNDP, 2006; Arkadie and Mallon, 2003).

The Government also took action to address the market distortions caused by policy lending (WB, 2006; MPI and UNDP, 2006). Banks for policy lending were separated from the commercial bank system. In 1999, the Government set up a Development Assistance Fund with the charter capital of 200 million USD financed by the State budget to replace the BIDV in policy lending. In 2003, the Vietnam Bank for Social Policies (VBSP) was established with the charter capital of 200 million USD. The VBSP's mandate was to serve the poor and replace the SOCBs in policy lending (MPI and UNDP, 2006; Lam, 2006). The separation also facilitated the SBV to supervise the banks' operations in a more transparent manner, and at the same time freed the SOCBs from policy lending, thus improving their business efficiency and risk management (Oh, 2002; MPI and UNDP, 2006; WB, 2006).

The SBV revised the regulations and relevant procedures to improve its supervision over the banks (MPI and UNDP, 2006). Accordingly, a more risk-based methodology was applied in the supervision. The SBV also sought to enhance the capacity and skills of on-site inspection and remote supervision, and improve the bank auditing. CAMEL<sup>120</sup> and BASEL<sup>121</sup> standards have been gradually institutionalised and

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<sup>119</sup>Two banks had their licenses withdrawn, three others had to halt their operations and many were placed under the special control mode.

<sup>120</sup> CAMEL stands for Capital, Capital, Asset quality, Management, Earnings, and Liquidity, which is an assessment system for the healthiness of a financial institutions based on the above 5 criteria.

<sup>121</sup> BASEL standards are set up by the Basel Committee on banking supervision, a banking supervisory authority set up by central bank governors of the group of 10 countries. These standards were a set of minimum principles for best practice of banking supervision, which include international standards on capital adequacy, the Core Principles for Effective Banking Supervision and the Concordat on cross-

applied (WB, 2006; Oh, 2002; Lam, 2006). Nghia (interview, 2011) noted that “the SBV requested the SOCBs to launch internal and independent auditing. Vietcombank, Incombank and BIDV implemented independent auditing in line with international standards by inviting international auditing firms to assist in the audits. The reports produced were all forwarded to WB, MOF, SBV, and the Executive Boards of the banks so as to verify the conditions of the banking operations and assess accurately the financial positions of the banks, including the appropriate loans classification and provision for credit risks”.

SBV introduced regulations on the organisational reform of the commercial banks and improvement of banking administration, restructuring banks on the basis of their targeted clients instead of their functions (CIEM, 2004; Oh, 2002). A number of Committees related to the bank safety and risks were set up, helping improve bank administration and risk management.<sup>122</sup>

A proposal on equitisation of the commercial banks was introduced in 2003 (NCIEC, 2007). Vietcombank and MHB were to be equitised with foreign banks as potential shareholders. In parallel to the equitisation of SOCBs, the Government permitted the foreign commercial banks operating in Vietnam to buy up to 30% of the shares in local commercial banks, and the commercial banks were allowed to be listed on the stock market (Du and Anh, 2005). The quota of shares owned by foreign organizations in commercial banks was lifted from 10% to 15%. Meanwhile, the quota for individual investors remained at 10% (WB, 2007; Masina, 2006).

Nghia and Lam (interviews, 2011) both suggested that “reform implementation had been very slow due to technical issues and difficulties in the resolution of the NPLs of SOEs”. The banks provided loans based on the ‘signals and guarantees’ from the

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border banking supervision (Bank of International Settlement, 2013). So far, their major set standards on the banking supervision subsequently have been developed and upgraded from Basel I to Basel III.

<sup>122</sup> Examples are the Risk Control Committee, Credit Council, Inspection Unit and Asset/Liability Management Board

Government. Nghia (interview, 2010) strongly emphasised “the banking sector reforms did not make much progress”.

### **6.3 Impacts of WTO accession process on banking reform**

#### **6.3.1 The WTO’s commitments on banking sector**

Upon accession, Vietnam had to comply with the GATS on an open market for the banking sector. Vietnam accepted all four modes of delivery for banking services. Foreign credit institutions could establish their commercial presence in Vietnam under such forms as a representative office, a branch of a foreign commercial bank, joint venture bank, 100% foreign-owned bank, joint venture finance company and 100% foreign-owned finance company, joint venture and 100% foreign-invested financial leasing companies. The 100% foreign-invested banks were permitted from 2007.

Foreign credit institutions operating in Vietnam can offer most of the banking services described in the GATS Annex on Financial Services and issue credit cards<sup>123</sup> (NCIEC, 2007; US Aid and NCIEC, 2007). However, Vietnam also attached a range of exclusions and limitations on market access and on the national treatments to assist the effectiveness of the state management in the banking sector as follows:

1. There was a schedule for foreign banks to take VND deposits based on the capacity of Vietnamese people who did not have credit relations with banks,
2. Foreign banks not allowed to open other transaction points outside its branch office but entitled to install and operate ATMs,
3. Limitations on equity participation of foreign credit institutions. Foreign capital contributions of the joint venture banks cannot exceed 50% of the chartered capital. Total equity held by foreign institutions and individuals in

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<sup>123</sup> i.e, acceptance of deposits and lending, finance leasing, forex trading, money market instruments, derivatives, money broking, asset management, payment services, advisory services and financial information

Vietnam's joint stock commercial banks may not exceed 30% of the bank's chartered capital, and

4. Licensing conditions for the 100% foreign-owned banks must satisfy requirements on capital safety ratio, solvency and corporate administration (NCIEC, 2007).<sup>124</sup>

Khanh (interview, 2012) said “the WTO's commitments on the banking sector are not far from the commitments in the US BTA. They basically sped up the schedule for implementation”. He believed that “the Vietnam commitments in the WTO are balanced, tight and safe for the development of Vietnam, which generated enough force for reforms but also not too strong to destroy the industry. The banking sector has prepared for these under the US BTA”.

### **6.3.2 WTO's accession process has provided pressure for reforms**

The banking sector saw strong pressure from the US BTA to open the sector but WTO accession generated a greater pressure for reforming the banking sector. The WTO is a larger market with a much larger community of trading partners. Lam, a member of the negotiation team and director of Central Banking Department, SBV, (interview, 2010), suggested that “services, especially in banking, were given a particular focus. Commitments in this area often exceeded the existing standards. Negotiations were very tense and sensitive for Vietnam”. He suggested “the determination of the Government to accelerate the accession to WTO since 2004 placed new pressure on the government agencies and enterprises to think deeper about self-reforms given the growing pressures of integration”.

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<sup>124</sup> The parent bank of the foreign bank must have total assets of at least US\$ 20 billion in the year prior to applying for a license for the foreign bank branch. The conditions for opening 100% a foreign-owned bank or a joint venture bank, means the foreign parent bank must have total assets of over US\$10 billion. For conditions to open a 100% foreign-owned finance company, a joint venture finance company, a 100% foreign-owned financial leasing company or a joint venture financial leasing company, the foreign credit institutions must have total assets of more than US\$ 10 billion at the end of the year prior to application

Foreign banks are superior in terms of capital and foreign reserves thanks to the guarantee of their parent banks, and they also possess advanced technologies, enabling them to offer more advanced services. The profit- and market-based operations of foreign banks give them much greater expertise in risk management, project appraisal and system safety. They also display superiority in administration with experienced and well-trained human resources. Their clients are often generally foreign investors in Vietnam and they were pioneers in introducing new technologies and services into the country (Lam, 2006; CIEM and UNDP, 2004).<sup>125</sup>

The Vietnam banks remained at a low level of development with restricted competition from foreign banks. The ratio of total assets of Vietnamese banks/GDP was merely 54% in 2003, far below that of other countries in the region (Kovsted et al, 2005; CIEM and UNDP, 2004; MPI and UNDP, 2006).<sup>126</sup> Vietnam was still a cash economy (CIEM and UNDP, 2004).<sup>127</sup> Therefore, Lam (interview, 2010) noted that “the domestic banks were inferior to foreign banks in all aspects”.<sup>128</sup>

Nghia (interview, 2011) noted that “the competitiveness of the domestic banks was very low and the quality of the banks’ assets was poor, while ratio of NPLs under international benchmarks remained high. The level of technology application among the Vietnamese banks was low”. Due to their limited finance, the domestic banks also experienced difficulties in technological upgrade and introduction of new services (MPI

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<sup>125</sup> i.e, internet banking, telephone banking and various complex derivatives

<sup>126</sup> For instance, the figures in Thailand, Malaysia and China were 145%, 193% and 211%, respectively

<sup>127</sup> The ratio of M2/GDP of Vietnamese banks was 62.4% in 2003 while the cash/ GDP of the Vietnamese banking system was 15%.

<sup>128</sup> After four years of raising capital, the total charter capital of the Vietnamese banks only registered at 1.2 billion USD as in 2005 against 400 million USD in 2001. The largest Vietnamese bank only had 350 million USD in charter capital (Lam, 2006). The average charter capital of the commercial banks was as low as US\$ 10 million. CAR of domestic commercial banks averaged at about 5.3%, far lower than the 8% of the international benchmark (MPI and UNDP, 2006; Lam, 2006).

and UNDP, 2006; MUTRAP, 2006).<sup>129</sup> Lam (interview, 2010) suggested that “banks were not effective in retaining and training qualified staff. In many SOCBs, the staffs were mostly civil servant types, not the dynamic services provider type, and they tended to be afraid of responsibilities”. Most of the SOCBs were not dynamic as they waited for the clients coming to them instead of going out and seeking them (Oh, 2002; Kovsted et al, 2005). Services offered by credit institutions was low quality (Lam, 2006). Domestic banks worried about losing their protected markets. They feared the competitive advantages of foreign banks and the weaknesses of the domestic banks. Lam and Nghia (interviews, 2010) shared that “the accession to WTO was indeed a race against time to adjust the competitiveness of domestic banks”.

The accession increased the number of transactions and ensuing risks due to increasing market participants and services, as well as the dependence of the banks on the world market. This forced the SBV to adopt effective measures to forecast and stabilise the market. It required the SBV to actively renew its modus operandi so as to ensure that the market developed in a healthy manner with monetary tools matching international standards, while supervising potential risks for better performance of the commercial banks (SBV, 2012; Lam, 2006; MUTRAP, 2006; MPI and UNDP, 2006).

### **6.3.3 WTO’s accession process has influenced the balance of politics to support reforms in banking sector**

The Asian financial crisis forced the Vietnamese policy makers to halt the reforms in exchange for economic stability (Chi Lan, interview, 2012; WB, 1999; Hung, 1999; Thayer, 2000). Technical difficulties emerged in the restructuring of the banks, but the biggest impediment to the reforms was the strong opposition of interest groups whose core interests would be taken away by the reforms.<sup>130</sup> Although the banking sector reforms might benefit the society as a whole, the interest groups who were likely

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<sup>129</sup> By 2004, there were only over 700 ATMs, and 3 banks issuing international cards and about 1,250,000 cards issued, and 15 banks issuing domestic cards and about 760,000 cards issued (Lam, 2006).

<sup>130</sup> For deeper reforms in the banking sector for instance the liberalisation of interest and exchange rates, the money market instruments, the application of international standards on loans and risk assessment, etc



to be 'losers'. Policy change would strongly hit the interests of three major relevant groups (SOCBs, SOEs and the state management agencies) (Kovsted et al, 2005; Oh, 2002). Chi Lan (interview, 2012) agreed that "these three groups were interrelated and benefited greatly from the maintenance of the old policy system".

SOCBs dominated the market in terms of market share and total assets (Kovsted et al, 2005; Oh, 2002). Any competition threatened their loss of market share, particularly given many issues related to their weak competitiveness. Despite the risks from lending under the government's orders, their profits were made up for by many other benefits and privileges from the Government such as more concessional terms of loans, better discount interest rates, and Government guarantees etc (Lam, 2006; Oh, 2002). SOCBs dominated the deposit-taking market, taking advantage of government support and their monopoly (Kovsted et al, 2005). The SOCBs understand that the liberalisation of the banking operations meant they would have to compete directly with one another and they showed resistance to reforms (Lam, 2006; Kovsted et al, 2005).

Reforms of the banking sector required SOE reforms (Kovsted et al, 2005). SOEs are the biggest beneficiaries from the government's interventions. They are still seen as the foundation of the economy and given priority for government investment (Kovsted et al, 2005; Oh, 2002). The Government often guarantees loans of the SOEs or 'instruct secretly' the SOCBs to provide credits to them (Kovsted et al, 2005). The majority of the SOEs experienced frequent losses and had to rely on the assistance from the Government, especially in terms of capital (Masina, 2006; Painter, 2006; Le and Liu, 2006).

The relevant state management agencies are also seen as interest groups in the banking sector reform. They are the agencies either controlling directly or drafting policies, and represent the ownership of the Government of the banks (Tran, 2007). The SBV assumed the role of the lead agency in managing monetary policy and banking operations as well as supervising the banks' activities and being in charge of licensing credit organisations in Vietnam. It is responsible for macroeconomic policy, giving priorities to growth over stability. Limited capacity has forced the Bank to favour the old less complicated market and existing conditions rather than a new and unfamiliar

environment. If the banking sector reform is geared toward transparency and independence, the SBV will lose its exclusive power of licensing and administrative supervision over the SOCBs. Moreover, the SBV is also the authorized representative of the state as the shareholder at the SOCBs, thus, the banking sector reform would directly alter the management of the state's capital at the SOCBs. Nghia (interview, 2010) suggested that "if the international benchmarks on risks and loans are applied, the ratio of risk provisions will be higher, shrinking the profit margins of the SOCBs".

The second influential government agency is the Ministry of Finance (MOF). The MOF is in charge of the finances of the financial institutions, insurance and development funds, and also responsible for steering the governments financial instruments like Treasury Bills and Government Bonds (Tran, 2007). The regulations issued by the MOF are relevant to the banks' operations. The MOF also represents the government in managing the finances of the state corporations, including their expenditure and tax payments (Tran, 2007; Kovsted et al, 2005; WB, 2006). The liberalisation of the banking sector, including the removal of credit appointments and more competition among the banks, will affect a series of the SOEs, placing more burdens in terms of resources allocation and corporate reforms on the MOF (Tran, 2007; Kovsted et al, 2005).

Groups representing the majority of businesses are adversely impacted by limited policies on banking reform, for instance private companies and foreign-invested enterprises. Despite the economic policy impacts and resources allocation, private and foreign-invested companies still account for over 61% of the GDP (Lam, 2006; MPI and UNDP, 2006; WB, 2006). Joint stock commercial banks (JSC) represent the private sector. In 2003, 30 JSCs operated on a fairly small scale. These banks target SMEs, but it is a small market fraught with risks as SMEs are tiny and inexperienced in business (Kovsted et al, 2005; Lam, 2006; Tran, 2007). For these banks, a fair competition environment is essential. Private Banks therefore tend to support reform in the banking sector (Tran, 2007).

Foreign banks were mainly confined to trade finance and banking services for FDI companies in Vietnam (Kovsted et al, 2005; WB, 2002). Foreign banks have a

stable customer base as they have bonds with parent banks and they have enormous potentials in terms of capital, technology and managerial expertise (WB, 2002; MPI and UNDP, 2006). Nghia (interview, 2010) mentioned that “restrictions make the role of these banks in the entire system become modest. Further opening of banking system will surely help these banks expand their operations”.

Nghia (interview, 2010) further mentioned that “groups having an important political role like management agencies, SOCBs and SOEs are cautious with reform. These groups indeed have direct relations with policy makers so reform is likely to be postponed. In contrast, groups wishing to speed up reform include private banks, branches of foreign banks and SMEs, but this group has a small political role. So they cannot put adequate pressure on reform and liberalisation policy conducted by the State”. In an environment tending towards a conservative tendency to fear change, influential anti-reform groups on policy means weak reforms in banking sector and reform thus tends to be slow and cautious (WB, 2006; Nghia, interview, 2010).

Vietnam committed to assuring conditions for foreign companies to operate in line with the trade criteria; the State does not make any direct or indirect interventions in trade decisions of companies, except the interventions suitable to WTO rules (NCIEC, 2007; NCIEC and USAid, 2008). However, the practice of being government shareholders in private companies should be re-considered as this is merely an avenue for legitimising its continued intent to remain in ‘control’ of the economy and the private sector. WTO membership led to greater opening up of the banking market for foreign banks, while building a more equal and transparent market to all stakeholders in banking sector.

The SOEs sector undertook several reforms due to the WTO accession, and this relieved the pressure of imprudent policy lending and NPLs for the banking system. SOEs were not only facing the threats of increasing competitions, but also were forced to change due to WTO commitments for transparency and fairness (Khanh, interview, 2012; Basu, 2008). At the 10<sup>th</sup> Congress (2006), the CPV affirmed that “they would accelerate reform and increase SOEs’ efficiency, which focuses on equitisation and encouragement of strong development of multi-ownership, particularly for newly

equitised companies; so as this form of economy will become popular and make up a larger percentage in the economy” (CPV, 2006, p.84-85).

The Unified Law on Enterprises (2005) eliminated many discriminative practices in economic sectors. The Government’s Enterprises Reform Board established concrete steps to speed up transformation of enterprises (WB, 2006). The number of equitised SOEs increased and big SOEs were restructured as 100% wholly State-owned limited companies (Nguyen and Hoang, 2010). SOEs appeared to be transformed toward a more independent sector in the economy, separated from the politics and state management. SOEs are still the main tool for the Government and Party to remain in control of the economy and centrally command its operation, while Banks are merely the channels through which the Government can divert finance to the SOEs.

Private companies have increased from 31000 enterprises in 2000 to more than 541,000 in 2011, accounting for around 40% of GDP in 2010 (GSO, 2011; Quang Ha, 2010). Their rapid development is a potential for banks as they are dynamic and have diverse demands (Lam, 2006; CIEM and UNDP, 2004). Nghia (interview, 2010) said “banks also do not want to miss this opportunity and as a channel to diversify risks because the returns of these companies are often higher than that of SOEs. So the growth of the private sector also generates a wave of reform in banking system”.

Foreign-invested companies often ask for professional and high-quality banking services. Therefore, this group tends to use services and products of foreign banks (Lam, 2006; Kovsted et al, 2005; CIEM and UNDP, 2004). Although State-owned commercial banks have advantages regarding market share, client and distribution channel, these banks are aware of the challenges facing them in the coming years. Lam (interview, 2010) suggested that “a new economic cycle appeared after the crisis in Asia and the wave of investment in Vietnam is mounting. The economy has developed since 2004 with an average growth of 8.4%, generating new momentums for banking development. Against that backdrop, State-owned commercial banks are aware that without reforms, they will be left behind and face tough competition”.

Private Banks, in the context of WTO negotiations, play a critical role in changing the perception of the need for reforms. In spite of its small scale, private banks are very dynamic and active and seek to improve service quality with a view to generating greater competition in the banking sector (CIEM and UNDP, 2004; MPI and UNDP, 2006). Accession to WTO offers these banks a chance to extend their capital if foreign banks buy their shares or become their strategic investors. Many new banks are founded or the old banks expand their business strategy to wait for external investment following WTO membership. Private Banks promote banking reforms to gain profits through selling their shares to foreign banks (CIEM and UNDP, 2004; Barre, 2006).

Foreign banks are willing to engage in Vietnam's market acquiring Vietnamese banks. Standard Chartered Bank purchased shares in ACB and 3 other banks also contributed capital to Vietnamese banks, for example; CitiBank, HSBC and ANZ, etc. Western banks pay special attention to emerging markets like Vietnam. Many banks want to be the strategic partners of Vietnamese banks (Nhung, 2007; Thanh Trung, 2012).

WTO membership required Vietnam to comply with and revise the legal system to ensure transparency and equality, thus leading to the shrinkage in tools used by management institutions to support enterprises. The benefits from licensing of management institutions have been narrowed due to tightening mechanisms of control (Nhung, 2007; Bao, 2010).

WTO membership generated a new balance for the support of reforms. Prudent groups in the course of reform are adhering to WTO regulations or realize the opportunities in reform, and this reduced pressure that prevented policy makers from planning policies for reform. Khanh (interview, 2012) suggested that "groups taking benefits from integration enjoyed a new status to gather stronger support for reform". When political pressure for prudence in reform is cut down, policy makers are able to take stronger actions in carrying out necessary reforms. Reality shows that banking reform took place robustly and quickly from 2004 to 2007.

#### **6.3.4 WTO's accession has guided institutional reforms in the banking sector**

The laws on banking and SBV were formulated during the Asian economic crisis, and suffered from a common cautious attitude towards financial liberalisation. There were strict articles to manage the operation of the domestic banks and market penetration (Masina, 2006; Tran, 2007; MPI and UNDP, 2006). Both Nghia (2010) and Thai (interview, 2012) has commented that “The laws were considered as a set-back for the process of financial market reforms, which were not as open as the previous decrees on banks and SBV”.

The process of the WTO's accession had exerted a positive influence on the reform of the banking system's institutions. WTO agreements stipulate compliance with WTO commitments under direct or legalisation formats, unified application of regulations in the entire territory and establishment of independent judicial bodies in judging WTO issues (Basu, 2008). WTO required Vietnam to provide the national treatment for foreign suppliers of the service sector. Admission to WTO led to a series of reforms in laws and institutions in banking sector as follows:

##### **Reform of SBV**

The two laws on banking systems were revised in 2003 and 2004 with a view to building a modern banking system in compliance with international practices and standards, eliminating subsidies in monetary business, cutting down administrative procedures in the State management over banking activities, reducing unnecessary interventions of State management agencies in activities of credit organisations, expanding and working out new forms of credit organisations (Cong, 2010; MPI and UNDP, 2006). The roadmap of banking reform elaborated by SBV was endorsed by the Politburo in 2005. The plan revised the Law on Credit Organisations and the Law on SBV. With the draft Law, SBV was structured as an independent and modern Central Bank with the functions of implementing monetary policy, monitoring the banking system, ensuring commercial-based operations of commercial banks. Restructuring of SBV was conducted by cutting down SBV's branches at local level, merging provincial branches in regional office to reduce interventions of provincial authorities in activities

of SBV and ensure more focused decisions and enhanced oversight of the system (Tran, 2007; Cong, 2010)

### **Banking inspection and supervision**

Bank inspection and supervision were reformed, with enhanced supervision on the banking system conducted by strengthening and upgrading the supervision through a new Committee on Financial Supervision. Regulations on banking safety were changed to be more suitable to international practices. The inspection and supervision mechanism was improved to increase effectiveness of distant supervision by using internal accounting, independent auditing as supporting tools for inspection to assure and assess transparency, objectivity of credit organisations' information. Inspection and supervision duties were classified to devolve inspection power to SBV's branches in provinces and cities (Lam, 2006; Tran, 2007).

SBV customised its monitoring methods based on the CAMEL system, establishing a new information system and delivering reports suited to serve distant monitoring (Lam, 2006; Nhung, 2007). The Department of Control of SBV was tasked with auditing operations, finance and compliance for all units under SBV and its branches in provinces and cities, especially investment projects using and managing public assets within the system (Lam, 2006; WB, 2006; Barre, 2006; MUTRAP, 2007). In 2005, SBV started to assess its monitoring activities in accordance with BASEL standards (Lam, 2006).

### **Monetary policy management**

Since 1998, SBV has gradually managed monetary policy through indirect tools instead of direct or administrative ones as it did previously (Cong, 2010; Don, 2009; Thanh et al, 2008). Open market operation, refinancing and compulsory deposits have been flexibly and effectively utilised since 2000 and have become major indirect tools for monetary policy of SBV (Lam, 2006; Thanh et al, 2008). Since 2003, the State has allowed all long-term bank notes such as the Government's bonds to be used in

transactions between SBV and other banks (Cong, 2010; CIEM and UNDP, 2004). This has substantially increased the volume of bank notes transacted with SBV, expanded the banks' access to capital supporting channels of SBV, creating the SBV's possibility to adjust the money market. Since 2003, SBV has adjusted the interest rates of re-financing to play as an inter-bank interest rate ceiling, and bank discount rates have been adjusted to be closer to the rate ceiling. SBV has distributed discount quotas to the banks and accepted bank notes in refinancing transactions. So these two rates will form a trading margin for the banks, and indirectly adjust interest rates of commercial banks in markets. SBV has been more flexibly using compulsory deposits in monetary policy (Cong, 2010; CIEM and UNDP, 2004). Since 2004, SBV has encouraged credit organisations to make use of capital sources by paying interest rates for compulsory saving deposits in Vietnam Dong at the rate of 0.1% per month instead of just paying interest rates for the difference exceeding the compulsory deposit (Cong 2010). Besides, new tools have been taken up, such as foreign currency swaps as a tool of monetary policy (Cong 2010; CIEM and UNDP, 2004; WB, 2006). Through this operation, SBV has injected Vietnam Dong to support credit organisations temporarily facing difficulties in terms of disposable capital in Vietnam Dong (Cong, 2010).

Since 2002, SBV has initiated negotiable interest rates in commercial lending in VND- the final step in liberalisation of Vietnam Dong interest rate and also an important breakthrough in management of monetary policy in line with market rules (Cong, 2010; Don, 2009; CIEM and UNDP, 2004). The banks can expand its operational network, provide loans and mobilise capital at an appropriate interest rate based on supply and demand, improving business autonomy and competitiveness of credit organisations. On loans in foreign currency, credit organisations are able to fix interest rate according to SIBOR rate plus a permissible margin (Cong, 2010). The shift to management on basic interest rates shows that this is a step forward in liberalisation of interest rates. Basic interest rate is determined based on market rate of low risk and assurance of rate control by SBV.



### **Foreign exchange rate management**

At present, Vietnam Dong is still under control of the State. Since 1999, forex rate management has been formed on the basis of market signals (Thanh et al, 2008; Ngoc and Nghia, 2008; Cong, 2010). Instead of announcing a formal forex rate, SBV publicises the average forex rate of interbank transactions of the most recent working day and commercial banks are allowed to trade within a forex rate not exceeding the rate plus a certain margin announced by SBV (Lam, 2006; Thanh et al, 2008; Cong, 2010). Flexible management of forex rate in accordance with market signals will help promote export, control import, improve balance of payment and increase foreign reserves. Stability of the forex rates also facilitates the circulation of inflow and outflow capitals in Vietnam to absorb foreign investments (Thanh et al, 2008; Lam, 2006).

Since 2003, foreign exchange surrender requirements of commercial banks have been continually cut down to 0% per year from 80-100% (Cong, 2010; Lam, 2006; Ngoc and Nghia, 2008). Liberalisation of current transactions has advanced, contributing to business financing. Regulations on opening accounts in foreign currency and transferring foreign currencies across the border have been eased (Ngoc and Nghia, 2008). In addition, SBV has engaged a larger number of players in remittance services, creating favourable conditions to attract foreign currency from ‘overseas Vietnamese’– Viet Kieu (Ngoc and Nghia, 2008; Cong, 2010; Thanh et al, 2008).

### **Payment policy and mechanism**

Progress has been made in reform of banking services to meet the demands of WTO membership, with improvements in legal platforms for banking payment and non-cash payment. A series of legal documents on payment have been formulated and enhanced such as the Decree on payments through payment services suppliers, the Decree on provision and use of cheques, a Statute on payment through payment services suppliers and a Statute on interbank e-payments and other related documents, etc (Lam, 2006; Tran, 2007). These documents facilitate commercial banks to better conduct payments, attract clients to open accounts for using means of non-cash payment and

other banking services. The payment mechanism is built upon modernisation in line with international practices.

### **Development of money market**

SBV has developed and upgraded the legal frame for activities of the money market in compliance with international practices. To promote the money market, SBV has released the statutes on money brokerage, new regulations on tools of money market, especially tools against risks in line with international practices (Lam, 2006; Cong, 2006; Thanh et al, 2008). SBV has also issued regulations on operations of the money market between SBV and credit organisations such as open market swaps, discount, lending mortgaged by bank notes, regulations on auction of treasury and Government bonds through SBV, regulations on custody of bank notes, etc. An Interbank money market has developed and links supply and demand of foreign currency of credit organisations. The Bonds auction market with its rising revenue has vibrantly operated and become a source to provide goods to money operations (Thanh et al, 2008; CIEM and UNDP, 2004; Cong, 2010; Lam, 2006). The money market system has been established and operated in a stable fashion (Cong, 2010; Lam, 2006). Through these markets, SBV is able to closely supervise market developments and adjust the market by indirect measures to help the market become more transparent and effective.

### **State-owned banks' reform**

One of WTO's basic objectives is to create equal treatment in trade and investment. WTO Membership influenced reform and equitisation of State-owned commercial banks. Nghia (interview, 2010) noted that "Banking renovation was fast and strong in the early years of reform. Yet State-owned commercial banks still play a key role in the banking market and are associated with SOEs before the WTO accession". Nghia (interview, 2010) suggested that "the Asian financial crisis was an external shock challenging the Vietnamese economy and SOEs, placing Vietnam's financial system at risk of collapse. Against that backdrop, SBV has carried out tremendous reforms to restructure commercial banks to avoid a foreseeable collapse".

International organisations are still much concerned over banking reform. Nghia (interview, 2010) was sceptical as “reforms have been delayed due to technical issues and financial constraints of the Government, and setback from interest groups”. All banks have carried out reform, but its implementation has been very slow. This has been reflected in the assessments of the IMF and international financial organisations that banking activities in Vietnam are still not transparent (Kovsted et al, 2005; Lam, 2006). For the banks, difficulties are dealing with debts and improving efficiency of SOEs and its reform (Lam, 2006; Nghia, interview, 2010). However, SOEs equitisation and has not achieved its goals (Chi Lan, interview, 2012; Anh, 2008; WB, 2006). The banks have also limited lending under direct guidance of the Government. Increased capital for SOCBs from the Government is continuing, even for the banks, which do not meet the conditions for increasing capital (Nghia, interview, 2010; Du and Anh, 2005). This results in a decreased pressure for reform in banks with the implication that capital will increase without consideration of outcomes or performance (Du and Anh, 2005). Application of international standards is also retarded. Nghia (interview, 2010) said “risky loans of the State make loan loss provision too large for the banks’ capital, reducing profits of the banks. This also makes the Ministry of Finance and even the banks find ways to deny this task”.

Although the guidance on equitisation of SOCBs is welcome, the realisation is delayed due to many reasons. First is the technical issues, such as addressing outstanding debts, financial penalties and banking evaluation. Advisory bodies for banking equitisation are facing difficulties (Anh, 2008). However, the technical issues is just the tip of the iceberg. Issues related to banking ownership following equitisation are serious concerns (Du and Anh, 2005). The decision to hold large Government percentages of SOCBs’ shares is controversial and damaging to the industry. The State’s agencies are cautious on the decisions on banking ownership (Anh, 2008; Du and Anh, 2005; Masina, 2006). The banking sector is decisive in the health of economy. The State therefore wants to play a key role in management of these banks (Masina, 2006).

Initial reforms of SOCBs have been conducted on the basis of urgent requests to avoid collapse of the banking sector. The reforms are mainly implemented at an extremely slow pace. Joining the WTO in 2006 left the Government little time for the banking sector to reform and meet WTO competition requirements (Minh, 2007; Barre, 2006). WTO membership helped work out the benchmarks of reforms, but also generated a political strength and thoughts for a stronger resolve in reform, but despite all this, the actual depth and pace of reform is far from adequate and systemic problems continue.

Given the pressure of WTO with the goal that by 2010 there will be a full participation of foreign banks', SOCBs had to promptly carry out its reform, first and foremost in risk prevention and banking governance. All banks have applied new standards of credit risk and sought international standards in their operation. Banks have proactively expanded their operation to provinces and cities, developing broad networks to occupy the market. Banking services have been expanded, particularly modernisation programmes for banking information. Investment has gone into new services such as the ATM system, credit cards for international payment, factoring and banking services, etc (Lam, 2006; Trung, 2008).

### **6.3.5 WTO's accession process has influenced the economic development ideology of the banking sector**

Nghia (interview, 2010) suggested that "experts assessed that banking reform in Vietnam was fairly progressive and even faster than other sectors". Yet banking reform faced external obstacles from the Asian financial crisis in 1997. Many SOEs at that time were on the verge of bankruptcy and the banks were burdened with bad debts due to deferred payment in foreign currency (Kovsted et al, 2005; Nghia, interview, 2010).<sup>131</sup> State-owned banks were in a fragile state and many private banks and credit funds were also on the verge of bankruptcy (Lam, 2006; Cong, 2010). The economic policy of Vietnam returned to protectionism, which was criticised by economic organisations

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<sup>131</sup> Such as Epcoc Minh Phung Company

(WB, 1998; Thayer, 2001). In the banking sector, many experts held the view that the Law on SBV and credit organisations in 1997 partly reflected concerns on integration of banking sector. The Law strictly regulated conditions of market penetration (Nghia, interview, 2010; Oh, 2002). Nghia (interview, 2010), Thai (interview, 2012) and Chi Lan (interview, 2012) agreed that “Government protected groups criticised that the domestic crisis was the result of fast opening and economic reform. In that context, the gloom of the Asian crisis cut down the spirit of reform”. Significant was the refusal to sign the US BTA in 2000 (Nghia, interview, 2011; Chi Lan, interview, 2012). Thai (interview, 2012) said “policy makers at that time argued that the early conclusion of BTA with the US would not benefit Vietnam and lead to the penetration of American businesses in Vietnam, causing tough competition with Vietnamese companies”.

SBV proposed reforms in 2000 with a view to enhancing financial capacity, banking management, and promoting integration of banking sector. Not much progress was recorded from 2000 to 2003 (Nghia, interview, 2010). After the signing of US BTA, the economy saw positive progress and a new cycle of economic development started. GDP growth recovered and hit above 7% since 2003. Exports to the US market skyrocketed (Masina, 2006; Fforde 2005; Luong, 2006). Foreign investment, after stagnation, rebounded. This was a surprise to policy makers as before such signing many people forecast that American companies and goods would penetrate into Vietnam, putting the Vietnamese economy at risks (Masina, 2006).

US BTA was a strong driver for Vietnam to further promote its admission to the WTO. Chi Lan (interview, 2012) suggested that “success of export to the US market and limited penetration of American companies strongly affected the prejudice on the impacts of integration. Domestic companies not only had more opportunities for export, but also for capital, technology, and managerial expertise, creating conditions for them to grow. Economic integration helped ministries and sectors readjust their management policy in a proper manner, coordinate with various agencies and improve their efficiency”.

Political thought was vigorously transformed in the 9<sup>th</sup> Party Congress Resolutions, to “active integration into the international economy, expansion of external

economic relations aligned with improving independence and autonomy of the economy” (CPV, 2006, p.120). Chi Lan (interview, 2012) suggested that “along with transformation in political and economic ideology, the market economy has increasingly affirmed its advantages compared with a centrally planned economy. Thus, determination to join WTO by the Vietnamese Government was increased”. A resolve to join WTO put forth a demand for SBV and other banks to actively prepare for membership. Khanh (interview, 2012) suggested that “this pressure came from initially favourable conditions of opening up the banking sector in line with the BTA”. In contrast to predictions, the market share of saving deposits and lending of foreign banks was substantially reduced. In 2003, the Bank of America- a major bank also withdrew from Vietnam. The market share of private banks went up. Vu Quang Minh<sup>132</sup> (interview, 2010) suggested that “the outcome of the BTA was a surprise to the banking sector”. With an appropriate level of opening up, Vietnamese banks continued to grow, and transformations in both banking capacity and policy for integration generated a healthier and better financial market. This encouraged SBV and SOCBs to prepare for admission to the WTO.

Chi Lan (interview, 2012) suggested that “By participating in a bigger playing field [WTO], policy makers and banks all hoped that Vietnam’s general development would attract even more foreign investments such as FDI, indirect investments, ODA and new business opportunities for domestic companies”. This correlated directly to a more dynamic banking market yet also required a higher level of development (Lam, interview, 2010).

#### **6.4 Reforms after the WTO accession**

Banking reforms still continued to meet the WTO requirements and challenges. Khanh (interview, 2012) said “WTO commitments have a period of implementation, thus still put strong pressure on the reforms of the banking sector”. The foreign banks were entitled to full equal national treatment in 2011. They could mobilise VND and

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<sup>132</sup> Vu Quang Minh was the Director of the Department of Economic Affairs, Ministry of Foreign Affairs. He has been appointed to be the Ambassador of Vietnam in the UK and Ireland since 2011.

open branches in Vietnam the same as domestic banks with some limitations (NCIEC, 2007). The government issued Decree 22/2006/ND-CP (2006) allowing establishment of 100% foreign owned banks in Vietnam with conditions of minimum capital of the mother banks. Five new 100% foreign owned banks were granted licenses to operate in Vietnam. Four other foreign bank branches, three 100% foreign owned financial service companies, and six representative offices were granted licenses (Nguyet Anh, 2010). These banks and financial institutions quickly expanded their business and network of branches. In the last three years, they have opened more than 30 branches nation-wide (Hai, 2012). New joint stock banks were established.<sup>133</sup>

According to Chi Lan (interview, 2012), “there have been significant increases of incoming resources flowing into the country right after the WTO accession, which was expected by the decisions for WTO accession”. In 2007, there was a record of the FDI registered in Vietnam with investment of over 70 billion USD (GSO, 2010). Exports increased, especially in textiles and garments, agriculture, electronic appliances etc. These external factors gave a real boost for the economy (CIEM, 2010). The boom of the private sector has created incentives for banks to undertake further reforms and upgrade their service qualities. Banks have constantly upgraded and expanded their offices, branches and ATMs network and business quality (Linh, 2011). Private and foreign banks expanded quickly. Nghia (interview, 2010) suggested that “their ability to influence the policy for a healthy system is still limited or in the negative way”. There have been several reasons for this. Firstly, the banking sector reforms are very much related with the SOEs reforms. Reforms in SOEs needed to resolve the NPLs problems of the SOCBs (WB, 2011; Lam, 2006; WB, 2002; Oh, 2002). However, Chi Lan (interview, 2012) suggested that “the SOEs reform has not achieved the expected results. The reforms seem to be accelerated in a number of the equitised enterprises and on paper. The Government has silently supported them and consolidated them to be larger SOEs and Economic Groups. In 2011, it had increased to 13 State Owned Economic Groups without any review of performance. The establishment of SOEGs was a set-back for the SOEs reforms. The SOEGs have been getting bigger by acquisition of many smaller SOEs and they act as an umbrella for avoiding SOE reforms”. SOEGs receive secret government supports via the SOCBs under the loan

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<sup>133</sup> Lien Viet Bank, the Tien Phong Bank, and Bao Viet Bank.

contracts, which often do not go through the complicated procedures of risk evaluation and prudent lending (WB, 2011). These supports are considered as the soft budget of the Government. If these SOEGs are making losses then the SOCBs see the loans frozen or rescheduled (A, 2010). Parker (2012) suggested that the SOEGs have built up a huge debt of about USD 50 billion with their privileged access to credit. This is accordingly made up of huge NPLs for the SOCBs as well as other private banks. This was confirmed by the recent SBV announcement of the status of NPLs in the banking sector to nearly 9%, rather than the previous figures generated by the banks at 3% (The Economist, 2012; Parker, 2012; Thang, 2012). As a result, the banking sector is constantly facing liquidity problems, which are pressing banks to increase the deposit rate to a record high (Thang, 2012). This contributes also to the distortion of the interest rate and the market, as many banks have their short-term rate higher than long-term rate of deposit. These all have created a seriously distorted and risky situation for banking sector (Thang, 2012). Brummit (2012, p.1) said “SOEs are stacked with friends and allies of the CPV” to create a crony capitalism. Jonathan Pincus said “the State is being manipulated by people within the State to make money” (as cited in Fuller, 2012, p.1). This system has led these people to gain all the benefits, while leaving the loss and risks to the state.

Moreover, the SOEs and SOEGs also expanded their business to the banking sector. Many SOEs and SOEGs bought shares from the SOCBs and joint-stock banks. Thus, they can influence the banks operations, although the law in Vietnam allows a small percentage of shares for each investor in the banking sector (WB, 2011). These SOEGs also preferred to borrow money from the banks rather than mobilising money via IPO or stock exchange. They often gain the benefit of an easy lending policy and less supervision than other channels, especially IPO or stock exchange because these channels require more transparency and accountability (Chi Lan, 2012b).

The second reason for failures in reforms of the banking system is the drive of the private sector in banking. According to Nghia (interview, 2011), “private banks including joint stock banks and joint venture banks are not representing good market forces for fostering the banking reforms. As the banking sector is rapidly developing, many private banks have been established. In many cases that one bank is owned by one big stakeholder. One main private owner can own more than 50% stake in a bank and



can own several other banks. Thus, banks often operate under the objective purposes of the main owners of the banks rather than providing credit based on the risk. Secondly, many owners are unaware of risk management and do not have the experience and knowledge enough to operate banking services. As a result, the private banks are at risk of imprudent lending and mismanagement for quick profit". In August 2012, a banking tycoon Nguyen Duc Kien, founder member of the largest joint stock bank ACB was arrested on several charges. At the time of the arrest, he was the main stakeholder of many large private banks in Vietnam.<sup>134</sup> Questions related to the charges are illegal banking acquisitions and deliberately carrying out illegal business including issuing bonds and borrowing money from their own bank to buy other companies and banks. From his companies and position in the banks, he is able to overcome the prudent lending mechanism, borrow money illegally to finance mergers and acquisition of other companies and banks. These activities are seriously hampering the effort of the SBV to reforms banks and conducting monetary policies as well as control the banking market (Robinson and Bland, 2012; BBC, 2012).<sup>135</sup> These are now common practises in the banking sector according to Nghia (interview, 2011). In many cases, private banks are acting like interest groups and taking advantage of weak legal institutions including competition laws and supervision of SBV to drive and sometimes control the banking sector for their own personal power and benefit (Dung Ha, 2012).

The foreign sector has played an important role for fostering the development and reforms of the banking sector. WTO commitments lead to the expansion of the foreign banks and branches in Vietnam since 2007. The new Government Decree issued in 2006 not only allowed 100% foreign own banks but also relaxed restrictions on banking sector by extending license periods and allowing the expansion of ATM service points for foreign banks and branches (FRB of San Francisco, 2011). Although there are also restrictions based on capital capacity of mother banks and gradual process of relaxing restrictions on foreign banks under the WTO commitments, foreign banks are

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<sup>134</sup> Such as Kien Long Bank, Eximbank, Sacombank, DaiA Bank etc.

<sup>135</sup> Vnexpress Online News, 2012; Parker 2012; Le Duong, 2012; Tuoitre Newspaper 2012a.

increasing their penetration to the domestic market.<sup>136</sup> In 2010, these banks have built up 14 branches with many new and modern services. The balance between revenue and expenses reached 170 million USD. These banks are operating soundly with the NPLs rate accounted for only 0.4% of total credit balance (SBV, 2012a).

The current global financial crisis has limited the ability of international banks to expand business overseas (Van, 2011; WB, 2011; IMF, 2012). The development of major interest groups in the banking sector is showing a mixed picture of the impacts of the WTO accession process on the reforms of the banking sector. Although WTO accession has created a strong force and framework for reforms, the reforms on the banking sector are still considered as slow and hesitant (WB, 2010; *The Economist*, 2012; Parker, 2012). Delays in reforms have been caused by the failure of expected forces to act as agents for reforms. In this case, the private banks are acting as interest groups to distort the markets. This group together with the SOEGs and SOCBs are further pressurising the Government for slower reforms.

The WTO commitments are leading the institutional change of the banking sector but, these institutional changes may not be effective enough. After the WTO accession, the financial market has faced higher volatility risks due to the deeper international integration (CIEM, 2010). Thus, SBV has spent most of their efforts and time to cope with volatility of the financial market and macroeconomic instability (MUTRAP, 2011; CIEM, 2010; Nghia, interview, 2010). The flood of FDI inflows together with extended relaxed monetary policies for promoting economic growth has resulted in serious economic instability in 2008 (Tuyen et al, 2011; Fforde, 2012). This led to a policy switch from relaxed to a tight monetary policy in order to control the inflation and macroeconomic imbalance (Tuyen et al, 2011; CIEM, 2010). In 2009, the Vietnam economy also suffered from the Global Financial Crisis, which further worsened the economic decline (Tuyen et al, 2011). The monetary policy was adjusted

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<sup>136</sup> In the third quarter of 2010, foreign banks mobilised 3.5 billion USD of capital. Their total assets reached 4.65 billion USD at the 3<sup>rd</sup> quarter 2010, which increased 29.8% compared to 2009. The credit balance recorded at 1.9 billion USD, which increased 11.9%.

to support growth, but again brought back inflation. WTO accession has helped to expose the Vietnam economy to the volatility of the world economic situation.

SBV needed to consolidate and upgrade themselves on management procedures, capacity and on their priority of goals and targets (Bao, 2010). It adjusted monetary policy from following multi goals to prioritising goals and selecting goals flexibly for each period (Bao, 2010). These challenges are also pushing the SBV to use a greater variety of monetary policy tools, and be more flexible and skilful (Bao, 2010; Cong, 2010; Tu, 2008). Beside the flexible and combined usage of traditional tools such as interest base rates, discounted rates, refinancing, compulsory required reserve ratios, the open market tools have been primarily the buying and selling of valuable papers, bidding for capital in inter-banks market, trust and bonds, etc (Bao, 2010; Cong, 2010; Tu, 2008).

The SBV has called for improvement of legal frameworks and documents for meeting the commitments and the level of the Vietnam development, such as legal documents for foreign currency management, the capital adequate ratio, loan classifications, provisions of risks and its usage, licensing for establishing and operating joint stock banks etc (Tu, 2008; Cong, 2010; Tuyen et al, 2011).

Although the SBV is changing itself to cope with the situation, it has revealed its weaknesses as an institution. The monetary policies have not been managed correctly; they changed erratically and with no real planning, which created shocks to the market and businesses (Tuyen et al, 2011). The coordination between the monetary policies and other policies, especially the fiscal policies, has been inappropriate due to the limited capacity of SBV. There are also complaints about the lack of information, analysis and forecast support for the management of the monetary policies (Tuyen et al, 2011). Chi Lan (interview, 2012) said “the main problem may be rested on the level of the independence of the SBV”, because the SBV governor is a member of the cabinet and responsible before the Prime Minister and the National Assembly. The SBV has played a limited role as an adviser to the Prime Minister on building the plan for the monetary policies to propose to the National Assembly. They then implement these plans approved by the Government and the National Assembly (Chi Lan, interview, 2012;

Giang, 2011; Yen and Nhat, 2009). They cannot set the goals and target independently for their operation, thus this causes constraints on their flexibility and delay in managing the monetary policies. They are far from being an institution independently managing the monetary policies and the stability of the macro-economy (Giang, 2011).

Since 2009, the banking sector has been affected severely by the economic turbulences such as inflation, monetary tightening, growth slowing down and an asset price bubble (WB, 2011). Thus, many policies of the SBV rely on administrative measures to rescue the situation, such as a cap on credit growth, on deposit rates and a ban on gold mobilisation and lending (WB, 2011). For the current instability and decline of the financial market, these measures have proven to be effective, however, in the long term these direct measures may be harmful to the soundness of the banking system (WB, 2011).

The SBV's supervisory and regulatory framework has shown inadequate capacities and thus, in 2009, a banking supervision agency named as the 'Banking Inspection and Supervision Agency' was established under Decision 83/2009/QD-TTg, with the tasks of supervising and inspecting administratively all activities of the banking sector under the SBV management. This is a significant improvement from the previous mechanism, in which the inspection and supervision unit for banking sector belonged to the State Inspectorate General. The new division is directly undertaking the supervision and inspection tasks for the governor of the SBV and the Prime Minister. Two procedures have been compulsory in the banking sector since 1998 - on-site supervision and off-site supervision mechanisms (Le and Bui, 2010). The off-site supervision has been also conducted following the CAMELS criteria since 1998. However, the new supervision and inspection agency of the SBV has shown many shortcomings in their functions and performance (Le and Bui, 2010; WB, 2011). Their efficiency in performing the task has been limited by the limitations of the law, regulations and the standards of the accounting. There are still problems in regulation of risk classification, assessment mechanisms, and measurement methods. There are also too many laws and regulations applied on credit institutions, which are often not clear and compatible. The legal framework for supervision and inspection of macro safety risks is not adequate or applied properly (Nam, 2012). This reduces the effectiveness of the agency (Le and Bui, 2010). The standards of accounting in Vietnam do not comply with international

standards, which have led to false and inaccurate assessment on capital, reserve, CAR, cash income and expenditures, etc. Vietnam is still using Basel I standards while the most other countries are using Basel III for their calculation of the banking indicators. Information technology is under-developed and retards bank's networking, automatic information records, compatible platforms and formats. It does not provide adequate and timely information (Cuong, 2011). The SBV often complain about their lack of human resources and their poor quality for complicated and booming activities of the banking sector (Le and Bui, 2010; WB, 2011; Nam, 2012). The inspectors sometimes are young and less experienced and thus may not see through many complicated and diverse aspects of banking activities (Le and Bui, 2010).

Facing challenges of rapid development of the banking sector, four major pieces of laws and regulation have been issued to meeting the needs for a better legal framework for the banking sector and improved performance of the supervision of the banking system of SBV. The two new Laws on SBV and Law on Credit Institutions, which have been promulgated at the 7<sup>th</sup> and 8<sup>th</sup> meetings of the National Assembly XII in 2011, have provided a clearer regulation and they are more compliant to the WTO commitments and the current new development of the banking sector (Giang, 2011, WB, 2011; IMF, 2012; SBV, 2010).

SBV roles have been upgraded to higher levels of independence and authority. It is now specified to be a Ministry equivalent agency and to have clear functions and responsibilities of the Central Bank of Vietnam, who are implementing the monetary policies and supervising the banking sector operations (SBV, 2011). The new law has also specified clear positions, roles and authorities of different government ministries and agencies on deciding and implementing the monetary policies. The Law also confirmed the authority of the SBV in the supervising the operational safety of the credit institutions. The 'Banking Supervisory Agency' has been established under the SBV to closely monitor the credit institutions. The laws also state the responsibility of the SBV to be clear and transparent and have direct accountability to the National Assembly, the Government and the public. This is a new and significant change from the previous law as it is aiming to transform the SBV to be more transparent and publicly accountable in their operations and decisions on the banking sector (SBV, 2011). These laws has been changed to upgrade the SBV to new roles and to comply

with the WTO commitments on transparency, accountability and creating a level playing field (SBV, 2011). But new laws are ineffectual if the enforcement mechanism are not also appropriately and professionally applied, and at the moment the situation as regards enforcement is extremely disturbing.

The new Law on Credit Institutions has also been welcomed by the market participants. It has improved the shortcomings of the previous law on clarifying which services they are allowed to carry out. The law specified clearly the type of institutions, the scope of their operations and to be the reference for regulating the scope of other institutions operations. The separation line between banks and other credit institutions has been clarified. Non-bank credit institution cannot receive deposits from the public and provide payment services via personal accounts. The credit institution also regulated clearly the professional services automatically allowed to do business and the services required to have licenses from the SBV, as well as the services prohibited (SBV, 2011). One of the changes of this law is to enhance the safety level in operation of the credit institution and approach the international standards (SBV, 2010).

Circular 13/2010/TT-NHNN in 2010 regulated the operational safety of the credit institutions, regulating the safety of operations and investment activities (Vneconomy News, 2010). The circular has implied three major points for enhancing the operation safety of credit institution: (1) increasing the capital adequacy ratio (CAR) from 8% to 9%; (2) restricting the commercial banks to participate in stock and real estate activities; (3) enhancing regulations on the solvency capacity of banks (Cuong, 2011).

The Law of Supervision and Inspection was promulgated in 2010. The law clearly indicates the organisation of the supervision and inspection agencies as well as their rights and responsibilities, making these activities more transparent and accountable, for both the agencies and the public.

WTO commitments and their impacts have assisted Vietnam to improve the legal frameworks for the banking sector of Vietnam. However, the reality also proves that the law and regulation enforcement appears to be very weak (WB, 2011). Most of

important laws and regulations for a safe and competitiveness banking sector are in place, but the banking sector has still fallen into the deep systematic crisis in 2012 with problems of serious NPLs, solvency, credit vulnerability and unhealthy competition (The Economist, 2012; Van 2011; WB, 2012; Parker 2012).<sup>137</sup> One example of the weak enforcement is recent pressing issues of bank acquisition and cross ownership of banks. Nghia (interview, 2012) has suggested that “the market manipulation problems has been alerted by the National Financial Supervisory Committee to the Prime Minister two years ago”, but it has not been supervised, inspected and dealt with until now. SBV and the authority have not monitored and inspected the money invested in the banking system and how they raise their chartered capital. Recently the Governor has admitted in a questioning session at National Assembly that he does not know how and where a group of organisations and individuals mobilised the capital to acquire a big private bank- Sacombank (Nhat Anh, 2012).

The Commercial Banks have shown some alarming signs of institutional problems (Van, 2011; WB, 2011). SOCBs still hold large market shares and important positions in the market (WB, 2011). Equitisation of SOCBs has been very slow. The banking sector is experiencing an institutional problem at the micro-level, which is the weak and sometimes negligent governance of banks (Van, 2011; WB, 2011). This problem has led to a serious vulnerability of the current banking system to crisis and possible collapse. The authority and banks blame these problems on the global economic crisis, the inflation surge, and economic difficulties in Vietnam. But the main reason may be rooted in weak institutions at macro and micro levels, lack of supervision and enforcement, alongside the weak governance of banks (Van, 2011). Many risky or even illegal transactions still by-pass risk preventing mechanisms. This is often led by the decisions and autonomous implementation systems carried out by the Banks Board of Directors. They often act as if immune from censure or regulation and the reality is that through relationships and corruption they have largely been free from regulation. There is also no effective mechanism for dealing with this problem in credit institutions or Banks. This inspection often rests on the independent Board of Supervisors to stop or prevent these kinds of activities. However, the supervision of the Board of Supervisors often centres on the operation of the Executive Board, but not on the decision of the

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<sup>137</sup> Reuter, 2011; Bland, 2012; Nguyen and Brereton-Fukui, 2012; Reuter, 2012.

Board of Management. Internal auditing is often an important division and tool of the Board of Supervisors. However, the Internal Auditing unit does not have enough independence in their operations. In the Vietnamese system, the Head of Internal Audit has been appointed by the Board of Management and dismissed on request of the Head of Supervisors Board (Van, 2011). The credit institutions do not invest time and effort in strategic planning for long-term operations. Many institutions do not have special strategic and risk assessment committees. This is leading to difficulties in long-term competitive situations or changing environments (Van, 2011). These special strategic and risk assessment committees of the Board have quite limited capabilities due to the lack of information, mechanisms and capacities. They often make decisions on large loans or transaction based on the explanation of Executive Board without their own independent view on these matters being taken into consideration. Finally, the Board of Management is often comprised of groups of related or connected people. In many cases, one owner actually holds a dominant share of the banks but does this secretly under the name of different closely connected people or companies. They serve as interest groups who use banks as the fundraiser for their own projects without paying interest and overcoming all the complicated risk assessment mechanism of banks (Thanh, 2012; Doanh, 2012; Van, 2011). The organisation and operation of the Board of Management is closed and not transparent, serving the interests and benefit for particular private individuals only (Van, 2011). Nghia (interview, 2010) said “many of the banking owners are holding large shares (even 80% of a bank), do not have much experience and training. So they often seek short-sighted profits and leave the banks at risk of long term problems”. All these problems are showing that there is a loophole in the institutions of the bank sector at the macro level. These problems have actually led to the current consequence of high NPLs and liquidity problems, which have threatened stability of the macro-economy of Vietnam and the efforts to reform the banking sector.

WTO accession has brought many changes in the banking sectors, but changes seem to be in the laws and the day-to-day operation, but not in its enforcements and long-term stability and development of the sector as a whole. This may be the limitation of the WTO accession’s impacts. Nghia (interview, 2010) said he was sceptical and said that “due to the distorted business environment, business operation in Vietnam needs relationships rather than their core competence, thus the banking sector is the same. There is encouragement from the Government to ask both SOCBs and private banks to



find strategic partners to improve their governance and technology. But domestic banks often choose domestic partners who have relationships and powers rather than international partners who have technology and skill. All banks' need is connections and privileges, which foreign banks do not have".

The current global economic downturn has an important effect on the will of reforms. Thai (interview, 2012) has suggested that "WTO accession has opened up the economy further to the world economy, which has also meant reducing its abilities to prevent the negative impacts of these external turbulences". Many people often blame the WTO accession as a factor in destabilisation of the economic performance rather than thinking about their own economic problems (Thai, interview, 2012; Chi Lan, interview, 2012). SBV has been struggling to keep their macroeconomic situation stable, while many enterprises have gone bankrupt and left huge NPLs for the banks. The easy target for blame has been the fast reforms pushed by the WTO accession. Thus, the will for reforms has been slowing down in the banking sector in the last years. In a conference organised by MUTRAP in 2012, people from the business communities, authorities and scholars voiced the view that there needs to be some measures to protect Vietnam's enterprises and goods from the international imported goods and services.<sup>138</sup> This environment in a conference surely represents the present atmosphere for reforms in banking sector at present.

## **6.5 Conclusion**

WTO accession had a significant impact on reform of the banking sector. It led to new competitiveness, pressures for reforms in management, technology and human resource development. It brought opportunities for new markets, new products and services and the development of strategic partnerships with foreign partners, bringing increased capital, access to modern technology and demonstrated the vital need for reform. However, the reliance on relationships and the acceptance of corruption as an almost normal business practice within the banking sector has brought the system, the

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<sup>138</sup> The conference of "review of 5 years of WTO accession" was organised by MUTRAP in Hanoi in 2012.

economy and Vietnam to the brink of disaster. The level of crisis is difficult to ascertain as the individuals in control of Banks seem intent on acting in almost total disregard to the law and regulations and are convinced of their invulnerability to censure. Debt of banks in 2012 was declared as being twice last years at 8.6% while international analysts believe the figure is actually two to three times this (ThanhNien Daily, 2012). In essence, the banking sector is more reflective of the fact that the greater the fraud, the more intense, sophisticated and covert is the strategies for hiding the faults beneath a veil of apparent success. The lack of real reform is hidden behind an appearance of almost revolutionary change. Devolution of power has been used as a means to centralise authority and control. Financial success has covered up corruption and wealth creation reserved only for a very small elite interest group. Resolution of manageable crises has been replaced by a decline into a major catastrophe and thesis research has found numerous justifications for assessing the situation as one that was avoidable and is the consequence of a failure to reform as required under WTO accession commitments and responsibilities. For example: the Nguyen Duc Kien's hostile takeover of Sacombank was not a simple case of financial entrepreneurship and innovation, but a deliberate attempt to gain total control of the financial system, and it illustrated the close ties between financial affairs and political relationships.

The WTO involves merging into a global free market economy and changing systems, laws and practices to reflect a free market environment, but in the case of Vietnam the very core of the economy has become little more than a quasi command controlled system. This has led to the very brink of financial crisis, with the Party maintaining control of the economy through subsidisation of SOEs via government directed loans from Banks (Bloomberg, 2012a). The SOEs are controlled by individuals who are also directly related to the Party and Government, and through relationships have enabled themselves not to invest or support the SOEs, but instead use the loans to finance their own wealth creation schemes. Subsequently, the SOEs as mainstays of the economy are instead massive and crippling burdens upon development, prone to economic collapse and in the process leaving both Banks and Government in the grip of a financial debt calamity. All present data show the decline of the Vietnam economy, with for instance the recent fall of Vietnam's debt rating to B2, to the same levels as Cambodia and one of the largest SOEs, EVN, declared itself \$11.5 billion in debt (Blomberg, 2012a; Grudgings, 2012). WTO accession and membership relies on an

economy following a free market system, but in the case of Vietnam, the rhetoric is belied by the practice of the Party and Government refusing to release the centrally commanded system of control of the economy.

The banking sector is a vital reform area in development of a market economy. Centrally controlled economy is reliant on their dominance of the financial sector and banking is the chief mechanism for political mastery of all sectors of the economy. Its financial resources and how they are distributed determines the success or failure of almost every enterprise, and in a market economy the private sector is developed, shaped and economically controlled by the professionalism, independence and economic acumen of the Banking sector. This chapter has shown that the Banking sector depended on escaping the damage from crises such as the collapse of the economy in 1985, the slow introduction of Doi Moi and the Asian financial crisis by reforming under the guidance and assistance of the WTO reform process. The consequences of nearly a decade of reform was a sector crippled by debt, bad management, unclear and unsatisfactory financial practices and methods of ownership and control that means they have little independence from political control and have easily become the manipulative mechanisms of elite interest groups, intend on gaining total control of the financial and economic systems (Vuving, 2013, p.1-5).

The financial and banking sector was in need of reform in 1985 and required transforming from a State controlled centre of Party dominated systems of finance to one more reflective of adjustments according to market conditions. Doi Moi began the process and the Asian financial crisis, entry into international agreements, such as the US-BTA and the WTO, preceded revolutionary transformation in the financial infrastructure. These banking reforms were reactions to internal and external crises, with problems such as inflation, currency values and changes in patterns of foreign investment encouraging the banking sector to globalise its operations, become more risk aware and seek to manage the financial economy through a growing independence from political controls and influences. The US-BTA engendered an unrealised fear of crisis brought about by foreign competition, professionalism and business acumen threatening the very existence of a banking system burdened under the weight of too many small, insufficiently capitalised banks and larger banks entirely unprepared for the competitiveness of the global financial system. The US-BTA outcome was a period of

growth and improvements in the banking system, while foreign competition was successfully ‘crowded out’. The chief mechanism of profit and growth in the domestic market was the business of financing SOEs through Party directed loans; an area that was and could be monopolised to only the home banking system. This created a false economy for Vietnam banks to survive and grow in, attracting high profits and a sense that they were becoming competitive, when in reality the Banks were being cushioned against global pressures to reform. The system was predicated on the fact that at some point the SOEs would repay the debts, but eventually the loan time limits arrived from 2008 onwards, only for the Party to instruct banks to cancel/restructure or extend the loans so that SOEs were free from any demand to repay. Numerous bank heads resigned in protest, but the ensuing debt crisis was allowed to build into a major crisis. Many loans were set against real estate property/land values and the market had collapsed, aggravating further the burdens on Vietnamese banks, while a number of large loans were unsecured or based on collateral that did not exist. Fuller (2012, p.1) called its onset ‘crony capitalism with a communist twist’. Hua Ngoc Thuan (as cited in Fuller, 2012, p.1), Vice Chairman of a People’s Committee said ‘I can say this is the same as the crisis in Thailand in 1997’ (which was the main cause of the onset of the Asian Financial Crisis). Jonathan Pincus (as cited in Fuller, 2012, p.1) declared ‘the state is being manipulated by people within the state to make money’. Cox (2012, p.1) said Vietnam is ‘an example for emerging countries such as Myanmar of exactly how not to manage the opening up of an economy... in short, [Vietnam] has gone from global investment darling to poster child for mismanagement’. Economist Nguyen Quang A declares that Vietnam is ‘experiencing its worst ever economic crisis (as cited in AFP, 2013, p.1). Fforde (2013, p.1) notes how this ‘crisis’ has resulted from a growing inability of the Party to govern and the replacement of their authority by a ‘special interest group’.

The Party introduced a plethora of reforms during WTO accession, intending to appear that it was meeting its commitments. Institutions were restructured or newly established to help develop a market economy. Laws and regulations were introduced to help enforce the reforms. But the economy moved from trying to reform such sectors as banking, as a means to escape crisis, only for the banks to become the crisis. The ‘elite interest group’ is increasingly recognised as a reality and its power is accepted as being even greater than the Party. There is a growing acceptance that the reforms of

institutions and laws were in name only and that enforcement is almost non-existent. The Party's covert determination to centrally control the economy and use their dominance of the Banking sector as a means to centralise their power in SOEs and subsequently do the same to the economy, became instead a means for the elite interest group to gain power and wealth. The fact that the elite interest group is chiefly made up of people in the Party compounded the eventual loss of ability of the Party to govern the country, or control its economy. Even the most superficial examination of the Banking sector now shows that WTO reforms of the financial economy are merely visual images of change that conceal a deliberate lack of reform and non-compliance. Leading international experts on Vietnam (ex- Fforde, 2012; 2013; Thayer, 2009; Fuller, 2012) are now regularly supporting many of the main findings of this thesis. Institutional reform has not taken place, new regulations are not enforced, central control still exists and the general conclusion is a nation that is far more complicit with non-compliance than with commitment to reform through the guidance of the WTO.

In contrast to both Banking and Agricultural sectors, the T&G sector has seen far more benefits accruing to the vast majority of actors involved in this sector. Companies have grown profitable, workers conditions and salaries have improved, the levels of skills and education in T&G are higher and profits have been diverted to some extent into modernising, mechanising and developing the sector. Yet, the following chapter will again show that appearance belies reality, as the T&G sector should not only be judged on what it has achieved, but also on the levels of development it should of reached by now and the potential opportunities wasted.

## **CHAPTER 7      CASE STUDY: THE TEXTILE AND GARMENT INDUSTRY'S REFORM**

The Textile and Garment industry has a long and important tradition in the Vietnamese economy. The industry greatly contributes to the GNP and generates significant levels of employment. The industry carried out significant reforms to align with the integration process. WTO membership made an enormous impact on the textile and garment sector, creating opportunities for its development, penetration into new markets and increased investment. The sector played a strong role in encouraging the Government to join the WTO and strongly conduct reforms in the economic mechanisms to help the sector develop and integrate.

Yet, even in the midst of this apparent success in reforming, becoming more competitive and successfully taking advantage of new opportunities found in being part of the global economy, the T&G sector is still seen as another example of non-compliance. The power of SOEs remains, either through controlling the conditions in which the private and foreign sector has to operate, or through SOEs dominating the profitable areas of export trade. The industry still remains beset by problems with under-skilled workers (chiefly due to under-resourced and badly managed education and vocational training systems), a lack of investment and foreign investment with limited returns due to such burdens as corrupt payments for assistance in buying land, construction 'fees' and paying 'illegal' fees to customs.

This Chapter will examine the reforms in the Textile and Garment sector, the challenges and opportunities in the integration process and analysis its effects on promotion of admission to WTO.

## 7.1 Overview of the textile and garment sector

With the reform policy during the last twenty years, the T&G sector enjoyed favourable conditions for its development and played a key role in the strategy on the export direction of the Vietnamese economy (Hill, 1998, MUTRAP, 2007; Tuyen et al, 2011). It has been paid due government attention in its development into the national integration, modernisation and industrialisation processes as it has advantages in terms of a large labour force, low-cost investment and high returns on investment (IBM Belgium, 2009; Bui, 2003). Truong (interview, 2011) commented “the T&G sector is the first and relatively most successful in the international economic integration process”.<sup>139</sup>

The T&G industry is the leading export industry in Vietnam, outperforming the oil and gas export in 2007 (Quan, 2010).<sup>140</sup> Data shows the sectors stability and the export market potential, despite the severe impact of the recent global economic crisis. In 2012, Vietnam is among the top-five exporters of textiles in the world (Vietnam News, 2013). Textile products mainly focus on fibre, silk, knitting products and ready-to-wear clothing. The report on the “assessment of export potentiality of Vietnam” studying 40 goods and sectors by UNCTAD/WTO and Trade Promotion Centre (Ministry of Trade) shows that T&G industry will remain a major exporting sector. Through export, Vietnam is integrating into the regional and global economy and increasingly accumulating capital and foreign currency for national industrialisation and modernisation (UNCTAD/Viettrade, 2005)

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<sup>139</sup> The industry contributes more than 17% of the GDP and employs over 2.5 million workers, accounting for more than 9% of labour in industry and nearly 5% of the national workforce (VINATEX, 2010). There 3,208 businesses. Since 2002, the textile and garment sector has recorded firm progress with an average growth rate of 17% per year. Its industrial production value of textiles increased by 17.9% in 2007 against 2006 (WS Security, 2010).

<sup>140</sup> Export turnover in 2010 reached US\$ 11.2 billion, a rise of 23.26% against 2009 and accounted for 16.02% of Vietnam’s total export values (Habubank Securities, 2011). In the year 2011, the industry achieved a record high of USD13.8 billion, up 38% against 2010 (NgocVan, 2012).

## **7.2 Reform of the textile and garment industry.**

### **7.2.1 Textile and garment industry before Doi Moi**

Under French colonialism, Vietnam developed a series of modern T&G manufacturing facilities across the country. Craft villages were also popular. Following the victory over the French the T&G establishments were re-built in the North and placed under the State's management. Craft villages and T&G collectives continued with their traditional production methods (Chiem, 2003).

After 1975, the Government took over the factories in the South to develop a T&G manufacturing industry to supply products to the domestic market (Chiem, 2003). In the North, many new factories were established in the 1960s (Chiem, 2003; Phong, 2009; MOEAITC, 1999).<sup>141</sup> They operated under centrally planned management and output was at the request of State's order. Inputs for production were provided according to the central plan and the finished products were controlled and distributed by the State (Chiem, 2003; Phong, 2009). Materials and machinery were chiefly imported from socialist partners, such as Russia. The market was strictly managed, and goods were only distributed by the State (Phong, 2009). T&G products like fabric, silk, wool, ready-to-wear clothing, knitting products, socks, thread, scarf's, towels, cotton, scraps of fabric, etc were all under strict State management (Phong, 2009; Le and Liu, 2006; Chiem, 2003). During the planned economy era the T&G supply only met modest domestic demands set by the Government at a rate of 5m<sup>2</sup> per person (Phong, 2009).

After 1975, given the difficulties of the whole nation, the T&G industry also coped with challenges. The State could not supply adequate spare parts and inputs for production. Factories were out-dated and badly maintained (Chiem, 2003). Inputs of the State were only meeting 20-30% of the demand (Phong, 2009; Chiem, 2003). Workers

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<sup>141</sup> Such as Nam Dinh textiles Nam Dinh Silk, Hai Phong Wool, 8/3 Textile, Dong Xuan Textile, and at the local level, Thang Long Textile, Minh Khai Textile and Garment 10, Thang Long Garment, Chien Thang Garment Company, etc.



were often laid off and the productivity rapidly declined, while production was stagnant.<sup>142</sup> Shortages of raw materials, power and wages forced the factories to the edge of closure and many workers to return home to work in agriculture (Phong, 2009).

The problems were caused by the adherence of the leaders to an inefficient economics rooted in the leaders' thoughts (Phong, 2009; Le and Liu, 2006). Truong (interview, 2011) suggested that "the biggest barrier for the industry was not the competition, but sources of raw materials and rights to sell their products, which were restrained by the planned economy's mechanism". Since 1979, the difficulties at grassroots level led to a wave of 'fence breaking' in many facilities in order to find loopholes in the planned economy's strict regulations on production and circulation (Phong 2009; Le and Liu 2006; Arkadie and Mallon, 2003). The activities were also given a green light from the local government, who shared the difficulties of enterprises and workers (Phong, 2009; Tuoi Tre News, 2005).

Several enterprises in HCMC secretly colluded with Vietcombank to temporarily borrow foreign currency to import inputs such as cloth, dyeing chemicals and spare parts. Finished products were then sold in the tourist areas, bringing in foreign currencies to re-pay the bank loans. Later, they cooperated with other state import-export companies to exchange their products for agricultural products, which were then exported to buy inputs for the enterprises. These 'fence-breaking' activities helped these factories to survive in this difficult period (Phong, 2009; Tuoi Tre News, 2005). In 1980 Thanh Cong Textile Company secretly decided to borrow US\$ 180 million off Vietcombank to import raw materials and machines such as silk, thread, spare parts, etc. The end product was then sold to trading companies to earn foreign currency. That money helped the company repay its debts and accumulate US\$ 82,000 for their own production. After two years of production, Thanh Cong Company accumulated US\$ 1.3m and increased its capital to US\$ 2.5 m. By 1985, the company attracted 18,000 workers with the output increasing by 3.3 times compared to 1980 (Phong, 2009, Tien Phong News, 2005). Truong (interview, 2010) said "The success of Thanh Cong later

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<sup>142</sup> For instance, the fabric output of Thanh Cong Textile Company in 1970 was at 4.2 million meters but in 1980 decreased to only 2.5 million meters (Phong, 2009).

became an example on handling economic difficulties, which was considered as the first motivation factor for implementing reforms”.

Truong (interview, 2011) suggested that “generally, this was a tough period for the whole economy as the planned mechanism restrained economic growth. The T&G industry however, was very pragmatic and sought ways of reform to seize opportunities and overcome difficulties”.

### **7.2.2 Reforms from 1986-1997**

Since 1986, new policies produced positive influences on factories, as well as in craft villages (FEI, 2003; MOEAITC, 1999). The market, showed massive increases in the demand for consumer goods, regardless of their quality (Phong, 2009). With limitation in foreign trade rights, the SOEs and households in the handicraft villages became the main suppliers of the domestic market (MOEAITC, 1999; FEI, 2003). A more open mechanism enabled State-owned factories to produce goods outside the planned system in order to address the shortages in domestic supplies. After meeting the planned supply, excess products were sold at market prices, which brought new sources of income for the factories (Phong, 2009). The household sector was engaged in production for the market through contracts with SOEs. Rapid expansion of production also secured large contracts from the Soviet Union for processing garments, where Vietnam companies imported thread from the Soviet Union and exported the finished products back to Russia (MOEAITC, 1999; Phong, 2009).<sup>143</sup> In the period of 1987-1990, the industry grew impressively with the establishment of new factories everywhere, generating employment and substantially contributing to the State’s budget (MOEAITC, 1999). Truong (interview, 2011) suggested “in the period of the central command economy and in the first period of reforms, the T&Gs industry demonstrated that it was the leading force in economic liberalisation and integration process of Vietnam. The T&G sector was the first sector to establish a joint venture company with a British company in 1988, right after the promulgation of the Law on Foreign

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<sup>143</sup> This form of business was later expanded to include countries like Hungary, Czech, Slovakia, and East Germany

Investment in 1987, with the registered capital of US\$ 1 million”. Chi Lan (interview, 2012) suggested, “the growth and expansion of the T&Gs sector was not the result of the loosening of producing factor control mechanisms, but to the efficiency and the competitiveness of the industry. The industry had to rely on materials from, and markets of, the Soviet Union and the Eastern European countries, as; generally, Vietnam was diplomatically and economically isolated”.

The industry faced a very difficult period from 1990 to 1995. The economic reforms on SOEs, market opening and the shrinking in the traditional export markets forced the industry into difficulties (MOEAITC, 1999; Truong, interview, 2010). The Government gradually removed the subsidies for the SOEs, forcing them operate under the market economy and, the collapse of Socialist countries in Eastern Europe deprived them of the traditional markets of the industry (Le and Liu, 2006; FEI, 2003). It also affected the supplies of materials and machinery to the industry. Most of Vietnam equipment was imported from these countries since 1960s, and they thus depended on these countries for both spare parts and inputs material such as cloth and dye chemicals. Meanwhile, other options for import materials and spare parts were limited by the US embargo (Masina, 2006; MOEAITC, 1999). In addition, the economy was gradually reforming, but foreign trade was still under tight control of the government. Thus the problem of input shortages for production increased (MOEAITC, 1999; Truong, interview, 2011). Vietnam began to liberalise its trade relations with the outside world and normalised relations with China (Le and Liu, 2006). China’s cheaper textiles and garments strongly competed with Vietnamese products in the domestic market (Phong, 2009). Truong (interview, 2011) commented “in this situation, Vietnamese establishments faced a lot of difficulties in re-investment for production. Profits therefore shrunk due to losses of export markets and competition in the domestic market. Indeed the demand of replacing equipment and importing materials threw many establishments into financial difficulties. Profits could not compensate for investment costs, leading to the collapse of factories”. Truong (interview, 2010) commented that “most private businesses were in contracts with the SOEs for large orders for the export market. Many of them used material from SOEs to make their final goods for the market”. Truong (interview, 2010) also commented the industry was still dominated by the SOEs and the Private sector was small and lacking sophisticated machinery.

Truong (interview, 2011) provided an example: Nam Dinh Textile Company demonstrated the difficulties of textile companies in the 1990s. “It was the largest and most advanced factory in Indochina, providing employment for 18,000 workers. The factory was the centre and pride of the T&G industry, through its large scale and modern infrastructure for production and good conditions for workers. However, this company fell into financial difficulties because of the removal of subsidies, bad management and shrinkage in its markets. The factory faced difficulties in mobilising capital for re-investment and finding the markets for selling their products. Finally, it lost its liquidity due to repaying its debts”. This has been the typical case for most big SOEs companies in 1990s (FEI, 2003; VINATEX, 2010).

Truong (interview, 2010) suggested that during 1990 to 1995 there was rapid transformation of the T&G industry. The Government’s Decree 388-HDBT (1993) was issued to reorganise SOEs, forcing them to operate under the market mechanism and ending subsidies. T&G factories were merged, liquidised or equitised if they were not making profits. Surviving firms had to change their operations, become more flexible and look for market contracts, instead of producing products by State orders as they had done previously. These difficulties encouraged SOEs to find their own way to rescue themselves (MOEAITC 1999; Hill 1998; Nadvi et al, 2003; Viet 2005). Truong (interview, 2011) suggested “under the threat of bankruptcy, SOEs searched for new potential markets in Europe and Japan for fresh capital for re-investment”. Under the US trade embargo, Vietnamese enterprises still found ways to reach new export markets in Europe and Japan. At the same time, new FDI inputs entered Vietnam for the T&G sector. Truong (interview, 2011) commented “these markets were a real life buoyant for T&G enterprises, which were caught in difficulties at that time. Many first contracts to these markets were in the form of CMTs (Cut-Trim-Make), with little value added, in which the payments were made by machines, spare parts and chemicals rather than cash. These contracts helped the Vietnamese enterprises to replace their obsolete and old Eastern Europe technology with Japanese machines and technology. This was a breakthrough step for the development of the T&G sector”. After 3 years of restructuring the T&G industry was able to export 43% of its output to Europe and 42% to Japan in 1996 (Institute of Economics, 2001; Hill, 1998; MOEAITC, 1999). The

industry took advantage of its labour intensive production to cope with the challenges of the market mechanism (Truong, interview, 2010).<sup>144</sup>

Strong economic reforms led to the development of a multi-sector T&G industry. According to the Tuat (interview, 2010), the Director of Institute of Strategic Policies of Industry, “the T&G industry was based on labour intensity, with very small amounts of capital investment. Average investment for setting up one work place was only about USD 1,000 therefore, the industry attracted many FDI inputs and private domestic investment”. There was a fundamental change in the diversity of the ownership structure during this time, including SOEs, the private sector, and the foreign sector (Institute of Economics, 2001; Nguyen, 2010). SOEs were still the leading sector in industry, possessing large and long established production infrastructures. They also had advantage in capital access from State banks and the Government guarantees for borrowing, and an advantage of access to land, with good locations and large enough to accommodate new factories’ (Institute of Economics, 2001; Nguyen, 2010).<sup>145</sup> The private sector was growing rapidly by taking up the opportunities of economic liberalisation. They included the household sector, private companies, collectives and the mixed economy sector (Nguyen 2010; MOEAITC 1999; Institute of Economics, 2001). Small economic units (households) invested in machinery for their traditional crafts and worked long hours to provide their products for the expanding markets (Institute of Economics, 2001; FEI, 2003). In textiles, the private sector played a moderate role, accounting for only 25.9% of total output in 1995. In garments, this figure was higher at 47%. This was the result of their small size and lack of modern technology for producing textile and garment products (Institute of Economics, 2001).

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<sup>144</sup> The export values of the textile sector increased from US\$ 6.5 million in 1988 to US\$ 175.5 million in 1996. The garment sector increase from US\$ 21.1 million in 1985 to US\$ 1162.7 million in 1996. Since 1992, it contributed more than 17% to the total exports and more than 45% of industrial output. This was impressive after only 10 years of development (MOEAICT, 1999; Hill, 1998).

<sup>145</sup> SOEs accounted for 56.8% of the total industry production in 1995, due to the need for complicated technology and larger investment. In the garment industry, SOEs accounted for 35% of the total production in 1995 (Nguyen 2010, p.32; Nadvi et al, 2003).

FDI grew rapidly and played an increasingly important role in the industry. The preferred form of business for FDI was joint ventures with the SOEs, which possessed advantages of having lands, skills for large businesses and connections with the Government. 100% foreign owned enterprises were increasingly established (MOEAITC, 1999; Institute of Economics, 2001).

Since 1995, there were significant changes in the business environment in general and the T&G sector in particular. The Law on Company, the Law on Private Enterprises and Law on SOEs were issued to regulate the activities of these companies (Arkadie and Mallon, 2003; Masina, 2006; Le and Liu, 2006). However, Chi Lan (interview, 2012) commented that “the laws were considered to be too strict for establishments of new businesses. Private firms could only establish and operate in areas that were allowed in the laws”. The discrimination between sectors had been also reflected on the separate laws for these sectors (Thai, interview, 2012). Experts often complained that the Government started to develop import substitution policies, in which several important industries were well protected by trade policies and state investment via big SOEs (Masina, 2006; Womack, 1997; Sidel, 1998; Chi Lan, interview, 2012). These policies attracted much of the limited resources of the country into these industries and big SOEs. In the T&G industry, the State decided to establish the Vietnam Textile Corporation (VINATEX) with a vision of having a large-scale T&G company constituting a number of central large state-owned T&G companies (Truong, interview, 2011; VINATEX, 2011). It started with 52 members and over 85,000 workers, operating throughout the supply chain and included import-export companies and a fashion design institute (Sung, 2011). They soon accounted for 90% of fibre production, 50% of cloth production and 40% of the T&G production of the whole country (MOEAITC, 1999; Institute of Economics, 2001). Sung<sup>146</sup> (2010, p.205) suggested that “establishment of VINATEX was intended to re-organise the current structure of the SOEs in the T&G industry, because many SOEs at that time were facing difficulties or on the edge of bankruptcy. With the support of the Government, VINATEX as a group overcame their difficulties and built up into a State Corporation leading the development of the T&G industry”.

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<sup>146</sup> Tran Quang Sung is the former Chairman of the VINATEX

VINATEX was heavily invested in and supported to become a controlling corporation and monopolise scarce resources for its own development. This put the rest of the sector in the difficult position of competing for other available resources. The private sector suffered from the lack of access to capital and land, and difficulties in accessing new technology needed for developing large-scale businesses (FEI, 2003). The share of the private sector, especially the household sector, decreased since 1995 in both the T&G industries. This reflected partly the biased policies and operating conditions in the private sector. Many handicraft villages also faced reduced markets and returns due to their lack of access to capital and land to upgrade their businesses or to invest in new machines (FEI, 2003).

Nevertheless, 15 years of the reforms still brought a positive change for the industry. A market economy saw the sector gradually progress into a diversified multi-sector industry (VINATEX, 2010; Institute of Economics, 2001; MOEAITC, 1999). The annual export growth rate of this industry is 23.8%, making it the 2<sup>nd</sup> place in terms of export volume. In 1989, the Vietnamese textile products could access only 30 countries in the world but in 2000, they sold in more than 100 countries and territories. The export volume totalled US\$ 1.89 billion in 2001, 16 times greater than that in 1990 (Viet, 2005).

### **7.2.3 Reform's shortcomings in the industry**

During the reforms, the industry was able to develop a production base of diverse forms of ownership and to penetrate and compete in international markets (Truong, 2011). In spite of fast and flexible growth the T&G sector still faced barriers from their own internal policies and those of the government.

#### ***Lack of capacity and of large-scale production***

The problems were production capacities and productivity (FEI, 2003; Hill, 1998). The industry was beset with problems in acquiring new technology, gaining

access to materials, the low skills of labour and limited capabilities in marketing and design (FEI, 2003; MOEAITC, 1999; Hill, 1998). The T&G equipment was still outdated and inconsistent with modern production demands, with shortages of capital, and many factories possessing obsolete machinery that had been acquired from a multitude of different sources, creating many compatibility problems. The production chains in the factories were highly inefficient and resulted in very low productivity and a limited number of products (Tuat, interview, 2011; FEI, 2003). Production chains were outdated compared with that of the rest of the world. Production chains consisted of numerous risk factors and were not standardised, thus, made-in Vietnam products were under-valued and not very competitive (FEI, 2003; Hill, 1998; Institute of Economics, 2001).

Materials for the T&G manufacture were an obstacle to the sector's development. Truong (interview, 2011) suggested "the sector could only meet 5% of the demand for cotton products, and synthetic and cotton fibres, while chemicals and dyes were all imported". Domestic materials were low quality and could not meet the demand. The dependence on imported materials made it impossible for the factories to manage the supply and price of materials for fibre production, particularly in the tough competition of international markets (FEI, 2003, Institute of Economics, 2001). With 80% of fabrics and 90% of materials for garments such as buttons, zippers and threads being imported the reliance on imports resulted in ineffective control of the final quality and low added value of garment sector (FEI, 2003).

The T&G industry is specialised and intensive manufacturing so the issues of discipline, health and wages are always challenges to the enterprises (FEI, 2003; MOEAITC, 1999). In manufacturing, price competition is severe, so the already low salaries are pushed even further down. Tuat (interview, 2011) suggested that "therefore, finding sufficiently trained workers was always a challenging task for the industry. This was compounded by a lack of qualified managerial expertise. Many senior managers 'learned by doing', not by training and this led to severe difficulties in integrating into a global economy based upon higher productivity, technology and quality goods."



The garment industry focused mainly on CMTs for the export markets, while total reliance on foreign designers and fashion brands led to severe shortages of talent and skills in designing (FEI, 2003; Nguyen, 2010). Therefore, under the pressure of fashion changes and customer loyalty to a brand in the T&G industry, the industry was far from developing its own domestic brand names worthy of inclusion into the global fashion market. Tuat (interview, 2011) said “with the total focus appearing to be on benefiting from cheap labour and accessing as cheap as possible production methods, the industry could not hope to reach further stages of development, and risked future disaster as economic growth caused higher labour and resource costs, while witnessing no significant improvements in the skill of workers and the quality of the products”.

### ***Trade and investment barriers***

The export/import tax system of Vietnam was still complex, ambiguous and discriminated across industries (Hill, 1998). There were serious problems with the smuggling of finished products in order to avoid taxes (Hill, 1998; Nguyen, 2010). The tax structure was aimed to support the SOEs, particularly when those companies were in difficulties (Institute of Economics, 2001; Hill, 1998; Nguyen, 2010). In addition, the tax system was frequently inconsistent and unclear, with a variety of tariffs on similar products, often leading to the authorities applying multiple taxes onto the same item (Nguyen and Le, 2005; Institute of Economics, 2001). The tariff schedule publications were not available to investors, creating an ambiguous and confusing situation. Many non-tariffs measures were also not documented or published accurately enough to explain essential information (Hill, 1998; MOEAITC, 1999; Nguyen, 2010). Thus, custom officials were regularly applying a matrix of different regulations and tariffs on the same goods, in an atmosphere of secrecy and in an arbitrary way that made corruption in the industry rife (FEI, 2003; MOEAITC, 1999; Nguyen, 2010). Companies were either penalised or protected in the application of rules that either unfairly ‘taxed’ them or provided financial support/incentives. Thai (interview, 2012) commented “the opening up of the free market economy and its application to the T&G industry provided tools for officials and powerful Vietnamese to accrue personal fortunes from the misuse of the system through favouritism and relationships or by applying ‘official’ charges to competitors”. The distribution of quotas for export of finished products and quotas for import of machinery and materials were still carried

out more on the basis of relationships and personal greed serviced by bribery and corruption than by efficiency, productivity, quality and ability of the producers involved (FEI, 2003; Nguyen, 2010).

Export and import procedures were improved, but problems still faced the T&G industry. The period of exemption from import tax for inputs of production was too short (90 days), making the management of inputs difficult and complex, and not suitable to a cycle of production and selling products. Import and export procedures were still complex and troublesome. Priorities often focused on industrial processing zones, leading to preferences in choosing production locations (Institution of Economics, 2001; Nguyen, 2010).

### ***Bias in the structure of ownership***

SOEs enjoyed preferential treatment through State's subsidies, prioritised access to capital sources, export quotas, availability of land and facilities and close relations with senior officials (FEI, 2003; Nguyen, 2010; Hill, 2000). VINATEX consisted of various companies, where a number of under-performing companies actually acquired resources at the expense of better performing ones, and investment was unfairly and unprofessionally distributed to inefficient and badly managed SOEs (Hill, 1998; MOEAITC, 1999).

The bias towards the SOEs led to an inefficient investment environment, where resources were diverted to the SOEs, creating a major challenge for foreign and domestic investors. The private and non-State companies faced difficulties in obtaining land and capital for production facilities. This process was very complicated, expensive (especially in non-official payments) and time-consuming (Nguyen, 2010). Access to loans was also difficult for enterprises, compounded by the fact that some of those costs were not official and declarable. Financial services were mainly controlled by State-owned banks and they were hesitant to provide loans to private companies and often required large collateral, especially in the form of property and assets of the companies. They also could not access foreign banks for loans. Thus, private companies were beset with difficulties in mobilising capital for production and investment. Many big T&G

companies developed on the basis of financial sources from illegal sources, such as loans at high interest rates from unofficial moneylenders (Hill, 1998; FEI, 2003; Nguyen, 2010).

The access to export quotas was also an obstacle for the private sector. Quota allocations were often granted by the Ministry of Trade under a non-transparent process and criteria, which often benefited the SOEs and well connected businesses to the authorities (Hill, 2000; Nguyen, 2010). Hill (2000) suggested that gradually, and following much concerted lobbying and tedious bureaucracy, a trickle of private firms—usually those whose owners had good connections, began to receive small allocations. Many firms had to purchase quotas in the black market (Hill, 2000; Nguyen, 2010). Other firms had to bribe officials for their allocation of quotas and this damaged the competitiveness of the T&G sector and deterred investors (Nguyen, 2010).

#### **Legal institutions shortcomings**

Legal institutions for businesses were fraught with shortcomings. Regulations were unclear, making it difficult for interpretation (Arkadie and Mallon, 2003). Bureaucratic and complex management systems also prevented enterprises' development. State agencies often harassed companies, even on small issues, consuming the time and money of companies (Nguyen, 2010). Many companies employed people solely to navigate through the difficult relationships and dealings with the Government officialdom, with some companies seeking special relations with senior officials, and enjoying preferential treatment solely due to corrupt relationships with officials (Hill, 1998; Nguyen, 2010). The laws and regulations were not consistently applied due to vague and badly constructed regulations that were often enforced in a biased and unfair manner. Localities often had their own regulations that ran counter to the State's policy and guidelines (Arkadie and Mallon, 2003; Masina, 2006). This caused companies to spend significant time simply on communicating with the authorities in Hanoi, merely to just understand new policies and regulations of the State, and often then finding themselves unable to cope with badly constructed legal regulations. A further enhancement of the levels of difficulties was the export and

import procedures that were often complex and time-consuming, and also constituted obstacles to international and domestic business (Nguyen, 2010; FEI, 2003).

#### **7.2.4 Reforms since 2000**

The period 1990-1998 saw both problems and impressive developments for the T&G industry.<sup>147</sup> The industry developed a diverse structure and increased its competitiveness in the international market (FEI, 2003; VINATEX, 2011; Institute of Economics, 2001). The industry was hit by the Asian Financial Crisis, lowering its growth to 10% a year (Nguyen and Dang, 2010). A new wave of reforms started to restructure the economy to overcome the effects of the Crisis and improved its efficiency. Decision 161/1998/QD-TTg (2010) stated: "Development goals of the T&G industry to 2010 are to enhance exports to increase foreign exchange revenues, ensure payment balance of debts, expand the production facilities, meet domestic consumption demands in terms of quantity, quality, varieties and prices and gradually build the T&G industry as a key export sector, contributing to economic growth, jobs creation and industrialisation and modernisation of the country" (Nguyen and Dang, 2010).

From the Governments' new initiative for development of the industry, the industry was able to reinvest in production and find new markets for exports. They were able to penetrate the European and Japan market. In the EU market, T&G products accounted for 25% of the total export volume to the EU.<sup>148</sup> In the Japanese market, the 2<sup>nd</sup> biggest T&G market in the world, the Vietnamese T&G products increased due to a reduction in non-tariff barriers. Vietnam became one of the top 4 countries exporting to this market, despite the strict fashion requirements and the short cycle of products. Although the Vietnamese products could not meet the fashion criteria, they still

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<sup>147</sup> Growth of the industry hit more than 30% from 1995-1997 (Vinatex, 2010)

<sup>148</sup> For garment products, the EU was the largest import market of Vietnam, comprising 40% of the export volume. In 1999, textile and garment product exports to the EU reached US\$ 700 million. In 1998-2000, after the signing of the Vietnam – EU Textile Agreement, the export volume to EU went up to more than 31% compared to the 1992-1997 period.

competed through low prices and quality. Export volume in 2000 reached US\$ 620 million (Truong, 2011).

The industry was facing severe challenges for further development from 2000. Vietnam's export markets became saturated and products suffered from the harsh competition from other countries such as China, India, and Bangladesh, with cheaper prices and more options (Nguyen and Dang, 2010; Nguyen, 2010). As a result, exports to the EU and Japan decreased problems increased in the US market due to a lack of mutual consent and failure to sign the necessary Trade Agreement (Nguyen, 2010; Truong, interview, 2011; VINATEX, 2010). Import taxation to the US was very high, thus, the Vietnamese products were unable to compete.<sup>149</sup>

Against such a backdrop, the garment and textile industry, led by VINATEX, had consistently proposed to the Prime Minister to actively engage in negotiations of the Vietnam-US bilateral trade agreement. According to Truong (interview, 2011), "all progress reports of VINATEX submitted to the Ministry of Industry and the Prime Minister included a section on the issue of creating a US garment and textile market accessible to Vietnamese exports. According to the projections of VINATEX and VINATAS, the Vietnamese garment and textile exports would increase about 35% with a US-Vietnam BTA". Decision 55/2001/QD-TTg prescribed the main goals.<sup>150</sup> During the following 5 years, the industry became one of the spearheads in exports of Vietnam. It employed nearly 5% of the total labour (over 20% of the industrial labour), and accounted for 8% of the output value of the processing industries. The exports turnover of the industry ranked second after crude oil, and formed over 16% of the total exports value (Nguyen and Dang, 2010; Government of Vietnam, 2001).

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<sup>149</sup> The export volume to the US only stood at US\$ 26.4 million in 1998, US\$ 48 million in 1999 and US\$ 60 million in 2000 (VINATEX, 2010).

<sup>150</sup> To increase the exports turnover of the industry from approximately USD 2 billion in 2000 to USD 5 billion by 2005 and USD 8-10 billion by 2010; increase employment; increase the rate of localisation of the exports from the 25% of 2000 to 50% by 2010.

Signing the BTA in 2001 was a turning point for the T&G industry. The US lifted the quota embargo against Vietnam and lowered the export taxation from 40% down to 20%. After one year implementing USBTA, the Vietnamese T&G products became the 2<sup>nd</sup> top products exported to the US. Export products also diversified. The share of export to the US also increased rapidly from 4.7% in 2001 to 24.2% in 2002 (Institute of T&G, 2009; VINATEX, 2010; Nguyen and Dang, 2010; MUTRAP, 2007).

From 2005, the T&G quota restrictions were abolished among the WTO members. Thus, the T&G trade in the world developed quickly. China, India and Bangladesh raised their markets shares for both T&G products. According to the WTO roadmap, special trade defence measures against Chinese T&G imports were removed by the end of 2007 (for the EU) and by 2008 (for the US), bringing about both opportunities and challenges to T&G export countries in general and Vietnam in particular (Nguyen and Dang, 2010; MUTRAP, 2007). The industry was facing both new opportunities and challenges. From 2005, Vietnam expedited its negotiations process for WTO accession. Decision 36/2008/QD-TTg approved a new “Development Strategy” aiming to establish industrial clusters and zones for better competition given favourable geographic conditions and available workforces and addressing environmental issues locally (Nguyen, 2010).

### **7.3 Impacts of WTO accession on the textile and garment industry**

#### **7.3.1 Vietnam’s Commitments to WTO related to textile and garment industry**

Khanh (interview, 2012) said “the industry has performed better and reformed quicker each time the Vietnam has gone deeper into the international integration process”. After the success of the US BTA, WTO accession brought hope for further development and reforms (Khanh, interview, 2012).

**Table 7.7. Vietnam's Commitments to WTO on Import Tariff Reduction for Textile and Garment Products**

	<i>MFN tax rate prior to accession</i>	<i>Committed tax rate within WTO</i>		
		<b>At accession</b>	<b>Final</b>	<b>Implementation Period</b>
<b>General Tariff</b>	<b>17.4%</b>	<b>17.2%</b>	<b>13.4%</b>	<b>3-5 years</b>
<b>Average tariff for industrial products</b>	<b>16.7%</b>	<b>16.2%</b>	<b>12.4%</b>	<b>3-5 years</b>
<b>Average tariff for textile and garment industry</b>	<b>37.3%</b>	<b>13.7%</b>	<b>13.7%</b>	<b>Immediately</b>
<b>Fabrics</b>	40%	12%	12%	Immediately
<b>Clothes</b>	50%	20%	20%	Immediately
<b>Fibres</b>	20%	5%	5%	Immediately

Source: NCIEC, 2007; USAID and NCIEC, 2007; VCCI, 2011.

Under accession, there were 16 major agreements in the areas of trade and tariffs (GATT, 1994), T&G, trade-related investment measures (TRIMS), and anti-dumping, etc. Vietnam was also required to make all economic and trade policies transparent, and review all law-making programs to ensure the capacity for its commitments realisation (NCIEC, 2007; Nguyen and Dang, 2010). There were several agreements dealing directly with the T&G sector. Firstly, the GATT 1994 stipulated common regulations on MFNs and National Treatments of the goods trading, including the T&G industry. This agreement not only dealt with commitments on tariff schedule for goods, but also had commitments on Non-trade barriers such as quotas, import licensing, trading rights, subsidies and so on. A second agreement was on technical barriers to trade, ensuring regulations, standards, and inspection procedures and licensing did not create unnecessary obstacles to the trade. WTO members actively issued many new regulations and standards to ensure the quality of the goods and regulations on goods

origins also influenced the market penetration capacity of T&G goods. New Custom's processes were implemented to set the value and tariff rate of the import goods.

**Table 7.8: Summary of commitments to tariff reduction for textile and garment products in the Regional Free Trade Agreements.**

<i>Year</i>	<i>Tariff Rate under FTA</i>	<i>Tariff Rate under ACFTA</i>	<i>Tariff Rate under AKFTA</i>
2006	5%	27.8%	33.4%
2015	0%	1.97%	9.3%

Source: Nguyen and Dang, 2010

Vietnam abolished a range of non-tariff barriers and the quota system was eliminated immediately. Incentives given for the FDI in the T&G sector were eliminated upon WTO's accession. The trading rights (export and import rights) were also granted for foreign companies and entities to have the same rights as domestic companies or entities, with exceptions of several State managed products (NCIEC, 2007). The SOEs had to operate on a commercial basis without the direct and indirect interventions of the Government. Vietnam was required to make all economic and trade policies transparent, review all law-making programs to ensure the capacity for its commitments realisation (NCIEC, 2007). Khanh (interview, 2012) commented that "Vietnam's WTO commitments were aiming to prevent the distortion of trade and production as well as to ensure more predictable and fairer environment between sectors in the economy. These were what the Government of Vietnam was aiming for and implementing". These commitments created a great impact on the operation and management of T&G sectors. However, actual lapses in enforcing regulations weakened the impact of many of the new reforms.

Under the bilateral negotiations for market opening, Vietnam committed to opening up the domestic market to foreign products, mainly through tariff reductions. For the commitments in the T&G sector there is no implementation period for tariff reductions. Vietnam had to reduce tariffs for T&G products right after it became a



member of the WTO, while the roadmap for tariff reductions concerning other commodities often ranged from 5 to 7 years. Thus, this industry had no time for preparation, but had to compete immediately with other imported products due to tariff reductions. The sector had the highest reduction rate out of all commodities, including fibre, thread, fabric, clothes and ready-made clothes (NCIEC, 2007).

### **7.3.2 WTO's accession process has provided pressure for reform**

The Vietnamese economy and enterprises were also facing enormous challenges, with fierce competition in both domestic and international markets, due to the removal of the protection barriers and the realisation of the MFN and National Treatment as well as the abolishment of the Agreement on Textiles and Clothing (ATC) in 2005 (Nguyen and Dang, 2010). The global T&G production and business had an impact on the market with:

1. Removal of quotas led to changes in the free trade agreements, preferential tariff systems and protective tariff barriers;
2. There was a shift in labour, T&Gs technologies and equipment to countries with the most comparative advantages. Access to fabric and materials of high quality was decisive to the competition in this sector. Fabric products involving high techniques were increased. Orders were offered to enterprises with good material supply, high production and competition capacities;
3. Retail and multinational groups dominated the retail networks;
4. Rapid growth of countries with T&G export competition capacities hampered the production of countries with less comparative advantages, which led to unemployment and social unrest;
5. Lower prices of T&G products helped consumers and promoted consumption. Lower prices would reduce the profits of the T&G export companies, limited production and lessened the incomes of countries where the T&G exports were a major part of their economy, and lead to payment balance deficits (VCCI-WTO Centre, 2011; MUTRAP, 2007).

As a result of the abolishment of the ATC in 2005, Vietnamese producers were forced into a difficult position with two major challenges. Vietnam limited their export quotas into WTO member's countries, because it was yet to be WTO member, while WTO members were entitled free quota markets, thus they could compete to sell their products as much as wanted. Big producers in WTO took this opportunity to increase their exports. Vietnam exports were limited by its quota and competed with the big producers from other WTO members with free quotas (Nguyen and Dang, 2010; MUTRAP, 2007).

The other challenge was the changing nature of the T&G market. New T&G markets were dominated by the big and competitive T&G companies, who have been able to provide large and efficient orders to the distributors. Due to the competition and large production capacities, the T&G market tended to be organised around vertical chains. In this model, the distributors looked for capable producers to integrate into a chain from production to distribution and saved costs, controlled quality and were easily managed (Nguyen and Dang, 2010). WTO accession presented pressure for the Vietnam T&G sector to speed up their reforms for better efficiency and a large scale, in order to compete in the global market. The traditional markets of Vietnam such as US, EU and Japanese markets, witnessed strong competition from producers from China and India.<sup>151</sup> Without quick reforms Vietnam risked being left behind by its competitors, who had been able to establish long-term relations with the retail companies or signed long-term contracts with the T&G distribution chains in the US (Truong, interview, 2011).

T&G goods had sharp and quick reductions in tariffs (Nguyen and Dang, 2010).<sup>152</sup> Real protection for the T&G dropped significantly from 126% to only 34% in one year, due to the reductions in tariff of finished products. Such a sudden drop

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<sup>151</sup> In 2005, the revenue of Chinese textile and garment products into the US increased more than 67% (Nguyen and Dang, 2010).

<sup>152</sup> The average tariff was reduced from 37.3% in pre-WTO period to 13.7% without any implementation periods in other industries. For examples, tariffs for fabric were reduced from 40% to 12%, for ready-made clothes from 50% to 20% and for fibre from 20% to 5% in 2007

affected all branches of the industry. As a result of the reduction in import tax and protection, the value added in the enterprises was reduced if they did not improve their competitiveness and value added content (Nguyen and Dang, 2010).

**Table 7.9: Effective Rate of Protection of the Textile and Garment industry**

(%)	2006	2007	2008	2009	2010	2015	2020
<b>Textile and garment</b>	124,71	34,06	34,74	35,28	35,61	33,31	28,59
<b>Thread fibre</b>	4,00	-4,97	-4,46	-4,06	-3,81	-3,10	-2,66
<b>Clothing</b>	135,70	58,02	58,44	57,72	57,48	58,26	57,83
<b>Carpet weaving</b>	56,00	25,02	25,22	25,38	25,47	19,81	20,32
<b>Embroidery (excl. Carpet)</b>	62,33	17,44	17,69	17,90	18,05	16,03	16,31

Source: Adapted from Nguyen and Dang, 2010

The T&G industry could no longer enjoy the subsidies from the government. All export subsidies and incentives from the Export Subsidy Fund, tax exemption or reduction measures, land-leasing fees in association with export conditions, and preferential credit for development investment, were abolished. Some preferential measures to promote exports were maintained until 11 Jan 2012 (Nguyen and Dang, 2010; VCCI-WTO Centre, 2011).

**Table 7.10: Anti-dumping case against Vietnam's export products from 1994-2004 (see appendix 14 for more updated information)**

<b>Year</b>	<b>Products</b>	<b>From country</b>	<b>Measure against Vietnam</b>
<b>1994</b>	Rice	Columbia	
<b>1998</b>	Glutamate	EU	16.8%
	Footwear	EU	
<b>2000</b>	Gas lighter	Poland	0.09Euro/unit
<b>2001</b>	Garlic	Canada	1.48CAD/kg
<b>2002</b>	Water proof Footwear & sole	Canada	
	Gas lighter	EU	
	Gas lighter	Korea	
	Catfish	US	36.84-63.88%
<b>2003</b>	Oxide zinc	EU	28%
	Shrimp	US	4.13-25.76%
<b>2004</b>	Metal ring	EU	51.2-78.8%
	Tyre	Turkey	29-49%
	Bicycle	EU	15.8-34.5%
	Steel type	EU	
	Stainless fastener	EU	7.7%
	Fluorescent lamp	EU	66.1%
	Surfboard	Peru	5.2USD/unit

Source: Adapted from Van and Tong (2009); VCCI, 2012

Nevertheless, the industry also faced higher risks of anti-dumping, anti-subsidy and defence lawsuits in its large export markets. Vietnam was still subject to the non-market economy status for 12 years from the accession date (NCIEC, 2007). This was the legal basis for any WTO members to start a lawsuit or a defence mechanism for antidumping. Thus, they expected more lawsuits and defence mechanisms when dealing with any surge of imports in their countries. They could also use the price index and standard from other members to accuse Vietnam of dumping their T&G products (Nguyen and Dang, 2010). Table 7.10 showed that, Vietnam had to deal with 7 out of

18 anti-dumping lawsuits in 2004 alone (See Appendix 14 for updated information).<sup>153</sup> On 11 Jan 2007, the US officially started its Supervision Program on Vietnam's T&Gs, in order to monitor Vietnam's export to the US and be prepared for legal proceedings if there were any violations, causing a challenge for the industry because many customers were afraid of possible anti-dumping lawsuits from suppliers who had more stability in terms of price and supply (Van and Tong, 2009; VCCI, 2012).

Another side effect came with the increase of labour costs. Although Vietnam is labour abundant, the trained labour is still limited for industrial productions. Given that situation, T&G offered the lowest salary in the economy, but labour costs increased in order to retain their workers (Nguyen and Dang, 2010).

Despite rapid developments since 2002, the sector had been facing some essential weaknesses, which limited its competitiveness in both domestic and international markets following Vietnam joining the WTO. Firstly, the T&G enterprises were mostly on the small and medium scale due to the low investment requirements and lacking flexibility for the international market (Truong, interview, 2011). Many enterprises were upgraded from the household sector. According to Le Duong Quang<sup>154</sup>, suggested that "after few years of accessing the US market, enterprises were able to invest in new technology and expand their business significantly, but still limited in scale with a majority of small enterprises" (as cited in FEI, 2003, p.142).<sup>155</sup> The capacity of the garment industry was equivalent to 16% of Thailand and 13.3% of Indonesia (FEI, 2003). The biggest company was the VINATEX. However, its members had mixed performance results. Some of them operated efficiently with modern technology, such as Thang Long Garment, Viet Tien Garment, Duc Giang Garment, but many of them were still struggling with efficiency and liquidity (NgoiSao Online, 2004;

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<sup>153</sup> EU topped the complainant list with 9 cases, followed by the US and Canada with 2 cases. Since WTO accession, there have been 20 cases against antidumping of Vietnam export products

<sup>154</sup> Former Director of Planning and Investment Department, Ministry of Planning and Investment

<sup>155</sup> At the end of 2002, there were only 700 garment enterprises in the whole country including 150 SOEs, in which only half of the non-state enterprises were on a very small scale with only 100-400 machines (FEI, 2003, pp.148).

Mai, 2003). The products did not develop well with poor designing, branding and fashion fields (Nguyen and Dang, 2010).

The inputs for the garment sector were mostly imported, thus, production was unstable and low value added. Vietnam enterprises preferred and targeted the CMTs market, rather than building their own brands or doing FOBs products (Nguyen and Dang, 2010). The localisation of the Vietnamese garment was only at 20-25% in 2003, which was mostly the labour contribution into the value added of the export products (Nguyen and Dang, 2010; VITAS, 2006; FEI 2003). Meanwhile, the textile products produced domestically, could not meet the standards of export productions in domestic enterprises. So the industry was still heavily dependent on the inputs from outside the countries.

### **7.3.3 WTO's accession process has influenced the balance of politics to support reforms in T&G**

In late 1990s, the Vietnam Government tended to follow the strategic industrial policies with the intensified trade protection and investment for the SOEs to produce export replacement goods (Thai, interview, 2012). However, the Asia financial crisis in 1997 and its effects put many of these SOEs onto the edge of collapse (Masina, 2006; Thai, interview, 2012). In order to rescue the economy, the Government tried a range of reforms, but they slowly progressed (Chi Lan, interview, 2012). Chi Lan (interview, 2012) suggested that “given the preferential treatment of the State, SOEs became a strong interest group that would opposed any policy changes that might affect their existence. Their influence based on their dominant role in the economy with the heavy investment of the government on them and their large number of employees”. The Government still had to provide many relief packages for the SOEs to survive the crisis, and government officials were cautious about the reforms. These middle level management agencies were mostly in charge of granting licences and providing government funds for the economy. Many still kept an old fashioned philosophy of the central command economy and saw reforms as risky and hard to control. Others had their own organisational or personal misgivings related to the loss of power. These groups acted to prevent further reforms.

The industry has utilised well the country's advantages in labour. Truong (interview, 2012) suggested that "the T&G is a dynamic industry and always pioneering in the reforms process. Each time, Vietnam took reforms and further integrated into the world economy, the industry has taken opportunities to further develop itself for higher demand of the market".

The T&G industry benefited from the reform and integration process. The Government policies of late 1990s provided protections and investments towards the import substitution industries such as steel, cement, ship building, chemical, construction industries etc. These companies were often the capital-intensive industries, and thus required heavy government investment and protection but, were not efficient and well managed. The Government subsidised these companies' losses. Capital was diverted towards these companies, and away from export competing industries and private companies (Nguyen, 2010). The Government's protection facilitated foreign investment inflows into the protected areas, making the investment structure move towards the industries in which Vietnam did not have comparative advantages.

Shortage of capital in 1997-2000 put T&G companies in difficulties as regards their re-investment in production and forced the companies to accept processing contracts to gradually repay their investment to build up their facilities (Nguyen, 2010; Truong, interview, 2012). By 2000, T&G companies were coping with new challenges as demand of all major markets (except America) came to a saturation point and penetration into new markets required a huge amount of investment. SOEs were heavily affected by the Asian Financial Crisis and forced to the edge of collapse. This forced the State to provide more support for them through preferential credits from the State Bank (Nguyen, 2010). According the Mai Hoang An, the General Director of the VINATEX, "the corporation needed USD 230 million USD in 2001, but the Development Fund could only provide USD 26 million. In 2002, it needed USD 258 million, but received only USD 32.2 million, less than 10% of needed capital" (as cited in FEI, 2003, p.308). This is a demonstration of the shift of capitals to protected areas compared with that of those areas with comparative advantages. Apart from drawing capital investment SOEs attracted a large number of labour and left the T&G industry with human resource

problems (WB, 2002). Companies put pressure on the State to continue retaining protection policies based on rationales of employment and strategic development of areas, with the focus of support on SOEs. These SOEs diverted capital out of the T&G industry and into a variety of other industries, such as taxi companies, hotels, etc and this led to further difficulties for many enterprises.<sup>156</sup>

Policy makers represent a large interest group, capable of delaying changes in policy. Due to the lack of coordination between agencies and no clear laws and regulations, policy-makers filled the vacuum between the laws and regulations inefficiency and the market mechanism required to regulate and run the market operation (McCarty, 2001). They had authorised powers to issue licenses for operations and made administrative decisions to adjust the market in line with the State's purposes and management of export and import trades (Thai, interview, 2012). They were also in charge of reporting, consulting and drafting policies for high-ranking agencies or leaders. So as changes in policies occurred, the interests of the management agencies were directly affected and those involved in controlling the markets found their power, influence and benefits under threat. Those policy-making groups often found change difficult as they previously held a privileged position in their means to influence senior policy makers. These were often the middle ranking bureaucrats who controlled not only the regulation and management of the market but often earned bribes and favours from their powers to control the trade. The corruption at this level was almost unbridled and created extra costs, tedious administrative tasks and untold damage to any private company seeking to gain profitable business. In addition, Chi Lan (interview, 2012) suggested that "the corruption of these officials was more firmly embedded in many SOEs with both SOE leaders and government bureaucrats able to enjoy highly lucrative 'relationships' that benefited them personally, but did little to actually benefit the industry".

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<sup>156</sup> The Phuoc Long Textile Company was an example. It was a leading company before and during the first phase of reform from 1990-1995. However, the increasing competition and weak management forced the company into a liquidity problem that made finding resources for reinvestment impossible. It is similar situation for the Long An textile company, another large and long established manufacturer in the industry, which had been forced to the edge of bankruptcy (FEI 2003; Vietnamnet Online, 2004)



Management of export and import trade directly affected the industry and was biased against the private companies. The Ministry of Trade (MOT) is responsible for management of licensing export and import for T&G products. Before Vietnam joined the WTO, all Vietnamese T&G exports to Europe and US were subject to quotas. Following the boom of export to the US market, Vietnamese companies started to face difficulties in getting export quotas to the US (Nguyen and Dang, 2010). The distribution of quotas became a hot issue from 2003. The Department of Export and Import at MOT had the mandate to distribute the quota to T&G companies. Though this was work to manage appropriately and maximise the use of resources and quotas, it became a tool to generate power for managing agencies due to its ambiguous criteria and regulations on quotas allocation (Vnexpress Online, 2004; Phong and Vinh, 2004). Quotas were allocated to the companies based upon their export performance in the previous year, multiplying with a coefficient set by an inter-agency board instead of introducing a competitive bidding mechanism. The quota allocation mechanism appeared fairly transparent as it was based on the record of the previous year. However, the criteria for determining the coefficients in the mechanisms of each company were vague and unclear. Thus, it led to lack of transparency in determining quota distributions. This resulted in negative incidents, as capable companies failed to receive export quotas, while many companies receiving the quota were unable to actually produce enough for the quota allocation (Phong and Vinh, 2004; Thanh, 2004; Vnexpress, 2004). Quotas were not correctly transferred and the result was:

1. Companies, which lacked quotas, had to pay to re-buy quotas from companies having abundant quotas,
2. Companies having abundant quotas had to pay to return quotas to managing agencies without deduction of quota in the following years, and
3. Companies which needed quotas had to pay for receiving the quota from the return of companies having abundant quotas.

The cost of quotas was too low enabling speculation and corruption. Many companies' used illegal ways such as bribes, false performance results or purchasing quotas from other enterprises (Thanh, 2004). The quota allocation mechanism was too vague, leading to the official agencies abusing their power on a massive scale (Vo, 2004). In spite of claims of abuse in the quota distribution, this mechanism was

unchanged and remained active for many years, indicating the depth of corruption within the Ministry of Trade. Thai (interview, 2012) said “maintaining such a mechanism was ineffective but the managing agencies still kept it on purpose for protecting their department and personal benefits”.

The roles of the private sector in the industry contributed to the downward trend of the SOEs shares and the slight increases of foreign sector shares in the total output. But, VINATEX retained an advantage as the dominant player in the market, yet it failed to attract sufficient capital, investment and market share to the Corporation. Due to its large share in the export trade, this Corporation was able to maintain close links with the central and local government. In an interview, the General Director Mai Hoang An mentioned that “ the industry had achieved two important targets of the CPV and government’s concerns, which were (1) enhancing the export performance to earn strong foreign currencies and (2) generating jobs for millions of people with thousands of new jobs every year. The CPV and the Government reckoned special supporting policies for the development of this industry were needed” (as cited in FEI, 2003, p.308). Local governments welcomed VINATEX due to its need for labour and its payment of taxes. Thus, special treatments often generated even further advantages for VINATEX (Nguyen, 2010). Based on their scale and backup from the Government, they were able to gain large loans from the Government with very low collateral terms. It had further privileges in obtaining land for setting up production facilities, especially from the local government, due to its advantages of being large scale and connected directly to the central government (Nguyen, 2010; Nguyen and Le, 2005; Hill, 2000; MOEAITC, 1998). Quota allocation was also an example of the SOE bias. Firms often got more quotas than they could produce, and often sold these on the black market, to smaller firms, at higher prices. These firms were often short of investment and unable to meet the quotas. In the investigation on corruption cases concerning quota allocations, there were about 45 SOEs involved in bribing or using connections for gaining quota allocations and selling them in the black market. Chi Lan (interview, 2012) said “providing a more level playing field in the T&G means more opportunities for the private sector to grow. In this sector, there is no need for the domination of the State sector, because the private sector now has the capacity to invest and to lead the sector”.

In the context of the slow reform progress in early 2000s, the interest groups were able to influence the policies for reforms because they were the products of the CPV's ideology and close connection to the system. Reforms were re-started in 2001 to rescue the poor performance of the economy with lack of growth, poor performance of SOEs, budget deficits and fragile banking sector. However, the normal politics could not provide much force for progress in the domestic reforms because of the deep commitments of CPV and Government to anti reform groups, and the rampant levels of corruption that both officials and SOEs were involved in; levels of corruption that persist to the present day.

Clearly, the persistent tendency towards corruption and relationships between SOEs and the Government officials means that although the surface presentation is of compliance, the reality is far from this and involves massive bribery and corruption that regularly threatens not only WTO membership, but also the very future of the industry.

As a result of the WTO negotiation for accession and the USBTA, the trade regime of Vietnam had changed significantly (in appearance) towards a more transparent and neutral regime since 2001 (MUTRAP, 2008). These changes were to have helped to neutralise the bias for the import competing industries and to create a more efficient business environment for better resource allocation. Law changes under the WTO accession helped to remove, gradually, protection for the SOEs and the control of the SOEs on the import and export activities (MUTRAP, 2008). But one has to treat this with great caution, as the reality is that the relationships have become even more covert, and continue to bestow great advantages on the SOEs. Secondly, the non-tariff barriers were removed significantly since 2001 as a result of the negotiations for the WTO accession. They were actively used before 2001 for several 'key' goods<sup>157</sup> for protection of import competing industries with the reason being a balancing of supply and demand. Under the negotiation for the WTO accession, the tariff rate was also reduced sharply from 19.98% in 2003 to 10.53% in 2006 (Athukorala, 2005; Tuyen et al, 2011). According to Athukorala (2005), the reduction of EPR in manufacturing was mainly due to the increase in the tariff for inputs and the WTO accession process

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<sup>157</sup> Such as car, cement, steel, sugar, etc...

gradually corrected the bias against export competing goods by the liberalisation of trade under the WTO framework and negotiations. This would help to redirect resources from the capital-intensive industries towards the labour-intensive industries like textiles and garments or agricultural, where they are holding competitive advantages for Vietnam (Athukorala, 2005; Nguyen and Dang, 2010).<sup>158</sup>

The WTO regulations helped build a transparent and non-discriminative market. WTO requirement for SOEs is to operate under commercial-based standards and the State can only influence enterprises by its ownership (NCIEC, 2007). It also required Vietnam to report its progress of SOEs equitisation programme every year to the WTO, providing a framework for the relationship between SOEs and the Government, which would help to reduce intervention from the Government on the behalf of SOEs and make the market a more level playing field for all companies in the sector. At the 10<sup>th</sup> Congress (2006), the Party highlighted its policy that “speeding up the reshuffle, reform and enhancement of SOEs’ efficiency with a focus on equitisation. Encouraging business forms of multi ownership, concentrating on newly equitised companies to make it become a popular format and make up a high ratio in the economy”. The result of the WTO accession process and change in the CPV policies was the basis for the Unified Law on Enterprise (2005). Enterprises increased from 150,000 in 2002 to 500,000, accounting for 40% of the GDP in 2010 (WB, 2012). The Government’s Board of Enterprises’ Reform introduced concrete solutions to accelerate the transformation of SOEs, such as categorising SOEs by business performance and dealing with under-performing companies. As a result, the number of equitised SOEs surged since 2004 (WB, 2006). The Government had to adjust the mechanism for supporting their strategic industries in order to comply with WTO regulations. These commitments further neutralised the privileges of the SOEs, who were the main receivers of the Government investments and supports (NCIEC, 2007). However, for one to understand the reality, it must be understood that these equitised SOEs were privatised in name only on many occasions, with their past ‘relationships’ maintained and advantages through bribery and corruption as prevalent as ever before.

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<sup>158</sup> The Effective Rate of Protection was reduced sharply from 2001 to 2005, from 54.1% to 20.43% in 2006. In manufacturing, the EPR was reduced rapidly from 95.97% in 2001 to 43.94% in 2003 (54%) (Athukorala, 2005; Tuyen et al, 2011).

Accession did help to enhance the political power of the private sector (MUTRAP, 2007). The private sector has had direct benefits through expansion of business opportunities and from the increased market access, as Khanh (interview, 2012) notes “The incentives for the further reform in the business environment and a level playing field among different economic sectors has not only come from the improved business environment due to the WTO accession process, but also from the business opportunities from improved non-discriminating market access via the WTO accession”. Although the importance and the contribution of this sector have been acknowledged by the Party-State since 1986, this sector was often discriminated against through State investment and preferences (Sidel, 1999; Tuan, 2006b). There was still a “strong view from conservatives who were concerned about the role of the private sector in the economy” (Tuan, 2006, p.79). This viewpoint has been not only been the anchor for the special roles of the SOEs but also the basis for discrimination over the private sector (Dixon, 2004; Forsyth, 1997; Masina, 2006; Painter, 2005; Sjöholm, 2006).

The interaction between different interest groups on reform was exposed during the WTO accession process and this was seen as an external levelling force to motivate the pro-reform groups to assemble and put pressure on the Party-State on the reform progress. It restrained the interest groups, who were against the reforms, and influenced the Party-State through its regulations and standards. WTO accession was significant to the industry as it presented an opportunity of access to huge markets for exports and also of easier access to materials not yet available domestically (Hanh, 2005). WTO compliance produced a safer and more open investment climate, enabling the industry, with its inherent competitive advantages, to attract more foreign investment and development assistance from countries and such international financial institutions as the WB, International Monetary Fund, and Asian Development Bank. Thus, the industry was further enhanced thanks to the know-how and management experience transferred through foreign-invested projects (Hanh, 2005). Given such enormous benefits, the garment and textile industry was one group who strongly advocated the economic reforms and WTO accession.

One fact that convinced most policy-makers was the benefits gained by the garment and textile industry after signing the US-BTA. The Vietnamese exports turnover increased impressively.<sup>159</sup> Success of the garment and textile exports into the US market strengthened the confidence in the potential economic benefits gained from deeper integration and reforms. This also built an impetus for the Vietnamese Government to consider the acceleration of WTO accession as opening the market would likely bring about enormous economic benefits to industries where Vietnam possessed comparative advantages (Truong, interview, 2011). The previous isolation from the WTO had placed the garment and textile industry in a disadvantaged position given the termination of the ATC in 2005 (Nguyen and Dang, 2010). It was easy to notice that Vietnam's exports of garment and textiles plunged immediately in 2005 when the ATC was terminated, and that many CAT items experienced negative growth (Nguyen and Dang, 2010; Nguyen, 2010). Without fundamental reforms of institutions and an economic governance approach, it would have been difficult for Vietnam to join the WTO.

One of features of the industry is the large number and diverse ownership of enterprises, but often small in size ranging from households to small and medium size enterprises (FEI, 2003; Nguyen, 2010; Nguyen and Dang, 2010). Many of them were spontaneously developed from the household sector, thus they were in the situation of 'every man for himself' without any coordination of market and production (FEI, 2003). Truong (interview, 2011) suggested that "[at that time] private firms were very small and often surviving around the operation of the SOEs. Many of them often made use of superfluous and discarded material from the SOEs or did subcontracts for the SOEs. They had limited capacity in marketing and collecting information in the international market as well as access to the customer network. Thus, their operations were not able to create enough profit for reinvestment to upgrade their business". Moreover, the Asian Financial Crisis had had deep impacts on the T&G industry due to the decrease of orders from international markets and increasingly competitive foreign goods<sup>160</sup> in the home market (Arkadie and Mallon, 2003; Kokko, 1988; Hung, 2000; 2001). The small

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<sup>159</sup> The exports turnover of the garment and textile industry increased by more than 190% in 2003 and 260% in 2004 and registered at USD 2.484 billion in 2009.

<sup>160</sup> Due to the currency depreciation in most Asia countries.

and medium enterprises became vulnerable before the crisis, as the SOEs received most of the quotas and orders due to its connections and capacity (FEI, 2003). There was a need for an organisation to assist these small and medium enterprises negotiate for the contracts and provide information for the trading partners. As a result, the Vietnam Textile and Apparel Association (VITAS) was established in 1999, marking one of the earliest business associations established after the economic reforms. This Association acted as a bridge between enterprises, the Government and the international market (FEI, 2003).<sup>161</sup> VITAS members, especially the SME were able to express their concerns on the development of T&G enterprises. This helped to mobilise diverse, scattered and weak voices from many enterprises for their potential benefits and developments of the industry. Thus, it plays a more natural role of mediating all industry's sector to represent their industry interests. Truong (interview, 2010) suggested that "the Vietnamese garment and textile industry, particularly through the VITAS exerted their influence on policy-makers in considering reforms in various sectors of the economy in exchange for the benefits of the garment and textile industry". The channels for their concerns were based on two strengths. First, the performance and contribution of the industry to the economy was significant to the country, especially during the first phase of the reforms (FEI, 2003). Second, VITAS members also included VINATEX, as the largest and core SOE for the Government strategic plan for the development of the industry. The VITAS also represent the concern of the SOEs in the industry. From connections of VINATEX and other member SOEs, VITAS was able to approach Government agencies and officials to lobby and consult their concerns and suggestions to the Government (VINATEX, 2010).

Since its establishment, the VITAS worked closely with the Government to form the strategic policy for development of the T&G industry towards 2010. The industry was given mechanisms and targets for development, in which they encouraged the multi- economic sector including private and foreign sectors in the development of the industry. The Government set up a financial mechanism for the development of the industry, in which it allocated 2.3 billion USD for the years from 2001-2005 and 2 billion USD for the period from 2006-2010 and arranged a range of tax and financial

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<sup>161</sup> Within 3 years of establishment, it had attracted more than 450 enterprises, out of 1200 T&G enterprises, and included foreign invested enterprises (FEI, 2003).

incentives (Government Office, 2001). VITAS have made use of the industry strengths, which are its rapid growth in exports and contributions to the export volume, to negotiate and consult with the government for policies and resource allocations.

Truong (interview, 2010) declared “VITAS worked actively and hard to lobby for the international integration as they understand the vital roles of the international standards for market expansion. The associations, together with VINATEX, reported monthly and in these reports, there was a profit and loss analysis of different scenarios with or without integration under the USBTA or WTO”. WTO accession provided incentives for VITAS and the T&G enterprises to assemble together to bid for the economic changes and reforms to meet the WTO requirement for accession.

WTO accession process played an important role in balancing the political economy on the reforms in the T&G sector. It helped to change the trade policy towards a more neutral regime in which competitive advantage sectors like T&G can get more resources for their development. The WTO accession provided a motivation for groups benefiting from reforms to form their own interest groups to influence policy makers. Thus, the balance of political economy of economic reforms changed towards a more positive approach.

#### **7.3.4 WTO’s accession process has guided the institutional reforms**

The WTO accession process has made both direct and indirect impacts to the process of institutional reforms. Direct impacts of the WTO accession have been the changes of laws and regulations to comply with the WTO standards and requirements. Meanwhile, the WTO accession process has helped to set up a more neutral market economy with less dominant roles of the state sector.



### *Reducing the role of SOEs*

Since 1995, the Government of Vietnam intended to establish large SOEs, which could take leading roles in development of the strategic industries. The Vietnam Textile and Garments Corporation (Corporation 91) was one of them and established under the Prime Minister Decision 91-TTg in 1995 (FEI, 2003). The performance of VINATEX was not highly rated as the ROE of the entire corporation was 3.2%.<sup>162</sup> Most of its companies suffered losses (Institute of T&G, 2010).<sup>163</sup> The performance of subsidiaries was worrisome despite the designated role of being the leading Corporation for the development of the industry.

After the Asian Financial Crisis, the second stage of economic reform was started to enhance the efficiency of the economy. The restructuring process of the SOEs was a practical strategy in order to improve the governance and efficiency of the SOEs for a more market oriented economic environment as well as to reduce the financial burden of inefficient SOEs (Le and Liu, 2006; Arkadie and Mallon, 2003). VINATEX was also undertaking the Government's equitisation process under the Decree 44/1998/ND-CP. However, the process of equitisation was very slow. Only 13 of VINATEX subsidiaries were equitised. Most of them were garment subsidiaries, which were easy to be equitised because of its high returns and small investment. Later, the subsidiaries with poor performances were equitised. The progress of equitisation was slow in this period (IOTG, 2010; VINATEX, 2011). The cause of the slow equitisation process involved the still strong discrimination between SOEs and the private sector, where leaving the state sector meant giving up benefits and privileges attached to the SOEs status, and several unsuccessful cases of equitisation. A number of enterprises, after becoming joint-stock companies, became loss-making enterprises, due to mismanagement and lack of supports; such as Chien Thang, Thang Long and Binh Dinh

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<sup>162</sup> Revenue: VND 7,761 billion, profit: VND 74 billion, tax: VND 287 billion; Equity: VND 1,840 billion; Debt-to-Equity: 2.9%; Average income of an employee: VND 1 million/year.

<sup>163</sup> 10 subsidiaries suffered losses, four made no profit, 12 had the ROE under 0.01%, three had the ROE above 10%, three had the ROE ranging between 5-10 %, and 13 subsidiaries had the ROE between 1-5 %. This meant that 30% of the forty-five 100% State-owned subsidiaries of VINATEX made no profit and only 13% produced profit with the ROE above 5% (Institute of T&G, 2010; VINATEX, 2010).

Joint-Stock Garment companies (IOTG, 2010; Truong, interview, 2011). Third, was due to reasons ranging from lack of finance to confidence in the companies.

However, the equitisation process picked up its speed from 2002, when the US BTA came into force and brought the significant increase of nearly 200% in the export of garments and textiles to the US market. From the positive results of the US BTA, the WTO accession process was accelerated from 2003 by strengthening views on the benefits of the international economic integration process (Masina, 2006). The process provided a new impetus for the SOEs restructuring process. It provided a new hope for market access, especially when the ATC expired in 2005. Firms needed to enhance their capacity and quality in order to take this opportunity and cope with the change and increased competition from international markets after the ATC ended. On the other hand, the WTO accession process also generated pressure for firms to restructure themselves to face more challenges from increasing competition in the domestic market due to the market opening under the WTO negotiation process. Truong (interview, 2012) said “enterprises in the industry had been propagandised for the better preparation for the event. They wanted these SOEs taking this opportunity to improve their governance and capacity to face the new challenges of the market”. A range of policies were issued to facilitate this process and equitisation was further strengthened with much stronger policies since 2004, when Vietnam accelerated its negotiation process to join the WTO.

WTO accession provided new business opportunities but also was expected to provide much needed capital inflow into the industry and many SOEs found that their current ownership system and operation might not fit for the future development under the new market opportunities. Three years of the US BTA also had helped them to improve the capacity and the chance to be independent operations. Some SOEs were willing to undertake equitisation. The conditions for equitisation were vastly improved. Not only the mechanism and procedure were improved but more important the tools for equitisation also contained more options. The success and fast growth of the stock market also became an attractive channel for equitisation. Thus, SOEs were more willing to go down the route for equitisation.

2004-2006 were the pivotal years of Vietnam's WTO accession. The strong determination coupled with the approaching deadline, placed increasing pressure on proper restructuring of economic sectors. The legal system was promptly reformed with new regulations and in a more transparent and equitable manner for economic stakeholders. The introduction of the Enterprise Law 2005 addressed the long-standing inequality among economic stakeholders as well as the perception of differences between SOEs and joint-stock enterprises. The changing of perceptions, the demand for funding and administrative reforms forged momentum for the equitisation of garment and textile enterprises (IOTG, 2009; VINATEX, 2011).<sup>164</sup>

Vietnam amended the majority of its laws and policies in compliance with WTO rules prior to membership. Between 2003 and 2007, Vietnam gradually removed all regulations and policies that hindered trade. The T&G industry relied on export-import and world markets. Approximately 80% of the machineries and inputs were imported and also about 80% of the outputs were exported (Nguyen and Dang, 2010; Habubank, 2010; IOTG, 2009). Therefore, the trade policies of Vietnam would exert direct impact on the industry.

Prior to 2001, the foreign-invested companies were only permitted to export the items registered in their business license. After 2001, these restrictions were removed. The Investment Law and the Foreign Investment Law were also combined into a single Law on Investment to ensure that the legal framework on investment was compatible with international norms and practices given the deeper integration of the country (Dordi et al, 2008).

One of the major changes in the assistance policies for the T&G industry was the termination of subsidies to domestic enterprises. Between 2003 and 2007, Vietnam had removed all policies and regulations on prohibited subsidies. The removal had taken 2 forms:

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<sup>164</sup> During this time, forty enterprises had been equitised wholly or partly, under Decree 187/2004/ND-CP dated 24/12/2004 which nearly doubled the number of equitised SOEs in 2002-2003

1. Complete abolition of the related subsidies; or
2. Adjust the related subsidies in compliance with the WTO rules.

Export subsidies and bonuses for the T&G industry were terminated. The Export assistance programmes and bonuses from the Export Assistance Fund were no longer applicable from 2007. At present, a Fund for trade, investment and tourism promotion is being developed to replace the Export Assistance Fund. In the draft proposal, all prohibited subsidies described in the Export Assistance Fund were removed and the goals of the Fund were adjusted in compatibility with WTO rules. The investment incentives, i.e. exemption and reduction of corporate income tax, tariffs, land use tax, land lease, which had been attached to the export conditions under the regulations on foreign investment were removed (IOGT, 2009; Tuoc, 2007).<sup>165</sup> The incentives on credit for development investment, including loans, interest subsidies, credit assurance, bidding assurance, contract implementation assurance, based on the export criteria described in the Development Assistance Fund.<sup>166</sup> The Development Assistance Fund, with the mission of assisting export-based enterprises, was transformed into the Development Bank operating under market principles (WB, 2006; WB, 2011).

Subsidies to encourage the consumption of domestic produce, based on the rate of localisation, were also abolished or adjusted in compliance with WTO rules and market economy principles. Tax incentives, based on the localisation rate, applicable to all industries were terminated.<sup>167</sup> The localisation-based investment incentives, including the waivering and reduction of corporate income tax, import tariffs, land use

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<sup>165</sup>Under the Law on Investment 2005 and Government Decree 108/2006/ND-CP on guidelines to implement the Law on Investment 2005

<sup>166</sup>Founded under the Prime Minister's Decision 195/1999/QD-TTg, were also terminated under the Prime Minister's Decision 108/2006/QD-TTg. The Government Decree 151/2006/ND-CP and Circular 69/2007/TT-BTC stipulated that the levels of interests for export credit should be identified on the basis of market interests rates. Decree 24/2007/ND-CP provided for a phasing in period of 5 years for investment incentives, including the export-merit based tariff incentives granted to projects licensed and put into operation prior to Vietnam's accession to WTO (Nguyen and Dang, 2010).

<sup>167</sup> On 1/10/2006 by Decree 43/2006/ND-CP.

tax and land lease were all abolished (WB, 2006; 2011; NCIEC, 2007).<sup>168</sup> A peak of subsidy cuts for the textiles and garment industry was the termination of Decision 55/2001/QD-TTg. This included abolishing preferential credit for investment, preferential VAT and other incentives described in the Law on Domestic Investment (Dordi et al, 2008).<sup>169</sup>

The Prime Minister's Decision 108/2006/QD-TTg on transformation of the Development Assistance Fund into the Development Bank ensured that the assistance criteria of the Fund excluded the export subsidies or subsidies to encourage the use of domestic produce. The Prime Minister's Decision 279/2005/QD-TTg on the Trade Promotion Programme provided for the automatic termination of subsidies not in compliance with the WTO rules.

In summary, it can be concluded that Vietnam no longer maintains any policy or regulation on prohibited forms of subsidies against the commitments of Vietnam and relevant WTO rules.

### **7.3.5 Reforms after the WTO**

WTO's accession continued to generate the motivation for the reform process through the implementation period. Khanh (interview, 2012) said "Vietnam has implemented many tariff reduction's commitments and border issues seriously. They are playing important roles in keeping the pace of the reforms after the WTO accession". The structure of the economy has shifted gradually towards the industries that Vietnam has competitiveness advantages in (CIEM, 2010). All commitments on tariff reductions and subsidies to the industry have been implemented and removed (NCIEC, 2007; IOTG, 2010).

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<sup>168</sup>Under the Law on Investment 2005 and Decree 108/2006/ND-CP on guidelines to implement the Law on Investment 2005.

<sup>169</sup> Vietnamnet Online News, 2005; Vietnam News Agency, 2006.

Motivation for the reform process in the industry comes mainly from the competition in the both international and domestic markets. As a member of the WTO, Vietnam can export freely to the WTO members' markets. However, they have to compete fairly under market economy conditions, rather than be allocated certain quotas for market access with less competition (Nguyen and Dang, 2010; Nguyen, 2010; FEI, 2003). This removal of the quota system will mean a survival of the fittest only, and the Vietnam industry will have to compete with countries like China, Pakistan, India, etc. Thus, pressure for reforming and upgrading the industry still exists. The slowing down of the industry's exports after the end of ATC in 2005 was a clear sign for a need to strongly compete in the international markets (Kien Giang, 2005)<sup>170</sup>. Vietnam applied the US special import monitoring program on Vietnam's exports, which easily set the grounds for the anti-dumping measures from the US. In addition, the industry was no longer entitled to the support from the government in the form of subsidies for development. The Decision 55/2001/QD-TTg, a strategic policy for development of the T&G industry from 2001-2010 was cancelled under the WTO's commitments (IOTG, 2009). Thus, the enterprises have had to increase their productivity in order to hedge against the economic risks. The pressure for reforms also comes from the range of behind border measures on trade and investment. The industry is required to obey and implement the WTO's regulations such as CSR, SA8000; Oeko-tex, Reach's waste processing and TBT. These regulations are complicated and mean increased costs for Vietnam enterprises.

The domestic market was opened dramatically after the accession by its commitments to the WTO. The average real protection rate of the garment and textile garment has been reduced sharply in 2007. The international market is more competitive and put further pressure on the industry to become more efficient and competitive (Truong, interview, 2011).

After the accession, the WTO is still providing the motivation for reform by changing the balance of the political economy of reforms for the T&G industry in particular and the economy in general. The export performance of the T&G sharply

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<sup>170</sup> Nguyen Thuy and Kieu Giang 2004; Son Nghia, 2005.

improved since 2007.<sup>171</sup> In 2008, this industry took over from the oil and gas industry to be the largest export industry in Vietnam (Tuoi Tre Newspaper, 2007).<sup>172</sup> The industry has been in the top 10 of the world's exporters in garments and textiles since 2007, and moved to 7<sup>th</sup> position in 2010 with nearly 3% of the world market in 2010 (Habubank Securities, 2011).<sup>173</sup> Vu Duc Giang, (2010), the Chairman of VITAS and VINATEX mentioned that “the industry has been considered the key industry of the economy, as well as playing a key role in the economic recovery process. It helped to earn foreign currencies and reduced the trade deficit of the economy” (as cited in VINATEX, 2010). Thus, the industry's performance has proven its advantages and economic strength over the other industries, shifted significantly the thought and balance of political forces towards the competitive industries as against support the protected ‘strategic’ industries for import substitution.

The change in the political position of the industry has also been reflected in the enhanced role of VITAS in the Government policymaking process. Since the WTO accession process, VITAS has participated in consultation sessions and cooperated with Government for the bilateral and multilateral negotiations. At the beginning, the role of the VITAS was not significant in these negotiations. However, Truong (interview, 2012) said, “after the WTO accession, its roles has been improved significantly due to the industry performance and its active contribution and consultation on implementing the WTO commitments, the strategy for T&G development to 2020 and the successful settlement of the US Monitoring Mechanism for the T&G industry. VITAS is the capable partner of the Government and assists in consulting and forming policies and strategies for negotiations, as for example with the TPP Agreement”. This has been a significant outcome of the WTO accession process, and indicates the increased influence of the enterprises in the policy-making processes of the Government. Truong (interview, 2012) commented that “VITAS has been calling for further improvement in

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<sup>171</sup> The value of exports in 2007 had jumped dramatically with 33.5% compared to that in 2006. It continued to increase by 16.5% in the following years. The export revenue was not increased due to the effect of the Financial Crisis in 2009, however, it picked up sharply at 23.2% in 2010 (IOTG, 2009).

<sup>172</sup> IOGT, 2010; AFTERX, 2010; Tran, 2012.

<sup>173</sup> After China (36.6%); Bangladesh (4.32%), Germany (5.03%), Italy (5%), India (3.9%) and Turkey (3.7%)

the policy-making process, and movement towards transparency and efficiency, especially in the commitments and the implementation schedules in the FTA and WTO, as well as for accelerating negotiations for TPP, FTA with EU and Russia, etc”.

#### **7.4 Conclusion**

Reforms in the T&G industry are still continuing after the WTO accession. The general tariffs have been significantly lowered (Nguyen and Dang, 2010; Athukorala, 2005; MUTRAP, 2007; Tuyen et al, 2011). The custom procedures have also been upgraded and simplified for both import and exports. Currently, the electronic custom procedures have been experimentally applied with the participation of 21 Custom Offices and 50000 enterprises throughout the countries as part of efforts in administrative procedures reforms (Huy, 2012).<sup>174</sup> The authorities, including the Ministry of Finance, the Custom General Office and Tax General Office have regularly conducted consultation conferences with enterprises all over the country, in order to exchange views on policies and concerns of the enterprises since 2004. In the first 9 months of 2012, there have been 41 conferences organised between Custom Offices and enterprises in all sectors, at both province and city level, and are used to explain the policies and listen to the concerns of the enterprises, which are reported back to the Customs General Office for improvement of the procedures (Huy, 2012).<sup>175</sup> Despite improvements and increasing consultation levels, there are still many complaints from the T&G enterprises about the Custom procedures. Most of the complaints are about the quick and frequent change of the regulations on export and import and overlapping of these regulations. Thus, these created difficulties for enterprises to follow and obey the regulations (Ha Mai, 2009). T&G enterprises also complained in the consultation sessions with the Ministry of Finance and Custom General Office about the inconsistency and arbitrary nature of the application of regulations and laws, especially in the field of tariff rates, tariff categories and values. There are also different procedures, applications and decisions of custom offices in different provinces (Bao

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<sup>174</sup> Huy 2012; Hai Yen, 2012; Custom Office Online, 2012; Minh Tam, 2012; Thanh Tu, 2012

<sup>175</sup> Huy, 2012; Custom News, 2012



Hanh, 2012).<sup>176</sup> The new Circular 79/2009/TT-BTC, concerns the procedures for supervising customs, monitoring trade, and the tariff management of import and export goods. There were complaints about the increasing complexity of procedures (Thu, 2012).<sup>177</sup>

The benefits and working conditions of the employees have been improved remarkably. The employees bought shares at discounted prices and were given appropriate jobs in a dynamic business model. The labour force was refined with better quality. Many employees who were either old or not compatible with the jobs, received pension benefits under Decree 41/2002/ND-CP of the Government, and the majority of them were satisfied with the pension. Meanwhile, those who were retained demonstrated better productivity and enjoyed higher incomes (IOTG, 2009).

WTO accession rapidly exposed the T&G industry to the demands of competitive dynamics and brought about revolutionary changes that resulted in attraction of international investment and development of the industry that brought much needed impetus to economic growth. By providing both guidance and incentives to reform, accession enabled the industry to break free from reliance on subsidies and developed an international level ability to grow as a worldwide exporter. This provided capital, employment and future opportunities for even more growth that is vital to the country and essential in avoiding the impending economic crisis.

Much of the development of T&G industry was initiated by crisis, with the industry secretly reacting to that crisis by expanding its exports and financing this through ‘loans’ that were illegally acquired. The Party and its policies of quotas and deterring export trade left the industry no other choice but to tackle crisis through its own means and deliberately ignore Party policies and direction. The success of this strategy forced the Party to join in the industry’s own version of ‘central control’ and its growing demonstration of market driven competitiveness. However, SOEs dominated

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<sup>176</sup> Government Online News, 2012,; TuoiTre News, 2012

<sup>177</sup> Bao Hanh, 2012; Quoc Anh, 2012

the 'reforms' and continue to be the main force of control of the sector. Foreign investment is declining, while 'State' investment and support still favours SOEs and discriminates against the private sector. Institutional and regulatory reforms are ignored with impunity, and the sector should be more accurately judged on the heights of growth it should have reached, rather than the success that now exists. Even major positive institutional reforms such as the establishment of VITAS are questionable, given the dominance and control of the institution by the SOE – VINATEX. The profits of exports are still largely not returning to the State in the form of taxes, and debts continue to build even in the face of growing revenue and the benefits are still the sole preserve of an elite interest group rather than in the re-investment into higher salaries, better working conditions and training of workers, and the greater mechanisation and technological improvement of a successful industry.

In the conclusion the thesis now considers the overall benefits to Vietnam of WTO accession and membership, and considers it in the context of a threatened economic crisis that was avoidable, but may have been caused by the Party and the Government having actually thrown away most of the possible benefits of the WTO process.

## CHAPTER 8 CONCLUSION

### 8.1 Introduction

This thesis has examined the impact of the WTO on the Vietnam economy and its reform from a central command economy to one based on the WTO free market doctrine.<sup>178</sup> Balding (2010, p.193) found that the WTO was the “defender and promoter of free trade... opening up markets and facilitating the unparalleled growth of economic interdependence. Until recently, however, little systemic research had studied the impact of the WTO”. Yet, despite those who find that it ‘freed global trade’, its critics believe it favours “multinationals and rich countries while ignoring the development concerns of lesser developed countries” (Balding, 2010, p.193). This thesis finds that the position of Vietnam in global trade has improved due to WTO accession and membership. There has been dramatic economic growth, reductions in the influence of Government and Party on the economy, improved laws and institutions along market principles and unprecedented improvements in prosperity. However, the foundations of that development remain problematic. As McGough (interview, 2012)<sup>179</sup> summarised ‘WTO accession provided Vietnam a gateway to the global economy, yet its impact has to consider where the failures continue to threaten the future stability of the economy and even economic collapse’. Although focused on trade and trade freedoms, the WTO was seen as a far more influential process upon the economic and political system in Vietnam’. McGough (interview, 2012) notes ‘A simplistic approach to the impact of the WTO would do little to help understand its actual purpose as a tool of reform. It goes beyond just being a trade improvement tool, and instead it can be understood by the Vietnamese as a mechanism for reforms across the whole system. From SOE

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<sup>178</sup> Free market doctrine and the WTO see Chomsky N (2007) Market Democracy in a Neoliberal Order: Doctrines and Reality. <http://www.chomsky.info/articles/199711--.htm>

<sup>179</sup> Dr. Sean McGough ADB/World Bank- Political and economic advisor to the Vietnam Government and Professor of Economics in Vietnam National University/Andrews USA partnership.

restructuring to addressing the capacity problems in governance, the WTO is seen as a panacea for all of the development concerns, and judgement of its success must address these expectations, however unjustified or how far removed they may be from the actual purpose or intent of the WTO. What the Vietnamese believe the WTO to be differs significantly from foreigners understanding’.

The impact of the WTO has brought major improvements in Vietnam, but aspects of its impact, such as the advancement of a wealthy and powerful elite interest group, the continued failures of the education and training system, the sustenance of corruption and the increasing governance problems are all directly related to the impact of the WTO upon Vietnam; as failures to improve them threatens the benefits accrued from accession and membership. As Chi Lan (interview, 2012) says “to restrict its evaluation to simple trade outcomes is neither helpful or a true reflection of its impact. The WTO shone a light upon the system and provided new ways to evaluate its outcomes and the weaknesses that it has now helped identify”. Although we can see the benefits of WTO, the failings in the economic structures continue and negatively affect the future outcomes of WTO membership.

In examining the impact upon Vietnam of the WTO it has become clear that one meets a prior problem that needs presentation and analysis. The WTO impacts are often negated by the domestic reform process which subsequently shows Vietnam as a country more identifiable as a case of non-compliance, rather than a country constantly moving towards the developments recommended and aided by WTO accession and membership. Reforms are carried out against a back cloth of conservative influences and interest group resistance that more often than not changes the intent and outcomes of the actual reform implementation. However, the success of this resistance against WTO led reforms is usually buried beneath a surface impression of change, reform, development and compliance. Beneath this cloak of compliance lies an embedded refusal to change and results in economic growth without sustainable development and an economy beset by debt, mismanagement and central central control based not upon a logical and structured ideology (whether communist or capitalist), but an almost irrepressible desire for Communist Party survival at all costs.

The original hypothesis was a simplistic belief in the WTO as an accelerator and structural supporter of reform, providing the tools to assist in the macroeconomic development and the opening up of Vietnam to the global economy. Vietnam entered into WTO accession in order to improve their dynamic competitiveness and competitive advantages, through opening up to the market system and participation in the global economy. The WTO was clearly seen in Vietnam as an entrance doorway into a ‘free market’ system. As Chi Lan (interview, 2012) said, “the general understanding was that Vietnam had moved away from the command system and decision-makers here saw WTO entry and further ‘free market’ reform as one and the same thing”. Little was actually understood about free market or market economy doctrines and more often than not the concepts were conflated by decision-makers and politicians. By the beginning of the new century the CPV realized that multilateralism and bilateral participation in the global economy was necessary to accelerate and structure domestic reform, and the WTO was seen as the gateway into this system, with membership a recognition that Vietnam was ready and able to accept its’ doctrines.

However, for the Party the benefits of WTO entry were a logical and positive prospect that they believed would provide the necessary development and advantages that would safeguard their own dominance of the political system. Compliance was something they believed could be controlled by the Party and where it challenged their authority (such as with a developing private sector, promotion of the ‘rule of law’ principle or independence of the financial system) they had the tools to direct and shape its impacts to a point where they remained its chief beneficiaries. The outcomes are very different, with non-compliance being the main strategy and deliberate undermining of the reforms engendered by WTO accession resulting in little change to the way the political system dominates the economy and virtually all sectors are chiefly directed through a central control, challenged only when a domestic interest group of wealthy elites interests are negatively affected, because they hold both the political and economic ascendancy to overturn those decisions.

Bilateral reform (such as the US-BTA) and multilateral reform (such as the WTO) enabled Vietnam to lessen the influence of protectionism and gain access to foreign capital, technology and new markets. The WTO membership presented Vietnam with an opportunity to achieve four main benefits:

1. WTO accession as a means to accelerate and lock-in domestic reforms. WTO strengthened domestic policies and institutions through reforms of laws and regulations;
2. The changes in economic policies and institutions that often accompany WTO accession also increase the credibility of governments in the eyes of the international business community;
3. Membership improved the access to major export markets; and
4. Vietnam now has access to a global disputes mechanism for trade policy conflicts.

The WTO is a global network offering its members a mechanism to reform their domestic economy and use it as a template for reforms to accelerate and sustain economic development (Weimann et al, 2006). Entrance into the WTO was a means to concentrate reforms on ‘long-term goals, which are industrialisation, modernisation and poverty reduction’ (Doanh, 2007). By 2000 it was realised that reforms were not keeping pace with economic development (Thanh, 2005). The government used WTO accession to lock-in internal reforms, to increase internal political support from export-oriented sectors, and to send a signal of stability and compromise with economic liberalization to international markets and foreign (Olivie and Steinberg, 2011). By setting targets that reflected international standards in economic performance and participation in the global economy, the WTO provided the impetus, guidelines and knowledge the Vietnamese needed to develop their openness to the global economy.

WTO accession accelerated reforms and encouraged transparency and accountability and reform of institutions. Yet, the process has been one of fragmented reforms, with no consistency and piecemeal in application, resulting in, for example, institutions still being dominated by a ‘legacy of central planning’ and often functioning badly because they are ‘missing, poorly formed, or incomplete’ (WB, 2012, p.19). In conjunction with this has been a decline in the Governments’ effectiveness, with both policy formation and application falling below required standards (WB, 2012).

Export growth, increased FDI and new supports and mechanisms for industrialisation were a direct consequence of WTO accession and membership. A primary responsibility of membership was the need to continue to improve the economy, firms and products, to strengthen economic and social institutions and ensure economic stability. In return, Vietnam was expected ‘to fulfil the sets of laws and commitments to non-discrimination, tariff reductions, open markets, intellectual property rights, regulations on law and social commitments’ (Doanh, 2007).

Central to understanding the domestic economic conditions structuring the WTO accession and membership is the political framework of Vietnam, which is based on the one Party rule of the Communists. The Party provides political stability and incorporates different forms of ‘democratic’ debate within its structures to gain legitimacy. However, the WTO process has eventually challenged that legitimacy. One Party rule in a ‘free market with socialist orientation’ is now a concept challenged by the accelerating problems of debt and economic crisis. Yet all interviewees, despite many critical views, believed that one-Party Communist rule remains the optimum solution to present and future problems. This is due to a faith in the ideology and a commitment to the continued legitimacy of the Party. The interview respondents felt strongly that the immediate situation required political stability and, that the Party was in the strongest position to provide that, alongside long-term plans to improve the political infra-structure and the democratisation of the Party system. McGough (interview, 2012) says ‘Vietnamese believe the WTO was created as a vehicle for US hegemony in trade, providing a support for its political aspirations and regime shaping principles. The victory of capitalism in the Cold War accelerated its intent as a means to shape the global economy in ‘its own image’ and although ruled by consensus, WTO membership is dependent on aligning to principles that basically reject the conflation of politics and economics. But Communists in Vietnam believed they could retain the ideological foundations of the politics and still play a part in a global ‘free trade’ regime’.<sup>180</sup> However, McGough (interview, 2012) also identified a contradiction in this as ‘the Vietnamese also felt the US-BTA was a very strong vehicle for American trade

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<sup>180</sup> For further discussion of this see Chomsky N (1997) The Passion for Free Markets, <http://www.chomsky.info/articles/199705--.htm>

power over Vietnam, and the WTO appeared as a softer alternative through which to manage trade relations with the US’.

In the thesis case studies of agriculture, banking and textiles there is clear evidence of success in integrating into the regional and global economy and domestic improvement of socio-economic infrastructures and institutions. However, national competitiveness has not been improved; institutions have reformed, but maintain an unsuitable administrative framework for socio-economic development; sectors have developed but still rely on an abundance of low cost labour and resources, with little improvement of levels of added value in the distribution chain. Transfer of technology has been inadequate and there is a consistent problem with productivity. These are not the most critical problems. A failure to adequately reform the SOE sector has led to a Banking crisis, with debt at unsustainable levels. There remains a problem with corruption at all levels of business and government, which threatens the authority of the Communist Party (Wiemann et al, 2006).

### **8.1.1 Vietnam and Compliance with International Agreements**

Vietnam has successfully entered into a number of international agreements and membership of major international organisations, but the entry and actual positive, transparent and active participation are questionable. While overtly a member pursuing compliance, Vietnam has domestically avoided its commitments, illustrated for example, by the increasing number of anti-dumping cases.

Vietnam’s membership of ASEAN reached a pinnacle when it hosted numerous summit and ministerial meetings of ASEAN in 2010. As an ASEAN member it was encouraged to then join AFTA, APEC and the WTO. In assessing the success of Vietnam’s commitments to international/regional integration, one needs to examine the domestic objectives in joining. Whether the WTO, ASEAN, APEC, etc, Vietnam has sought trade agreements as an avenue into larger markets. They have aimed to increase their multilateral bargaining powers. Through reciprocal concessions on trade barriers the opportunities for economic growth through trade liberalisation has clearly been achieved. Security arrangements in the agreements have helped improve Vietnam’s



position in such matters as the South Asian Seas disputes. Vietnam also improved its place in the international community, while its external trade relations are sufficiently improved to the point where Vietnam is now taking a strong role in the Trans Pacific Partnership (TPP) between the US and 11 Pacific Rim nations. However, even the TPP is negatively affected by Vietnam's relatively poor levels of domestic reforms. Chief concern for the US is that Vietnam's domestic reforms of SOEs lags far behind an acceptable standard, and the continued levels of protection is far below an acceptable level for US negotiators (Fergusson et al, 2013, p.21). Clearly, the external approach of Vietnam to international agreements has involved more interaction, cooperation and compliance, but these actions need to be supported by domestic reform that illustrates a far deeper sense of change from within. The position of SOE's in relation to the TPP demonstrates that lack of real domestic reform will eventually, negate any levels of international progress, and at worst, present Vietnam with outcomes that leave it seriously disadvantaged in international trade agreements.

### **8.1.2 Vietnam Crisis: The Rich Get Richer and the Poor Get Poorer**

The WTO has led to improvements in markets and in foreign direct investment, which has helped transform the country into middle-income status. Economic growth has brought impressive GDP growth. But Vietnam is a classic example of how the benefits of this can be misappropriated and the lack of sustainable development lead to a worsening situation for the majority of people. Tung (2013, p.1) notes how horizontal growth based on 'cheap labour, capital land and low technology' leads to a 'growth trap' or 'middle-income trap'. Vietnam has in reality become locked into a groove of horizontal growth. Vertical growth, with 'increased productivity of labour through improved qualifications of workers, application of advanced science and technology, organisational and production management reforms... efficient use of materials and natural resources... environmental protection' is essential to achieving 'real' growth. In all aspects of vertical growth Vietnam is deficient.

The horizontal model accrues the main benefits to a 'small number of upper class people' (Tung, 2013, p.2). The vast majority of the population are by-passed by development. Essential services increase prices beyond the poor's affordability with

regular above inflation increases. Education and health costs are increasingly taking a large portion of many households income. Unemployment benefits (for the very few who can successfully complete the procedures to access the benefits- aggravated by the fact that the most poor are the least educated) are low, providing very little support for an individual and virtually worthless aid to the family. Reform of SOEs often concentrates on divesting labour, and this is aggravated by a decline in the seasonal and temporary jobs available to rural workers supplementing income through occasional work in the cities (Vietnam News, 2011). The levels of social safety nets, especially in concern to unemployment, are at best inadequate, and more often than not, inaccessible, creating a society with a growing divide between the 'haves and have not's.

A common mistake in understanding communism in Vietnam is to believe that the social and welfare systems are a priority and support for the poor is credible. Health and education are costly at even the lowest levels. Speed or quality of service is dependent purely on how much can be paid, and often payments made in 'envelopes' and the 'envelope culture' is a way to access any form of effective health or education service. The prospects for the poor to improve their situation are low, with skilled workers only accounting for 13.3% of the population and only 200 students per 10,000 people and only 6% of the population having a degree or college qualification. There is little development of the situation and where it does occur then corruption soon limits its potential changes (Tung, 2013, p.1).

Reform has concentrated on horizontal growth and WTO entry has helped improve the rewards of this strategy. The WTO support and enhancement of vertical growth strategies was hoped to encourage the Party and Government to improve its workforce, encourage management reform, develop institutions and regulations and promote sustainable development. The present failures in all areas may be a result of non-compliance and refusals to carry out real domestic reforms in the economic and social infrastructures. The State has welcomed the benefits, while ignoring the responsibilities and the result is a prime example of economic growth without sustainable development.

## 8.2 WTO influence on economic reform

The slowdown in reforms prior to the WTO accession resulted in a growing demand for change. WTO accession provided a new pressure for reform, with the process of accession setting new guidelines, standards and objectives for economic development. The subsequent benefits from the reforms also changed the balance of interest groups. The interest groups that benefited, such as in the private and export sectors, found that the WTO accession provided them new legitimacy and powers; and increased their dominance over the conservative elements that opposed the movement towards a market economy. The accession process also enhanced the need for legal and institutional reform, with sweeping changes needed in order to meet the requirements of future membership of the WTO. The clearest statement of assenting to participate in accession was that the centrally planned economy model had failed and that Communism needed to move towards acceptance of the market economy as the only way to achieve further economic growth. Before this point the conservatives were the dominant force and reformers needed a mechanism and aspiration for restructuring the economy. WTO accession marked a point when reformers finally overcame the conservative ascendancy in economic planning. It also helped accelerate reforms and provided clear means to overcome many of the structural problems in the economy.

Changes in the Vietnam economy are clearly evident since accession and membership. Trade policy has reformed with commitments to reform in both manufacturing and service industries. Removals of quotas and trading licenses, improvements in custom valuations and procedures and significant reforms of the legal framework, provided vital improvements to the general economy. Institutional reforms, such as the delegation of greater powers to provincial levels of economic decision-making, enhanced the efficiency of the system to take advantage of new opportunities in the global economy.

The WTO accession provided each case study sector with the right tools for development. New markets helped agriculture achieve dramatic success in export growth and food security. Accession saw quota limitations removed, trading rights liberalised and directed non-tariff policies towards international standards. Institutions

were reformed to create a level playing field for all stakeholders. In the WTO process, the movement from not being able to provide sufficient food for its population to being the leading rice exporter in the world was enhanced. Improvements continued in 2012 with 4% growth, it accounts for 22% of GDP, 30% of the country's exports and 52% of the country's employment. Through improvements in technology, irrigation, investment incentives and better land use strategies, the agricultural sector has become far more competitive (FSP, 2012). The growth in agricultural exports and the importance of this to the national economy provided agriculture with increased levels of influence over economic decision-making. More attention was paid by the Government to the concerns of the farmers and resulted in more friendly policies towards agriculture.

The banking sector has seen chartered capital increase; Banks provide more services and options for customers and developed a market-oriented system. Institutional reforms accelerated; independence of the banking system improved; state banks were restructured; governance improved and the Government addressed market distortions caused by policy lending; bank supervision and accountability legislation was reformed; forex rate management was changed to react to market signals and the legal platforms for banking payment and non-cash payment were developed. The money market complied with international practices and reforms have enhanced Banks financial capacities, management and banking systems, and the success has encouraged the enthusiasm for further reforms.

The T&G industry has probably gained most from WTO led reform. The industry has actively joined in international economic integration and become a major exporting sector, accumulating capital and foreign currency for national industrialisation and modernisation. Because of WTO pressure to reform trade policy towards a more neutral regime, the competitive advantages of the textile industry forced the Government to provide it with more resources for development. With improved access to global markets, the Vietnamese textile industry found itself with ideal external conditions for expansion and its economic performance has become a mainstay of the Vietnam economy and proved its advantages and economic strength.

Joining the WTO has advantages for developing countries. Market access is a primary objective but the WTO process also gives gains with ‘the transparency, stability and security of these market conditions’ (Catteneo and Braga 2009, p.3). WTO membership means reductions in the cost of trade negotiations. Domestically, the necessary reforms result in ‘larger, more secure and predictable access to markets (Catteneo and Braga, 2009, p.6). It protects business against abusive state interferences and is an anchor for domestic regulatory and administrative reform.

On average it takes five years for accession. In the case of Vietnam it took twelve years. Past accessions show that the smaller the country and the more liberal the regime the quicker the accession process (Turksen and Nguyen, 2012). Vietnam slowly progressed through the accession process, but there were clear signs that the WTO help was needed. Domestically, the CPV was facing difficulties and WTO membership was a mechanism for solving the problems. It offered integration into international markets and the guidance on law and institutional change was believed a possible answer to the growing corruption of cadres and public servants who were by 2003 now seen as largely ‘ill-disciplined, corrupt and inefficient’ (Fforde, 2004). As Thanh (interview, 2011) says “Vietnam entry into the WTO provided the access to new markets and the incentives to carry out further reforms. Out of the pressure for increased competitiveness and improvement in systems, institutions, productivity and management, there was significant changes that contributed to impressive economic growth. The WTO membership was the initiator for these reforms and development was carried out with a Vietnamese perception of what the WTO required.”

In assessing the relationship between the WTO and Vietnam the essential factor is how non-compliance is addressed by the WTO. In the first place, any dispute is initially handled through the Dispute Settlement System. The Director General of the WTO in 1997 said that the system was ‘the most individual contribution to the stability of the global economy...which provides security and predictability to the multi-lateral trading system’ (Ali, 2003, p.2). Any issue of non-compliance is initially dealt with via the WTO requesting the member ‘bring the measure into conformity’. The member can end the dispute by offering compensation. If compensation is inadequate or rejected, the member asking for address of a problem can request counter-measures, including economic sanctions. Counter-measures are restricted to a level ‘equivalent to the level

of nullification or impairment' (Ali, 2003, p.9). The reality is that a country bringing forth the dispute and 'winning' the case 'has little or no option to ensure that the injury caused is reversed, compensated or even prevented from re-occurring in the future' (Ali, 2003, p.11).

However, non-compliance is generally addressed through a dispute system designed to settle issues between members. It is not predicated on forcing members to carry out essential domestic reforms. The clear logic is that there is an assumption that States will support their international strategy with the necessary domestic reforms, especially when not reforming is obviously going to damage their own economy.

The US has raised numerous concerns about Vietnam non-compliance, including anti-dumping cases, issues with Single Distribution Restrictions, violation of WTO and BTA commitments, weakening of retailing services commitments, the lack of publically available procedures in services and very poor guidelines on Economic Needs Tests (Amcham, 2013). Yet, the complaints are indications of accusations of international non-compliance which is fairly insignificant compared to the levels of domestic non-compliance. By not reforming SOE's, enforcing essential regulations allowing new institutions to operate effectively and developing improved infrastructures, such as transport, health and education, Vietnam creates weaknesses in its own competitiveness against other WTO members, and leaves other members little reason to complain about a fellow members economic 'suicide'. However, the overspill from any major decline in Vietnam's economic, social and security stability will lead to destabilisation of the region and affect global security problems such as the South China Sea disputes. It will place a country centrally positioned in the Asian economy in an unstable economic crisis that could seriously affect a region that has so far escaped the main affects of the global financial crisis. Large foreign investments made into Vietnam would be endangered and default on international loans is not just possible, but has already occurred in the case of VINASHIN, a crisis originating from default on a \$600 million international loan. Nguyen Quang A, head of the only independent think tank declared 'Vietnam is dancing on a razor blade' (Hookway and Tudor, 2010, p.1).

The problem for the WTO is that Vietnam's crisis is an internal affairs created by the Party and Government and fuelled by the individualist self-interests of an elite interest group. Yet, the consequences may be heading towards creating an international crisis for the global economy. The crisis is a result of Vietnam's failures to abide by the recommendations and commitments to the WTO. Yet, the WTO has few procedures to censure, control or remedy such domestic failures of a member to avoid a 'crisis of its own making'.

In examining the impact of the WTO we can see progress in institutions, reforms in business and overall economic growth. However, a better evaluation can be made by looking at specific problems prior to membership and the degree to which accession helped provide solutions. Although the impact of the WTO on Vietnam is clear and measurable the core problems of corruption remain; there remains an SOE refusal to reform/restructure and the Communist Party's governance is increasingly challenged.

We can also make a comparison here with China, and in doing so find that Vietnam's performance in the process of WTO led reform, and the subsequent outcomes falls far below the standards of China. With similar political systems, many of the same problems and challenges, the present levels of each country means that Vietnam's record of achievement and development, set against China, is one of failure.

### **8.2.1 Comparisons with China**

An essential point in assessing the Vietnam performance in the WTO accession process is that Vietnam, on balance, can clearly be seen as an overall failure, while China continues to progress towards even greater economic success. Whereas Vietnamese banks are burdened by unsustainable levels of debt, the Chinese Banking system flourishes. Vietnam SOEs are still mis-managed, inefficient, lack any real competitive edge and, while they dominate economic sectors, they have failed to use this advantage beyond being able to divert their funds and profits into the pockets of elite individuals.

The results of this are an impending crisis of levels never experienced before and the reasons for this are now much clearer, emphasised by the contrasts that can be made between Vietnam and China. The comparison demonstrates Vietnam's faults and the Government's inability to successfully manage the economy, or look beyond a fixation on their own survival, regardless of the costs to the Vietnam economy or society. Chinese leaders focused on policies to encourage banks to manage risk and improve genuine profitability, which also led to giving preference to the privatised sector, rather than risky lending to SOEs (Naughton, 2007, p.288-289). In contrast, Vietnam banks became virtually reliant on lending to SOEs, increased by Government pressure and coercion to make highly risky loans. This has been recently aggravated by direct instructions from the Government for banks not to demand repayment, regardless of the impact this will have on the Banks financial future. While China imposed market discipline on its state-owned firms and forced through sweeping reforms on the SOE sector, Vietnam made mostly 'cosmetic' reforms and created a debt-laden banking sector, further complicated by a lack of regulation, even less transparency and a system of cross-shareholding that has left banks hostage to the economic mismanagement of the CPV and the financial whims of the SOEs.

In Agriculture, China reduced the role of collective organisations and allowed farmers the independence to achieve higher profitability, competitiveness and productivity (Naughton, 2007, p.90). Although Vietnam farmers have increased productivity, they remain at subsistence levels, denied much of the extra profits gained from increased market access. China's agricultural sector is successfully moving towards higher value crops and developing the required sophisticated infrastructure, while Vietnam's farmers chiefly remain locked into an agricultural existence more suited to a bygone age. Farmers are denied access to advanced horticultural education, limited to only small holding farming, cut-off from the direct channels to their prospective markets and barred from amalgamating into any cohesive and effective political force for change.

In the textile industry Vietnam's chief competitor for exports remains China, as they retain many of their competitive advantages over Vietnam. Despite both enjoying advantages borne from trade liberalisation undertaken through WTO accession and membership, China retains cost structure advantages over Vietnam in "sector, size,



orientation and ownership types” (Tuyet, et al, 2007, p.22). Chinese firms are more profitable and competitive. In comparative terms, Vietnam’s workers are less skilled, the infrastructure and supply chain is under-developed, there is an uncertain investment climate and foreign companies find challenges such as confusing and non-transparent regulatory and financial procedures (Zhao, 2011, p.1).

Vietnam’s textile and garment industry totalled \$15.8 billion in exports in 2011, with record growth each year. But the main challenge is the subsequent cost of imports, with raw materials for T&G firms increasing to \$9.3 billion in 2011 and demonstrating a worrying challenge to the industry. Alongside poor management capacities, high costs of imported machinery and technology and weak and inefficient marketing strategies, Vietnam’s T&G is likely to remain at a major disadvantage to China, Pakistan, Indonesia and India (Textile World, 2012)

Corruption still besets both the CCP and the CPV’s drive towards development. However, the CCP would have seemed to have made more concerted efforts to combat it. As with Vietnam, the major difficulty is enforcement, rather than any lack of regulations. The deterioration of Government prestige incurred from the growth of popular disillusionment with the lack of governance capacities to reduce corruption is countered in China by quicker, more open and more effective and public punishment of offenders. Yet, as the thesis has argued here, the chief threat to communism would not appear to be democracy, but instead, the development of an elite dictatorship. As Pei (as cited in Li, 2008, p.247) declares, a “resulting democracy could easily fall under the control of its own oligarchs, whose illicitly acquired wealth could accord them great resources to manipulate an infant democratic system”.

There are many advantages the Chinese have over Vietnam that accounts for their greater success in participating in WTO accession and membership. They joined ten years earlier than Vietnam and possess far more advantages in geographic scale, economic and historic features. Decentralisation of economic management to the Provinces has been far more effective and successful with effective strategies in developing special economic zones, which were created quickly, effectively and with more cooperation between the Central Party and the provincial authorities (An and Duc,

2010). Yet, in relative terms, Vietnam has clearly not taken full advantage of what benefits they did have in joining the WTO, simply illustrated by China being financially stable, while Vietnam is virtually bankrupt. This thesis has shown that this has not been because of faults in the WTO, but because of failures to genuinely carry out wholesale domestic reforms in a credible and effective way.

Vietnam and China's record on GDP growth is equally impressive. However, An and Duc (2010, p.10) declare that "fast economic growth does not mean sustainable growth". Vietnam has strongly justified the analysis of the compatibility between economic growth and development. The thesis has found numerous illustrations of growth leading to great individual wealth creation, vast improvements in markets for many sectors, export trade dominated development and high levels of GDP growth over the past two decades. Yet, as shown with the comparisons with China, Vietnam has failed to deliver the necessary improvements in productivity and competitiveness. Its SOE's remain mistakenly dominant, even oligarchic, but continue to fail to improve efficiency, management, productivity or competitiveness, while also deliberately stifling the development of the private sector. The banking sector remains hostage to Government directed reliance on debt laden business with the SOE's, who in turn gain even greater control over the Banks decision-making processes through increased crossed-shareholdings. Institutions and the regulatory system are weakened by non-enforcement, compounded by a lack of capacities to successfully censure corruption when cases are carried through to arrests. As when shown in the quest for gathering information for this thesis, official data is corrupted either by manipulation or incapacity within the system to collect and correctly analyse it. Major economic and political decisions are being made upon the results of analysis of the economic situation accrued from various vital data sources. Yet, these essential decisions are often decided on 'facts' that bear no relation to the real situation. As for example in the data for debt ratio to GDP, which officially stands at a safe level but is more accurately calculated as being at a dangerously critical level.

Officially, GDP in 2011 sank to 5.9% and even lower in 2012 at 5.2%. In examining Vietnam's GDP growth since 1990, a rollercoaster pattern is identified, with it peaking in 1995 at 9.5% and then falling to 4.8% in 1999, than rising again to 8.5% in 2007. Sustained economic growth came in the 1990's and its fall following the Asian

Crisis saw Vietnam turn to WTO accession as an answer to the crisis. This led to another rise in GDP with the induced trade liberalisations greatly assisting in bringing the benefits of more exports, markets, profits and investments. But the latest declines not only shows that the WTO membership is not a panacea for all economic failures, but also demonstrates that trade and market improvements must also be accompanied by real improvements in economic infrastructures and sustainable development (WB, 2012). Excessive reliance on factor accumulation has produced cosmetic displays of growth that have pushed Vietnam to a middle-income status, but left much of the economic infrastructure in a less-developed status. The GDP growth is real, but its final destination has not been effective improvements in the economy and society. Instead, its main financial rewards have been accumulated by an elite oligarch that now controls many major sectors. GDP growth, FDI investment levels, statistics on SOE equitisation, the issuances of numerous new regulations and the establishment of new institutions have been attributed to some degree to WTO accession and membership. Yet, their value is brought into question by the levels of debt to GDP, the increasing poverty gap and insufficiency in education, transportation and health sectors that indicate declines in the infrastructure and obsolescence rather than development. GDP has been used as a cloak for the failures in actually dealing with the core problems in the economy. It is probable that even extremely low or negative statistics in GDP would force any real change of direction, but by that time the damage may be irreparable. In predicting the levels of danger now evident, one needs to examine what type of economic model Vietnam is following and the role the new 'elite interest group' has to play in this.

### **8.2.2 Vietnam's 'East Asian Miracle' and the role of special interest groups**

In examining the impact of external forces such as the WTO, ASEAN or the US-BTA, the major difficulty is that it soon becomes clear that the Party and Government have dominantly focused on domestic influences, interests and outcomes. Interviews<sup>181</sup> showed a political and economic situation that understood little about the commitments, responsibilities, influences and outcomes that would ensue from participation in international agreements. Such lacks in the capacities of the bureaucratic administration,

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<sup>181</sup> Such as Chi Lan, 2012; Thanh, 2012; Thai, 2012; Nghia, 2011; Khanh, 2012.

diplomacy and economic reform meant that alignment of policy and strategies with any well-defined, logical and planned East Asian economic ‘model’ is impossible. Vietnam has been dominated by its reactive governance, which is based upon the Communist Party passion to retain power. This governance acts as a major distortion of the domestic markets and economy and enslaves the private sector to a State system that maintains political central control over all aspects of business and society. Whilst advocating a path to free market economics, the single Party system of Vietnam maintains its past control of the economy and results in reforms being merely surface compliances to commitments.

An example here is the role of the Vietnamese People’s Army (VPA) and their growing (not declining as officially declared and regulated) corporate interests in the economy. Those corporate interests are actually illegal as the Army is directed to control corporate interests related solely to national defence and security, and are directly in contradiction of Party ‘policy’. The VPA is probably the largest and most powerful ‘voice’ in the Vietnamese economy. Their main corporation-Viettel Telecom, alongside nine other major SOEs, including the Military Bank and over 200 other companies in every sector of the economy, dominate the markets. Viettel revenue in 2012 was over \$7 billion and is growing at 20% per year. The VPA owned Saigon Newport Corporation controls over 46% of all container freight business (Nhung, 2013).

The military economic and commercial interests “directly clash with the imperatives of global economic integration when Vietnam became a member of the WTO” (Thayer, 2012, p.1). This non-compliance not only continues, but increases rapidly each year as the Army advantages in land ownership, political connections and monopoly over resources continues to crowd out all private competitors. Yet, there is an error in accusing the Party of being the ‘winners’ in this strategy of oligarchic economics. Although the Party ‘survive’, the prime victor in this model of a ‘Vietnamese economic miracle’ is the elite interest group.

To further understand this ‘elite interest group’ one needs to examine the Vietnam culture and the subsequent dangers within it of individualism. The elite interest group remains chiefly a group with little of the overarching formal organisation and

coordination of a traditional interest group. Although there are growing rumours that a formal 'group' or 'party' is developing 'behind the scenes'. Their 'common' interests are their own individualism and the independent wealth creation. Individualism itself has a particularly negative connotation in Vietnam culture and Ho Chi Minh declared 'individualism is the cause of red tape, bossiness, factionalism, subjectivism, corruption and wastefulness. Individualism is a brutal enemy' (CPV, 2011).

The original focus of this thesis was the positive examination of how the WTO had affected the Vietnam economy and its political system. However, the thesis shows excessive levels of non-compliance disguised under a veil of enacted commitments that have proved ineffective through a wholesale lack of mechanisms to enforce them, and a deliberate intent on taking benefits, but ignoring responsibilities.

An equally disturbing finding is that reform itself has become a victim. Whilst GDP grows, markets expand, poverty is reduced and development seems to progress, the stark reality is that reform itself has to be questioned. Whilst now listed as a middle-income country and subsequently seeming to have 'developed', Vietnam actually remains far from being a stable country or economy. London (2013, p.2) identifies a 'dysfunctional political system', the 'State harshly punishes calls for fundamental change' as growth is 'ruined' by economic mismanagement 'driven by a brand of interest-group politics whose main product is profligacy and waste'. Infrastructure bottlenecks, a lack of a skilled workforce and the continual focus on secrecy, rather than transparency has ended with a system where 'state power is too often used by elites for elites and their associates' (London, 2013, p.2).

Reform in Vietnam was planned through a gradualist transition strategy (Tho, 2013). This usually involves three phases: The non-state sector is promoted, with its development slowly replacing the economic dominance of the SOEs. Then SOEs are reformed and made to be more efficient and competitive, at which point the privatisation of SOE's becomes the third phase (Tho, 2013).

In Vietnam, the non-SOE sector has been deliberately suppressed. In the Textile industry, even FDI companies are dependent in some aspect on 'relationships' with

officials and business leaders connected to the State sector. In banking, the State Banks depend on their profits coming mainly from loans to the SOEs, while in Agriculture, the SOEs dominate the 'private' producers by enforcing a middle management 'wall' between the producers and the 'buyers'. A barrier that sweeps up all and any benefits that accrue from access to the global markets, while ensuring a subsistence environment onto the producers/farmers, which then leaves they remain economically and politically ineffective. The treatment of farmers and agricultural producers shows how political and economic strategies are entwined to make the 'status quo' remains at one level, while the rewards of reform and globalisation are given to one elite interest group. The outcome is declared by Cain (2012, p.2) as a "Vietnam... a country struggling with a weak currency, inflation, red tape and cronyism that has led to billions of dollars of waste'. A 'waste' that should have been directed into restructuring the economic infrastructure and investing in the future of the economy. The failure to do so means the economy will not have the skilled workers its needs to survive, that the infrastructure, such as in the transport system will remain obsolete, under-developed and under-invested, and that debts will cripple the financial system for decades to come.

### **8.3 Political and Economic update: Dangers and problems**

In evaluating the impact of the WTO the present impending crisis can be linked to how the positive aspect of reforms were possibly undermined by a failure to address political and economic structural faults. By 2004, Fforde (2005, p.146) noted that the 'situation in the country continues to deteriorate'. A 'crisis of authority' was clear and the Communist Party was faced with a human resource predicament (a lack of skills and knowledge and an educational and vocational training system plagued by corruption and unwilling to confront its low quality problems); the excessive bureaucracy and its 'desire to control business (and secure bribes)' (Fforde, 2005, p.147) and the 'leakages in the flows of government funds' (Fforde, 2005). Even though numerous reforms had taken place, it was clear that no 'fundamental change' had taken place (Fforde, 2005, p.147). The involvement in the decline of moral and principled governance was clear with 'resource allocations... made outside formal state channels' through 'horse-trading between corrupt officials' (Fforde, 2005, p.150).

By 2005 the debt crisis was beginning to climb towards its present levels, with SOEs diverting their Government directed loans into priming the real estate market; at the expense of using the capital to reform production, management and mechanisation. Individuals used SOE banks loans as their own personal funds for private venture capitalism. Meanwhile, reductions in the poverty rate concealed the growing gap between the rich and poor. The increasing gap was compounded by the rising costs of education and health care (Luong, 2006).

In 2006, economic growth and stronger global integration continued (Luong, 2007). But inflation, labour unrest and corruption continued to undermine the successes. Concerted efforts were made by the CPV to ‘make bureaucracy more accountable and to tackle corruption and abuse of power’ but despite high profile trials, the reality was still an inability to prevent or punish many of the ‘crimes’ (Luong, 2007).

By 2007, as export growth and liberalisation pushed Vietnam to ever higher points of success, the infra-structure supporting it (power, water supply, transportation and lack of skilled workers) demonstrated that the Party had been unable to adequately fulfil the necessary demands of the economy and failed to prevent politically aligned individuals gaining vast personal wealth and immediate returns, while the structures and long term planning needed to maintain economic growth were given almost no attention (Han, 2008). Chi Lan (interview, 2012) noted, ‘An evaluation of the WTO ‘venture’ has to now consider to what extent the Vietnamese economy and political structure was ‘ready’ for such a demanding process. The reality was that surface changes were not supported by deep innovation and reform in the structures and supporting mechanisms of the economy. Dramatic changes were made for instance in the institutions and laws, but the systems and capacities to enforce the changes were not altered and subsequently, some of those reforms have become burdens rather than improvements’.

By 2008, the buds of the present crisis were firmly taking hold. High inflation, economic slowdown, falls in GDP, widening trade deficits and governance that reflected ‘faulty policies and institutional shortcomings’ were aggravated by a growing global financial crisis (Han, 2009, p.187). By 2009 the economic crisis in Vietnam was firmly taking root; FDI was declining and the beginnings of an explosion in capital

flight were pointing to the long-term erosion of the benefits of WTO accession and membership (Amer, 2010).

Although membership was achieved in 2007 and the pressure for the reforms of the accession process diminished, the demands of now being fully part of the global economy, alongside the identification as a non-market economy member, maintained a pressure to move into yet further levels of change, in order to meet the new demands on the economy. It was not the case that on membership the reform process slowed down; because problems that impaired the economy's competitiveness, such as the capacity problems in management and administration, maintained a pressure to reform. Membership now highlighted many of the weaknesses in the economy and maintained the pressure for renovation and restructuring. The responsibilities of membership acted as a direct force on the Government to bring in significant improvements, in order to maintain the advantages achieved throughout the accession process. In accession, the need for change was clear, and mainly structured by the external demands of the WTO process. Now in membership, the leverage for reform is internal, with the Government and Party realising that many of the structural problems, such as SOE reform and governing capacity, must be addressed as primary priorities. Although one must also realise that Non-Market Economy Status for Vietnam to some degree maintains an accession mindset, and directly denotes that Vietnam has yet to achieve through reform the required standards for listing as a market economy.

A disturbing picture was being revealed that indicated that the Party was facing difficulties in governance. There were numerous cases where various means were being found to deliberately countermand or ignore new laws and regulations. An example is 'Official Letters' issued by local government agencies in the process of applications for the issuance of investment certificates. These are used to limit foreign shareholdings of companies but are 'not stipulated in law' and indicate a 'new legal regime' driven by administrative documents in contradiction to legislation (law directly designed to address WTO standards on market entry). These 'official' letters are widely used, but the Government declared they are not 'valid' and 'don't exist' (Turksen and Nguyen, 2012). Turksen and Nguyen (2012) point out that this 'is a matter of transparency... the current misuse and publicity of official letters by state authorities can be considered an



act of non-compliance to WTO commitments' while also an example of the endemic corruption.

There has been clear indications of a decline in the administration and management capacity of the state system. The failures are widespread and go far beyond just a failure to deal with the corruption. In addition to this is the lack of capacity of personnel in both the Government and in SOEs. The capacity problems exist not only in the bureaucracy, but even at the high levels of the Government. Many decision-makers do not possess the knowledge, skills or experience in economics, politics and the varied demands of governing a nation in a modern, global economy. Their understanding of the complex and integrated policies and mechanisms necessary for economic survival in a fast paced world of modern global governance is limited. This has also resulted in clear signs of an inability to manage, monitor and evaluate correctly government performance, while also allowing detrimental forces a free hand to subvert and defraud the system. As McGough (2012) said "there isn't just an 'anti-WTO' movement here, but, also an inability to fulfil obligations or maximise benefits due to failings in capacities of both business and government personnel".

#### **8.4 Limits on WTO influence on domestic reforms**

WTO accession provided not only access to global markets but also the tools to be able to deal with the demands of the market economy. This included templates for legislative reform to international standards and the restructuring of the economic framework. Essential was long-term stability and real reform that involved genuine transformations of the centrally commanded system; into a market model that is designed to best manage a liberal economy run on a market liberalism philosophy. A market economy involves the unhindered balancing of supply and demand, with minimum intervention from government. Vietnam failed to do this and instead relied on factors that would not provide long-term economic security. The strongest elements for supporting the reforms of the WTO accession were short term and insufficient to maintain progress once the country moved from less developed to middle ranking status.

Factor endowments have increased in Vietnam and the primary cause of economic growth has been factor accumulation. This has left Vietnam challenged by a need to improve the education and skills of its workforce, and a failure to adequately address the problem has left the country subject to macro-economic instability. Core consequence of this has been a failure to improve productivity, at a time when Vietnam's participation in the global economy makes efficiency and competitiveness central needs for survival. But, declines in growth, FDI and productivity, alongside high inflation, indicates that Vietnam, despite WTO accession and membership has failed to address the problems root causes.

The obligations to improve trading conditions, such as removal of tariff/non-tariff barriers and the ending of the quota systems were largely fulfilled, but in areas such as institutional reform the record is not as successful. A level playing field with the right balance between SOEs and the private sector has not been achieved and the continued dominance in the economy of SOEs is causing numerous structural problems. Major aspect of government intervention into the economy was the maintenance of support for the SOEs.

A primary focus of conversion from a controlled economy was the reform and restructuring of SOEs. Since the start of accession dramatic changes have appeared to occur, with SOEs reduced in overall numbers and claims that their power in the market has been greatly reduced. In fact, since 2008 there has been an increase in overall numbers and although gross numbers were used as a means to provide evidence throughout accession of SOE decline, the reality was that many were merged into State Owned Enterprise Groups. For example, VINASHIN accumulated 454 subsidiaries that were not required to change in any significant way and could continue in exactly the same way as before. The merging of subsidiaries into SOEGs required no changes on the parts of the companies and they carried into their environment all the problems of the past, free to aggravate these distortions of the market, rather than eliminate them (WB, 2012).

Today, those problems threaten the very core stability of the national economy and the future of the Party. Across the board, both large and small SOEs are crippling

the economy with productivity at least five times lower than the genuine private sector. SOEs require nine units of capital to produce one unit of output compared to the industry average; the average ratio of turnover to capital is falling to critical levels; turnover to employee ratio is declining; debt to equity ratio is double that of the private sector and nearly all SOEs are virtually totally reliant on Government bail outs/loans to survive (WB, 2012). Yet, the more support they have received the less inclined they have been to reform, and instead, under the luxury of domestic market domination and constant Government support they have grown even more inefficient, secretive and arrogant, safe in the knowledge that their control of the economy is guaranteed by the State. It is estimated that SOEs have cost the economy 0.6 to 0.7% in GDP growth every year since 2002 (WB, 2012). This was calculated to have meant that average standards of living, with this growth, would have been double the present figure. The trust of the Party in believing the SOEs would remain their vanguard in the economy has clearly not been returned and instead their lack of transparency, inefficiency, waste of capital and refusal to reform has left the nation in economic difficulties where SOEs 'have become too big to fail and too big to save' (WB, 2012). A major part of the SOE problem has been how it has caused significant problems for the banking sector, especially in concern to NPLs.

Pincus et al found that the declared Non-Performing Loans levels may be five times more than the official figure and much of the official data is simply identified as an 'accounting illusion' (Pincus et al, 2012 p.19). Many NPLs have 'disappeared' and even been re-classified as 'assets' in illegal accounting methods made possible through cross shareholding between banks and SOEs. The SOEs are avoiding reform through Government created and protected domestic monopolies (this takes away any pressure for the SOEs to 'serve' the export market and excludes foreign competition). SOE loans and profits are diverted to individual wealth creation through secret real estate deals (Pincus et al, 2012, p.20-25). It is economic blindness to ignore these factors when assessing the impact of the WTO on the Vietnam economy. Each factor influences the direct outcomes of membership and the effectiveness of the reforms that process supported.

#### **8.4.1 Reasons for the ineffectiveness of WTO's led reforms**

The initial intention was to use the WTO process as a means to advance economic growth and development of Vietnam. Yet, although Vietnam now stands as a middle ranking economy, much of this rests on unstable and unsustainable economic grounds. Essential to the development of the economy through accession and membership was a need for structural reform across a number of areas; from education to legal reform and improvement in the governing capacities of the Party.

The numerous problems became fully evident at the same time as the onset of the global financial crisis. Although the financial crisis has often been used as the main reason for problems with many of the reforms, President Sang (2012) made it clear that the crisis was influential, but the primary causes of the problems were domestic rather than external (Dung, 2013). One major concern is the continued opposition to reform, with both elements in the conservatives and reformist factions distrusting the opening up of Vietnam to the global economy, and still retaining many isolationist tendencies. Although the general belief is that participation in the global economy is essential, they fear lack of control over that process.

The incapacities at bureaucratic and administrative levels can be directly linked to the corruption within the education and training systems. Buying of certificates and qualifications (or paying bribes for exam answers or changing 'marks') is endemic and many 'qualified' people have neither the knowledge nor skills apportioned to them in their 'passed' courses. Through 'relationships', plus the necessary 'payments', they are rewarded with positions at crucial levels of decision-making in both the political and economic systems. The combination of corruption and low levels of knowledge and skills means institutions, legal systems, government processes and the business world is often subjected to levels of operation that provide mismanagement and failure on a scale that no modern economy can sustain. This is further aggravated by a systemic undermining of any talented individuals, from primary to adult levels, who attempt to replace the corrupt systems with a genuine thirst for better skills and knowledge. All interviewees confirmed this situation and expressed their grave concerns at its consequences, believing that even the best possible policies would meet serious

problems in their application in the system as the capacity to carry them out has never been weaker. This problem cannot be underestimated or its consequences diminished.

In examining the impact of reform, aided and abetted by WTO accession and membership, this thesis has identified a confusing mix of movement towards a 'free market', while consolidating central control over the economy through Banks and the SOEs. It has discerned that economic growth, the development of food security, restructuring of institutions to achieve international standards and the dramatic success of some industries has come at a high price, with unprecedented levels of corruption, distortions of the markets to a point where business oligarchs (usually embedded in the SOEs) enhance individuals wealth at the expense of the economic survival of the enterprises they run, and the country faces economic crisis in the face of a domestic banking crisis. The individuals responsible for this have manipulated both political and economic power to amass vast personal fortunes and achieve power in the political system.

Yet, the signs were clear many years ago. Gainsborough (2005, p.24) pointed out that Vietnam 'should not be seen as the withdrawal of the State, but rather the shift to *private indirect government* by the political elite, which is finding new ways of enriching itself and exercising power even in the external pressure [WTO, US-BTA, etc] to reform'. As noted by Gainsborough, civil servants can easily fulfil two roles: 'one public but not very active, the other private and often highly lucrative'.

However, this thesis must contest Gainsborough's findings and posit that corruption is not piecemeal but concentrated and systemic, with control organised and planned by an elite of powerful individuals who hold powerful decision-making positions in both politics and the economy. Gainsborough is convinced that the 'corruption is not centralised'; but recent cases such as VINASHIN and Vinalines, where billions of dollars were misappropriated, resulted in only business executives being arrested, tried and convicted. Even here it is hard to justify the misappropriation of over \$4.4 billion resulting in a mere \$149 million of fines. The popular illegitimacy that the Party and the Government now suffer is encouraged by such evidence of corruption and the lack of censure of it. McGough (interview, 2012) notes 'the future of

Vietnam as a WTO member depends on how the Party handles corruption and the elite wealthy interest group. This requires the maintenance of Communist authority and political idealism while incorporating the economic neo liberalism of the global economy. It is essential that the Party is allowed to maintain the necessary social stability, in order that the full benefits of membership can be realised.’

The declining performance of SOEs, the debt laden problems of the Banking sector and the Party/Governments’ lack of control of the impending crisis has already nurtured the first signs of social instability and unrest. Fforde (2012) identifies the public disquiet at limited responsibility being taken for scandals such as VINASHIN and the lack of responsibility to be assigned to any ‘officials’. There is increasing confusion and corruption; public demonstrations are becoming larger, more vocal, more frequent and sometimes violent (Fforde, 2012). The new elite interest group of extremely wealthy individuals are able to manipulate the political and economic system for their own personal gain with no regard to the negative consequences for State and Society. McGough (interview, 2012) said “The Party has constantly sought to achieve the right conditions for WTO membership and take full advantage of the new opportunities, but a new elite interest group of powerful and wealthy people have both the means and will to subvert that, basically in their own interests”. Recent speeches by the General Secretary of the Communist Party demonstrated the awareness in the leaders of this problem and their belief that it is a major reason for the present difficulties. “Only by directly centralising and taking back power from this new oligarch of wealth can the Party regain legitimacy and the right to govern the country” (McGough, interview, 2012).

The State system is becoming weaker, and the new elite interest group is attempting to govern the system (Fforde, 2012; WB, 2012). In order to avert further crisis the Party needs to consolidate its power, while also creating more independent regulatory and judicial bodies.

Vietnam’s increasing risk of a severe economic crisis is illustrated in a new report from the Vietnam Executive Leadership Programme at Harvard University (Pincus et al, 2012). Mirroring this thesis, the report identifies the banking system,

SOEs and inefficient public investment as major problems. A primary concern is that the situation appears far worse than officially revealed; McGough (interview, 2012) was concerned that ‘deliberate data distortions and suppression of negative data returns’ and the Banks cross shareholding model enabling a system of liquidity and capitalisation that is positive only through deliberate manipulation, was creating an impossible background for effective reform. Government debt is disguised through manipulation of contingent liabilities, while cross shareholding enables banks and firms to lend to themselves through bank ownership and large banks transfer debt out to small banks that are actually insolvent (Pincus et al, 2012). For McGough (interview, 2012) this creates conditions which impair the Party’s ability to actually deal with the crisis and disguises the extent to which development is challenged. Whilst WTO has provided the markets and the mechanisms for growth, the failings of the present system make their actual application far more difficult.

By 2011, the problems were no longer avoidable or concealed as there was an unprecedented tension. Unresolved and deep-rooted political issues harried politicians, bureaucrats, foreign investors and the long-suffering population. The lack of effective political change suited to the contemporary requirements of a dynamic, diverse and outward-oriented society, of itself, posed major questions to political actors about the ‘capacity of Vietnams’ political system’ (Fforde, 2012, p.176). Power could clearly be seen to be influenced strongly by elite interest groups and the Party was becoming merely an available scapegoat for the hidden and growing power of extremely wealthy elites, empowered by both political and economic ascendancy. Their power now is so pervasive and corrupt that the Party fears less its break up by democracy, and now is concerned by the far more likely threat of an elite dictatorship intent on sustaining and protecting its power by force if necessary. The likelihood of dictatorship, rather than Communist rule or a new democratic process should not in any way be under-estimated, or the probability that the Vietnamese culture of respecting strength, authority and control will chiefly welcome a more authoritarian regime, rather than a democratic process that bestows on them greater responsibility and involvement in governing the country.

The Party desired acceptance into the global economy, whilst retaining its core ideology and identity as a ‘Communist’ country; so they enthusiastically pursued

membership, believing they could shape the process to ‘fit’ the politics. The Party underestimated the perverting forces of greed and self indulgence that the ensuing opportunities for wealth would unleash. Convinced of the unanimous patriotism of leaders and decision-makers, and their loyalty to the principled morals and social values of Ho Chi Minh’s teachings, the Party manipulated the WTO process to fit an undefined vision of a ‘free market with socialist orientation’. The ideology of a ‘socialist orientation’ was immersed into a conservative Communist dogma that did not allow the Party to separate as far as possible the economic management from political doctrines, and convinced the leaders to use ‘conservative’ means to ensure their overall control of the economy and the politics. They had neither the confidence nor the lack of fear of ‘capitalist’ opposition to communism to entrust the Vietnam economy to the ‘hidden hand’ of the free market, but realised the translucent demonstration of this reluctance to accept the veracity of the claims of an ‘apolitical’ WTO, would at best, make accession difficult and at worst ‘impossible’. Forced by economic crisis and belief in the need for reform, they tried to balance their fears with their hopes by undertaking WTO accession in a strategy of compromise, that is epitomised by SOE reforms and the failings in that process.

#### **8.4.2 Non-Market Economy Membership: A ‘Half-Way’ House**

A consequence of the problems found in Vietnam’s accession and membership of the WTO is its failure to yet be accepted as ‘full member’. WTO classifies Vietnam (until 2018-the maximum period) as a Non-Market Economy (NME). This term is controversial in that many feel non-market economy classification is an ‘obvious violation of the WTO fundamental principles of non-discrimination’ and is more ‘politically motivated than economically justified’ (Son et al, 2007, p.4). However, it is difficult to criticise Vietnam’s classification as a non-market economy. It means that all factor production costs in such a country are ‘regarded as a distorted reflection of the markets supply and demand relationship’ and in the case of Vietnam such an assessment is hard to argue against (Son et al, 2007, p.4).

NME has led to a ‘two-tier WTO membership’ with Vietnam seen as a ‘second-class’ member (Son et al, 2007, p.5). NME status indicates the ‘official’ mistrust of



Vietnam's actual legitimacy as a market economy and points to a probability that Government's attempt to conceal its basic retention of central control has not been as successful as it thinks.

The use of NME classification is primarily a tool to handle former centrally planned economies; initially targeted at Eastern European members of the WTO countries such as Armenia, Azerbaijan and Moldova (Son et al, 2007). NME is the chief means to operate anti-dumping measures and this is justified by the US in that an NME 'does not operate on market principles of cost and pricing structures, so that sales of merchandise do not reflect the fair value of the merchandise (Son et al, 2007, p.13). Neither NME nor ME are clearly defined by the WTO. The NME status does appear a form of temporary probation, with the NME country not yet fully trusted. Movement from NME status involves proving that the State is not subsidising firms through soft loans, granting privileged access to resources and allowing questionable auditing methods. Production costs and the financial situation are required to have eliminated past centrally controlled influences and distortions. There must be no bankruptcy subterfuge. On all accounts there is strong evidence to show that Vietnam significantly fails on all counts. Although experts such as Son et al (2007) complain bitterly about NME status for Vietnam and find it unfair, a one-way process and forced onto countries in the case of Vietnam, after five years of membership with more superficial reform, rather than 'real' reform, the status would appear 'generous' rather than unearned or 'unfair'.

## **8.5 Solutions for the Future**

A central point here is the degree to which WTO led reforms can be utilised to advance Vietnam economic growth in the future but McGough (interview, 2012) points out that, 'WTO membership relies on the Vietnam Government managing the reform process and maximising its benefits. But this depends to a large extent on their ability to enforce their policies and laws. At the moment this is challenged by the negative influences on enforcement. The new elite interest group is often in control of this'. Although legislation and institutional reforms, promoted and structured by the WTO process provided the means to control and monitor economic developments, the elite

interest groups have both the access to wealth and the political influence to subvert the integrity and accuracy of assuring the validity of the 'ends'. In such circumstances it is highly unlikely that democracy in Vietnam will provide answers, or that further weakening of the central power and control of the Communist Party will solve the problems. The Vietnamese culture has far less problems with authoritarianism or one Party rule than does the West and it is suited to strong central control, with the language, culture and family system paying homage to the elder, leader and family head. But that patronage is backed up by a strong survival instinct that is ready and willing to revolt when leadership fails in its responsibility to sustain and provide for the society, the family and the life. The control of the negative influence of the elite interest group can only be addressed through strong Party control.

For Pincus (2012, p.44) 'two foundations for security and strength of the nation-state- strong economy and stable society- have been undermined', and 'the power of entrenched interest groups... benefit from maintaining their status quo'. Fforde (2011, p.185) notes that the political system is seen in the 'South as fundamentally illegitimate... in the North as by now irremediably corrupt'. However, a primary actor in the dramatic development of the Vietnam economy has been the stability and guidance of the Communist Party. Its problems now are a result of a loss of power and an inability to re-adjust to the negative forces bringing Vietnam to the brink of economic crisis. There is needed a quicker and more decisive decision-making framework, but one underpinned by greater regulatory and monitoring mechanisms, with credible and active enforcement. The World Bank (2012) recommended the establishment of a National Economic Restructuring Commission working to the DREAM framework (Disclose, Regulate, Equitise, Accountability, Monitor). Central to this would be credibility, the ability to enforce and punish illegalities and an independence from politics borne from trust and power-sharing between the Party and the Institution. The reality is that elite interests groups with decisive power have developed through infiltration of the political and economic systems and the corruption they have created and controlled is a consequence of having unbridled levels of power. McGough (2012) declares "my direct advice has been that more transparency, accountability and enforcement of the law are required. The WTO led reforms can be more successful but it requires committed efforts to purge the Party and Nation of the individuals responsible for the problems, regardless of their levels of power and wealth.

In evaluating WTO accession and membership, plus the future benefits, it is essential that the impact upon it of corruption is taken into account”.

WTO accession and membership has probably gained its most successful impact by providing the ‘light to shine’ (the demand for transparency and accountability) on the obvious faults in Vietnam and presented the tools to help turn the economy and political systems to turn to a more ‘rewarding’ pathway for Vietnam’s economy, society and politics.

Given the present problems following WTO membership, additional means to support future development and alleviate the crisis are being sought. One is a proposal that Vietnam takes on a \$12 billion IMF to rescue the banking system; presented in a report issued by the National Assembly. McGough (interview, 2012) explains “understanding the Vietnamese psyche allows one to realise that they always look for panaceas for immediate problems”. As Doanh (2007) said, the old way of thinking is ‘grabbing and running’- meaning that Vietnamese tend to rely on immediate fixes for even the most complex problems without regards to the long term consequences. Doi Moi was the first and replaced by the WTO. Now some see IMF loan as the next step, with all three justified as being reform vehicles as well as panaceas for all other problems.

### **8.5.1 IMF Loan: Easy Solution?**

One possible solution to the problems and avoidance of economic crisis is accessing an IMF loan for \$12 billion.<sup>182</sup> The WTO offers access to markets and its regulatory framework is rooted chiefly in the willingness of its member states to

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<sup>182</sup> The nation may need IMF aid to recapitalize banks and must act quickly to clean up bad debt or risk “prolonged stagnation,” the National Assembly’s economic committee said in a Sept. 4 report published on its website yesterday. The financial system needs an injection of 250 trillion dong (\$12 billion) to 300 trillion Dong, according to the 298-page report that included recommendations to address economic risks. Vietnam Risks Biggest East Asia IMF Rescue Since 1990s (Bloomberg, 2012).

comply. In contrast, the IMF offers money on conditional terms and has very different mechanisms in rule-making, rule-applicability and rule-enforcement (Chorev and Babb, 2009). A major difference is that the WTO encourages members to remain in the system, while the IMF has a more 'take it or leave it approach' that 'forces' its borrowers to comply. IMF loans require 'conditionality' which often manifests itself as a form of coercion on borrowers with the ability of the IMF to force members to adopt new economic policies as the 'price' for the loan. This conditionality is seen as a primary demand from the US and this seen by developing countries as evidence that the IMF is chiefly a vehicle for US hegemony (There is abundant evidence that both the IMF and the WTO are chiefly seen here as vehicles for US power and control. Ranieri (2008) found 'credible and measurable evidence of a distinct level of advantages that the US enjoys when compared with other members'. While there is evidence of the continued relative decline in US power 'there is no indication that the liberal international order crafted and sponsored by the US is faltering'. John Ikenberry argues that the US constructed the predominant international order of the WTO and IMF to 'perpetuate US hegemony' (Ranieri, 2008; Owen 2012). The conditionality forces macroeconomic reforms that control inflation, money supply and government spending, with pre-determined fiscal and monetary targets (Chorev and Babb, 2009). The structural conditions forces borrowers to follow strict neoliberal market friendly policies and surrender vast elements of their economic sovereignty.

Although an IMF loan would appear a pre-condition for surviving the present debt-laden problems of the Vietnam economy, the Party is adamant that taking an IMF loan is definitely not the way for the Party leaders to find a way through the crisis. Whereas the WTO is seen as a 'soft and easily manipulated process and membership, where compliance is 'negotiable', the IMF is seen as surrendering economic and political sovereignty and a force for 'economic colonisation' (McGough, interview, 2012). There is a strong aversion to an organisation that the Party leaders see as the chief instigator of the fall of communism in the Soviet Union. The leading Party members felt the IMF was merely a force for politically motivated policies that would challenge Party rule in Vietnam. McGough (interview, 2012) believed that the auditing involved would inevitably lead to 'embarrassment' as past financial misdeeds would clearly be revealed and increase the image of a failure to adequately govern the economy and begin a 'Cold War' type collapse of communism in Vietnam.

In Vietnam, the problems have been identified as ‘crony capitalism with a communist twist’ (Fuller, 2012). But the crisis has probably come at the worst time possible. Le Dang Doanh, a prominent economist, observed that “the problem in Vietnam is a very toxic cocktail, from the European debt crisis, the stagnation in the US economy plus a critical situation in the domestic economy” (as cited in Fuller, 2012, p.3). Managing this crisis and developing as a WTO member requires action be taken in both problem areas: corruption and the influence of the elite wealthy interest group.

### **8.5.2 Following China again: A future rescue or another failed strategy**

A major problem for Vietnam in the wake of the financial crisis is how it will handle the future economy. Central to this is that for the past 15 years the strategy for growth has relied on trade liberalisation and foreign investment. WTO entry contributed further to this reliance and provided immediate growth for the economy. However, as Riedel’s study (2009) shows, Vietnams growth has relied on exports to Europe, the US and Japan, where the financial crisis has had a significant effect upon demand and is likely to negatively impact on Asia for some years to come. Riedel (2009) suggests that China will follow a process of decoupling from its dependence on trade and foreign investment and develop such strategies as a growth in its domestic markets. Vietnam may be inclined to follow their lead. In fact, McGough (interview, 2012) noted ‘in recent talks with the Ministry of Planning and Investment over the movement of an American/UK billion dollar plus manufacturing facility and trade to Vietnam, the senior official involved amazingly declared that MPI’s new policy was to deter manufacturing investors and welcome more investors into development of domestic financial services. Further questioning revealed that the officials present believed that Vietnam could decouple from its dependence on exports and manufacturing and rely more on bringing in tourists and global financial services. My clients left the country in some state of bemusement’. However odd this approach may seem for a Vietnam so under-developed in financial services and suffering from incapacities in management and business acumen, it illustrates the equal lack in understanding and ability within the major decision-maker levels. Such incapacities make a decoupling strategy from trade and foreign investment a distinct possibility, greatly enhanced by any major movement of

China towards this strategy. But Riedel (2009) clearly indicates the faults in this approach. In the first place, Vietnam has proven in the past that it has the will to follow China's lead but not the capacity. Riedel (2009, p.44) notes: 'In terms of per capita income, China is about 15 years ahead of Vietnam. China is far more industrialised and its base is far more diversified than Vietnam's. China is far less dependent on trade, with an export/GDP ratio half that of Vietnam. Household and corporate saving rates are almost double those of Vietnam... the middle class plays a larger role...its real income is growing more rapidly...real appreciation can be more readily absorbed in the non-tradable sector at a lower adjustment cost than would likely be the case in Vietnam'. Riedel (2009) points out that Vietnam has no 'viable alternative' to its present strategy and notes that Vietnam must develop its private corporate sector and develop the social and economic infrastructure. WTO accession and the reforms engendered by participation were focused on doing this. Yet, the years of unenthusiastic participation and non-compliance make these two areas major concerns at present and provide evidence of the lack of progress, rather than any real improvement. The very basic reforms believed to be part and parcel of the reasoning for Vietnam joining the WTO are now indicated as the vital strategies needed for Vietnam to avoid the deepening of the economic crisis. "Protecting the price competitiveness of its tradable goods sector... structural changes in industrial output and ownership... efficiency of investment... strengthening the economic infrastructure... including education and health" were critical requirements before the WTO and why it entered accession. The lack of sustainable development in these areas is a chief reason for its failure to take advantage of membership, and the future of Vietnam's economy and its membership of the WTO are brought into question by the lack of any real indication that the history of non-compliance is going to be replaced by far more commitment to the promises and commitments made to the WTO.

## **8.6 Conclusion**

Vietnam's accession to the WTO began as a struggle between conservatives and reformers who disagreed on how reform should progress. Crisis meant that reform became an imperative and Conservatives were purged from the Party in order that reformers could be free to bring in the necessary changes in policies and practices. The WTO was seen as the vehicle for providing the means to enhance these reforms. By

encouraging transparency and accountability and rewarding that with access to global markets, the WTO became the reformers panacea for all Vietnam's problems. However, it would be unfair to judge the success of WTO membership on the same criteria, as the WTO is not, and was not, designed for such a role. Instead, we can see that by facilitating Vietnam's inclusion into the global economy, the WTO has successfully supported the development of Vietnam into a middle ranking economy. The changes needed for further development are solely the responsibility of the Communist Party and their active promotion of strategies to deal with the elite interest group, the corruption, debt and the reform of the SOEs is now an imperative.

The lesson of Vietnam's accession and membership of the WTO is that it provides a number of tools and mechanisms for structuring and locking in essential reforms. The objectives of the reforms are aimed at facilitating a country's entry into the global economy, improving its competitiveness and encouraging economic growth and development. However, besides the reforms to institutions, the transparency and accountability and the general building blocks needed for a market economy, a country also needs to thoroughly reform its infrastructure. Central to this ensuring an efficient and meaningful system of enforcement of new laws and regulations, the re-structuring of the private and public sectors on the basis of competitive dynamics and finally, the creation of institutions with real powers and responsibilities.

A further lesson of the Vietnam case is the need for prospective entrants to move away from only short term goals and objectives; and plan long term strategies for not only the accession period but long after membership. This entails maintenance of the levels and speeds of reform, and avoids a tendency to see accession as the process and membership as the final goal, without any further need for reform once accepted. The reality is that membership indicates a new era of competitive dynamics that requires continual improvements in efficiency, productivity and economic performance. Such demands can only be met through a commitment to further reforms and an understanding that the successful participation in the global economy requires a constant pressure for economic development. The accession process soon reveals the problems in a developing economy and indicates where the possible solutions to them may be. Without WTO accession the structural and developmental problems of Vietnam may have taken many more years to uncover, but with accession Vietnam has quickly

become aware of costs of neglect of the basic foundations of economic development. Institutional reform, improvements in productivity and financial efficiency and integrity are vital elements in successful economic development.

A major warning to other future entrants is the need for awareness and direct controls against the rise of wealthy, elite interest groups who have achieved their position through corruption and abuse of power. While entrepreneurialism is welcome and needed, the opportunity for a few to abuse the situation is increased, especially if insufficient care is taken in the reform of institutions and if enforcement is lax. This problem is aggravated when the capacities within business and politics are insufficient, and the education, skills and knowledge of bureaucrats is so low as to provide 'easy pickings' for the corrupt.

The Party embarked on a \$100 billion expansion in domestic credit stock from 2003 to 2010, but diverted it into state enterprises rather than the more efficient and competitive private businesses, and helped create 'a country struggling with a weak currency, inflation, red tape and cronyism that has led to billions of dollars of waste' and creation of greater wealth in a politically powerful elite interest group (Cain, 2012, p.1). Cox (2012, p.3) identifies clear 'capital misallocation, embezzlement and corruption, stemming from the billions of foreign investment where the 'creaky communist institutions couldn't absorb all the funds'. Cox (2012, p.2) shows that Vietnam is a 'classic case of a small country that had greatness thrust upon it', but its 'rulers were neither prepared nor competent to handle the huge inrush of foreign capital'. The outcome included an explosion of credit flows that were controlled by 'political apparatchiks and the well-connected beneficiaries of a Party spoils system' (Cox, 2012, p.3).

A final issue is the need for pre-planned and well thought out strategies for adapting two ideologies to work in tandem. In Vietnam the communist system found itself having to suddenly adjust to neo-liberalist ideas and methods in the economy, while maintaining the political tenets of its ideology. This was soon found to be a difficult affiliation, with many contradictions and difficulties, which mainly



metamorphosed in Vietnam into a constant fear of the Party in releasing ‘central control’ of the economy.

Further research highlighted by this thesis concerns first the need for clear identification of what a free market with socialist orientation involves. The merging of communism and capitalism into an economic model containing the political ideological foundations of Marxism, with the economic principles of neo liberalism is a new and challenging project. Clear guidelines and objectives need to be formulated as a consequence of research into how such a model would work.

Second question is whether or not a bi-lateral strategy would have provided Vietnam with a better model of development than the WTO accession. Research into the WTO accession showed that a major inadequacy was the lack of enforcement mechanisms in the process to ensure application of the reforms. WTO itself now struggles with this problem in the wake of the Doha Round and the stalemate that has ensued. A reason for the continued problems of the WTO maybe the consequence of the global financial crisis, which has encouraged many states to follow more zero sum strategies, rather than pursue the past tendencies towards consensus politics. Whether or not a bi-lateral or a multi-lateral path (or a mixed version) is more beneficial to economic development is a question that further research should answer. In the case of Vietnam the choice that has to be made is further cementing of the benefits of WTO membership, or finding an alternative method, such as IMF or bi-lateral/regional agreements.<sup>183</sup>

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<sup>183</sup> Social Science Research in Vietnam (especially in Political economics) is extremely limited in scope, under-funded and lacks any level of quality. Higher education ‘lacks even a single university of recognized quality... lack intellectual dynamism... use [their own] standards that bear no resemblance to those used elsewhere’ (Vallely T and Wilkinson B (2009) ‘Vietnamese Higher Education: crisis and response’ Harvard Asia Programme). McGough (personal communication, 2013) said ‘research is a sensitive subject, directed and constrained by the Party and limited by researchers outcomes being more often and not, what they think the Party wants to hear, rather than what the research uncovers’. Political economy research is further limited by the lack of credible data and the fact that all economic thought is ‘politically sensitive first, and based on economic reality, second. McGough (2013) added, ‘University research is far too limited to be even considered as of any quality, while research committees, groups, etc

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are bound almost totally by political influence and rely for their existence on how ‘friendly’ their reports are to the Party. They lack any independence and almost all rely on Party patronage’.

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## APPENDIX



## **APPENDIX 1 : Summary of the WTO's commitments of Vietnam**

Vietnam accepted all WTO's agreements and committed to have a ceiling rate for the whole goods tariff table of 10,600 lines and 11 services with 110 categories out of 155 categories specified by the WTO (Khanh, 2007). The commitments are phased in over a periods of a few years, and they are rather strong for a country with low levels of development (NCIEC 2007). These commitments are not only for the tariff ceiling on goods but also go deep into 'second generation' institutional reforms such as transparency procedures, judicial and administrative review and other domestic regulation such as intellectual property and product standards.

Khanh (interview), commented that "Vietnam achieved good acceding commitments compared with other countries. Although the commitments are detailed and concise, but secured for Vietnam. They put a lot of pressure on the domestic economy but, also allow enough room for the domestic economy to adjust under these pressures. They not only put pressure before and on the event of WTO accession but also maintain the pressure after the WTO accession due to the phasing out period of commitments".

For WTO accession, the members often see Chinese commitments for WTO accession as a standard of strong and determined commitments. It not only reduced the tariffs significantly, but also committed strongly in service and institution reforms (Sally 2004).

The average import tariff's commitments of China were reduced to only 10.1%. In comparison with the level of commitments of China, the level of commitments of Vietnam is lower in terms of the absolute figure. China also committed to lower levels of agricultural subsidies (of 8.5%), while Vietnam's commitment was 10%. However, Vietnam has lower levels of development as well as a much smaller market than China, so this commitment on goods is considered as being very bold for Vietnam (NCIEC 2007; Tran Quoc Khanh 2007). As a latecomer, many commitments of Vietnam in services were actually higher than China (NCIEC 2007).

*Vietnam commitment on WTO accession can be briefly summarised as follows:*

***A. MULTILATERAL COMMITMENTS:***

Multilateral commitments are agreements on changing and revising regulations, policies or laws in order to comply with WTO regulations and some special commitments for Vietnam specifically. Vietnam fulfilled all WTO's agreements upon the accession.

Vietnam agreed to abide fully on the Article X of GATT 1994, Article III of GATS and other requirements on WTO's policy transparency, including requirements for notice, comments and publicity (NCIEC 2007). Upon the accession, Vietnam fully committed to leave 60 days for public comments on proposed laws and regulations under the WTO's requirements. It also disclosed publicly all legal documents in Ministry and industry's newspapers and websites. Laws and regulations relating to WTO obligations had to be applied uniformly throughout Viet Nam's customs territory and other territories under its control. Independent and impartial tribunals review administrative acts including implementation of WTO commitments. Individuals, agencies and organizations have the right to lodge a complaint against administrative decisions issued by, or administrative actions taken by, a State administrative agency or a competent person of the State administrative agency. All these have been fundamental innovations in the legal system in Vietnam, which were major steps in the direction of the 'rule of law'.

Commitments on non-tariff barriers of Vietnam were equally bold in liberalising the trade regime. Vietnam reserved import bans on very few goods, basing these on the concern for social security, environment and health protection such as arm and ammunitions, explosive materials, toxic chemicals, used electronics, etc (Ministry of Trade 2007; NCIEC 2007). These bans fully complied with WTO regulations, and were based on scientific research. Under the WTO commitments, several import bans were

removed such as cigarettes, cigars, motorbikes with more than 175cm<sup>3</sup> engines, and used cars under 5 years of use, etc. Import and export quotas have been eliminated upon accession, except in the case of four goods; sugar, eggs, tobacco leaf and salt, which are reserved for tariff-quotas<sup>184</sup> (NCIEC 2007). These industries are very important for a large rural population of Vietnam, which provides jobs and earning for them for many generations. Although salt is not considered as an agricultural product, it secured a TRQ status due to its traditional role in the culture and life of many Vietnamese villages. Vietnam agreed to bring its *customs valuation, non-preferential rules of origin, custom procedure and pre-shipment-inspection procedures* into line with relevant WTO agreements from the date of accession. Vietnam adopted the WTO's agreements on *Technical Barriers to Trade (TBT)* and on Sanitary and Phytosanitary Standards (SPS), also without transition periods as the current legal system and SPS measures do not contradict the SPS and TBT Agreements (NCIEC 2007). Vietnam also committed to apply fees and charges for public services under the WTO regulations, which reflected the right value of these services, such as custom fees and charges. Previous fees and charges were considered too high for the services.

Vietnam has also made strong commitments on issues relating to enterprises and trading rights. Vietnam agreed to abide by the WTO's regulations on the SOEs. WTO does not have any regulation on prohibiting members in the setting up and development of SOEs. However, Vietnam agreed to apply fully WTO's regulation on SOEs operations upon the accession. In particular, State Owned Enterprises (SOEs) would operate based purely on the market criteria. The state would not intervene directly or indirectly in SOEs operations, except when allowed by the WTO or by their role as shareowners in these SOEs. Vietnam also makes sure that enterprises from WTO members can compete fairly with SOEs (NCIEC 2007). The State enjoys the same status as other shareholders in managing, operating and making decisions in all matters of these enterprises (NCIEC 2007). Viet Nam agreed to submit its annual report on its equitisation progress to the WTO. Upon the accession, Vietnam allowed foreign

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<sup>184</sup>The in-quota tariff rates for these 4 products are equal to the current MFN tariff (i.e. 40% for eggs, 25% for raw sugar, 40-50% for refined sugar, 30% for tobacco, 30% for cooking salt). Out-quota tariff rates are much higher. It committed to apply, allocate and manage tariff quotas in the manner of transparency, non-discrimination and in conformity with WTO rules

enterprises and individuals to enjoy the same import and export rights<sup>185</sup> as the Vietnamese enterprises and individuals, except several products under the State trading list such as Petroleum, cigarettes, cigars, video, newspapers and magazines. Some other sensitive products such as rice and medicines were opened up to foreign enterprises and individuals after a transition period. Foreign enterprises and individuals not located in Vietnam were also granted the right to register in Vietnam according to international standards. The licensing mechanisms are to follow the WTO's rules and regulations on transparency and non-discrimination (NCIEC 2007).

In regard to subsidies, Vietnam agreed to abolish all subsidies prohibited by the WTO's regulations. Vietnam also committed to eliminate trade-distorted subsidies for agricultural products from the date of accession. Other subsidies such as subsidies for poverty reduction, infrastructure building and agricultural encouragement under the green box are allowed. Vietnam were granted the exceptions under the 'treatments' for developing and under-developed countries, in which Vietnam as a developing country are allowed to maintain trade-distorted subsidies with the maximum of 10% of its output volume (Ministry of Industry and Trade 2007). Under the Agriculture Agreement, Vietnam is also not committed to eliminate export subsidies for agricultural products, as they are not prohibited and specified in the Agriculture Agreement. For non-agriculture products, Vietnam fully committed to remove all prohibited subsidies in the WTO regulations such as export subsidies and localisation subsidies. However, it was able to reserve the preferential treatment for investment in export production granted before its WTO entry date in a transition period of 5 years (except for garment and textiles).

Vietnam agrees to fully implement the responsibilities set forth in the *TRIMS Agreement* from the date of accession. Vietnam were required to remove all the trade related measures in the FDI policies, which violated the principles of national treatments and liabilities on eliminating quantities restrictions (NCIEC 2007) such as local content requirements, investment linked to domestic resources development, foreign currency balance, import-export balance or export restrictions. Vietnam

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<sup>185</sup>The export-import rights here are just the rights of undersigning customs declarations for export-import procedures, not including the right of domestic distribution.

committed not to use these measures as the conditions for granting investment licenses or providing investment preferential treatments (Ministry of Industry and Trade 2007).

As Vietnam's domestic legal system on intellectual property right conforms to the corresponding regulations of *TRIPS Agreement*, therefore Vietnam adopted WTO's TRIPS agreement in full without a transition period. Vietnam also issued several legal regulations to comply with the Berne Convention.

*In safeguard measures*, Vietnam commits to applying WTO's relevant agreements on antidumping, subsidy and countervailing measures, safeguard measures. Vietnam also agreed to inform the WTO on its countervailing and safeguard measures. However, WTO members still considers Vietnam as a non-market economy until the end of 2018<sup>186</sup>. This is a disadvantage for Vietnam because the non market economy status can be used as the reason for other WTO members to activate anti-dumping measures to protect their own market against Vietnamese exports (Ministry of Industry and Trade 2007).

## **B. COMMITMENTS ON OPENING THE MARKET**

Vietnam is committed to reducing the average tariff rate to 13.4%, which was a significant reduction from 23.32% in 1997 and from the current 17.4% (current applied rate) (Ministry of Trade 2007; World Bank 2008). The final average tariff was 23% lower than the rate before the accession. This breaks down into 20.9% in agricultural goods (from the current rate of 23.5%) and 12.6% on industrial goods (from 16.8%) (Table 3.2). Many tariff reductions came into effect upon accession in 2007; most of the remaining reductions in 5-7 years. Vietnam agreed to bind the whole current import tariff schedule with 10600 tariff lines. Among them, there would be tax cuts on 3800 tariff lines (35.5%), no change in 3700 tariff lines (34.5%), and committed at higher rates in 3170 tariff lines (30%). Products with high tariff of over 30% had tariff's reduction immediately upon the accession. As a result, the most drastic tariff reductions

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<sup>186</sup> 12 years after accession

were in garments and textiles, fish and fish products, wood and paper, other manufactured goods, electric and electronic machines and equipment (NCIEC 2007).

Vietnam also participated fully in 3 sectoral liberalisation agreements, which were IT, textiles and garments, and medical equipment. It also partially committed in agreements for aircraft equipment, chemicals, and building materials. These tariffs were gradually reduced over the period of 3 to 5 years (Ministry of Industry and Trade 2007).

### Average Tariffs by sectors

Specific sector	Number of tariff lines	MFN Commitment (%)	Bound rate at date of accession (%)	Final Bound (%)	Concession compared to the present MFN rate (%)	WTO commitments Of China (%)
Agricultural products	1,219	23.5	25.2	21.0	10.6	16.7
Fish, Fish products	176	29.3	29.1	18.0	38.4	8.9
Oil and gas	37	3.6	36.8	36.6		4.6
Wood, paper	630	15.6	14.6	10.5	32.8	5.3
Garment and textile	1,159	37.3	13.7	13.7	63.2	11.6
Leather, rubber	341	18.6	19.1	14.6	21.5	13.0
Metal	1,201	8.1	14.8	11.4		7.3
Chemical	1,579	7.1	11.1	6.9	2.8	7.7
Transportation equipment	1,026	35.3	46.9	37.4		17.1
Mechanic machinery and equipment	1,436	7.1	9.2	7.3		7.8

Electric machinery and equipment	766	12.4	13.9	9.5	23.5	7.9
Mineral	396	14.4	16.1	14.1	2.3	9.5
Other manufacturing products	723	14.0	12.9	10.2	26.9	11.1
<b>Total</b>	<b>10,689</b>	<b>17.4</b>	<b>17.2</b>	<b>13.4</b>	<b>23.0</b>	<b>10.1</b>

Source: Ministry of Trade 2007

### C. COMMITMENTS IN SERVICES

Vietnam has offered significant liberalisation commitments in services under the WTO accession. In general, the level of WTO commitments in services is the same as the level committed in the US BTA. These commitments are considered as strong with some breakthrough commitments in banking, telecommunication and stock exchange services. As a result, the service industries encountering heavy pressures for change were banking, stock exchange services, distribution and marine transportation support services.

In general, Vietnam allowed foreign companies to operate in service sectors, to buy shares in Vietnamese companies<sup>187</sup>, and to bring their foreign staff to Vietnam<sup>188</sup>. However, they are not allowed to have a commercial presence in the form of a branch in Vietnam, except in specific sectors. Vietnam also reserved all preferences given to foreign providers before the WTO's accession and subsidies for creating employment for ethnic minorities, research and development, and SOEs privatisation (NCIEC 2007).

*The commitments of Vietnam can be summarised as follows:*

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<sup>187</sup>Their maximum ownership is limited depended on ceiling given in commitment table.

<sup>188</sup>But required at least 20% of the managers of the Vietnam-based offices as Vietnamese.

*In business services*, Vietnam committed to 26 sub-sectors out of 46 sub-sectors under GATT's classification. Most of the services were opened to foreign companies and foreigners after one to five years of the WTO accession. Several sub-sectors required foreign companies to establish joint-ventures with Vietnamese companies, including advertising, agricultural and forest services. 100% foreign owned firms in computer services can provide services to only other foreign-owned enterprises and foreign projects operating in Vietnam (NCIEC 2007)

*In Information services*, most of services were opened to foreign firms including 100% foreign ownership forms after a period of 5 years from WTO accession. However, 100% foreign ownership is not allowed in telecommunication services. Despite that, foreign firms can have substantial market access. Foreign investors are permitted to form joint ventures with the Vietnamese operators with a maximum of 49% of ownership in infrastructure-based services, of maximum of 65% of ownership in non-infrastructure based services after three years of the WTO accession. In Virtual Private Network (VPN) and value-added telecommunication services, foreign investors are allowed to opt for partners to set up joint ventures and their ownership is at a maximum of 70% of the charter capital. In general, Vietnam's commitments are higher than China's ones in 2000, but much lower than commitments of other countries joining WTO after China (NCIEC 2007).

*In distribution services*, the restrictions on ownership (maximum ownership of 49%) remained until 2009. After 2009 wholly-owned foreign enterprises were allowed. However, foreign firms are not allowed to engage in distribution services of sensitive goods such as petroleum and gasoline, pharmaceutical products, books, magazines, video tapes, tobacco, rice, sugar and precious metals. Services in other sensitive items such as steel, fertilizer and cement, etc. were opened up to foreign firms after three years of accession. Most importantly, Vietnam also puts restrictions on opening retail points of foreign-invested companies. Indeed, Vietnam's commitments under WTO are lower than the status quo as several 100% foreign-invested supermarkets operate in Vietnam.



*In financial services*, Vietnam committed to open three sub-sectors at a relatively high level of liberalisation. This was an area that demanded high levels of commitments from many WTO members. *In insurance services*, 100% foreign invested insurance enterprises were allowed to engage in all kinds of insurance in Vietnam from one year after the WTO accession. After 5 years from the date of accession, non-life branches of foreign insurance enterprises were permitted. *In banking services*, Vietnam also allowed foreign banks to establish wholly foreign-owned subsidiary banks and to provide services such as credit cards and deposits in foreign currencies. They allowed branches to be set up, but not sub-branches. Capital transactions were not liberalized. They are also not allowed to own more than 30% of the total equity of a Vietnam's joint stock commercial bank, unless otherwise provided by the country's laws or authorized by a local competent authority. *In Securities service*, foreign companies were permitted to provide securities' related services across the border such as financial information and consultancy, support and intermediary services for securities business etc. After 5 years of accession, they are allowed to establish wholly foreign owned companies (currently joint ventures with a maximum of 49% of ownership) and branches to provide securities services with some types of services such as asset management, payment, consultancy related to securities and exchange of financial information (NCIEC 2007)

*In transport services*, Vietnam also opened all of the market with the following commitments. *In Maritime transport services and maritime auxiliary services*, Vietnam allowed foreign suppliers to provide services in goods transportation across the border, but made no commitments in transportation of passengers. However, foreign suppliers are permitted to establish joint-venture shipping companies to transport goods and passengers with a maximum of 49% of the total registered capital and to use Vietnam's flag. Upon accession, foreign companies are permitted to provide in-land and maritime auxiliary services<sup>189</sup> in the form of joint-ventures with 51% of foreign ownership. *In Road transport services*, Vietnam does not have any commitments on transport of goods and passengers across the border. Partners are permitted to set up joint-venture companies with foreign investment of 49% and increased to 51% after 3 years of

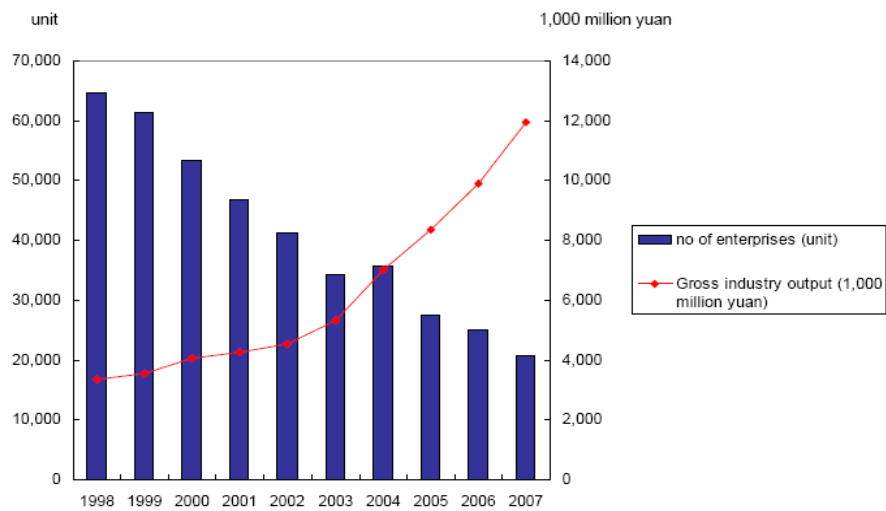
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<sup>189</sup> such as cargo handling services, customs clearance services, and container storage and warehouse services.

operation. In *Water-borne, rail and air transportation services*, similar to that of the road transport services, Vietnam does not have any commitments on this matter. Foreign companies are allowed to establish joint-ventures with a maximum participation of 49% in both rail (goods only) and water-borne transport service (NCIEC 2007)

*In education services*, foreign firms can establish education facilities in Vietnam upon accession. However, curriculums must be approved by the Ministry of Education and Training of Vietnam. The reality is that there very little enforcement if regulations, very little assessment and it is easy to make corrupt payments to bypass regulations. *In Environment services*, wholly foreign owned enterprises will be allowed by the end 2012 to replace the joint-venture form with maximum foreign ownership of 49%. *In construction services*, foreign investors are allowed to establish branches. *In Medical services*, foreign providers are allowed to set up joint ventures and sign business cooperation contracts or establish wholly foreign-owned hospitals in Vietnam. Vietnam also put forth principles on a minimum capital of US\$ 200,000 to set up treatment facilities. *In tourism services*, foreign providers are only permitted to establish joint-ventures. In travel services, foreign invested companies are not allowed to provide outbound services and domestic travel services. In the hotel and restaurant business, they are required to build, upgrade or re-buy facilities after 8 years of WTO accession. *In Cultural and entertainment services*, foreign parties are only allowed to set up joint ventures by the end of 2012 with a maximum capital ownership of 49%. In regard to electronic game business area, the provision must be carried out through a Business Cooperation Contract or joint ventures with Vietnamese partners who are granted licenses and the foreign capital ownership is not more than 49% (NCIEC 2007)

## APPENDIX 2 : Number of SOEs or SOEs holding units in China from 1998-2007



Sources: China Statistical Yearbook 1999-2008

### APPENDIX 3 : GDP growth and GDP capital growth (1977-1980)

<i>Year</i>	<i>GDP growth (%)</i>	<i>GDP per capita growth (%)</i>
1977	4.4	2.8
1978	4.0	2.3
1979	-1.7	-2.0
1980	-1.0	-1.4
5 Years	5.8	1.2
<i>Annual Average</i>	<i>1.4</i>	<i>0.4</i>

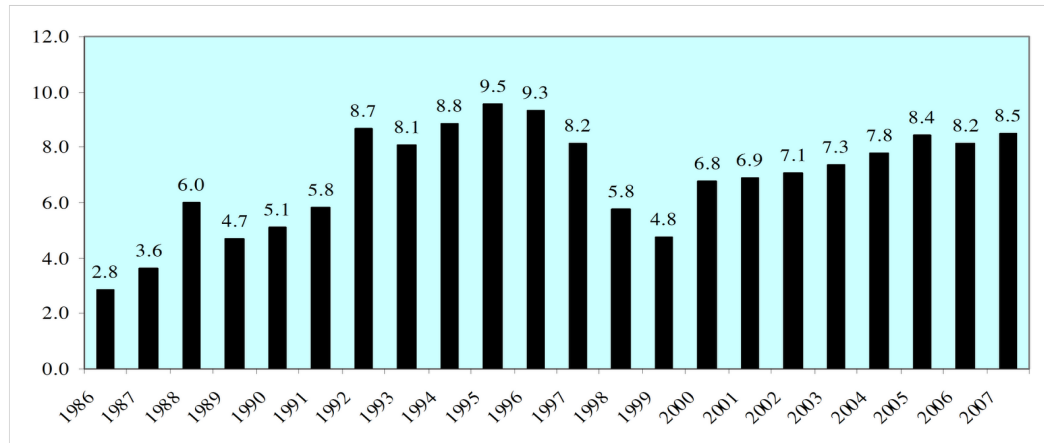
Sources: Dang Phong 2009

### APPENDIX 4 : GDP and its composition growth

<b>CHAPTER</b>	<i>2001</i>	<i>2002</i>	<i>2003</i>	<i>2004</i>	<i>2005</i>	<i>2006</i>	<i>2007</i>	<i>2008</i>	<i>2009</i>	<i>2010</i>
<b>GDP</b>	6.9	7.1	7.3	7.8	8.4	8.2	8.5	6.3	5.3	6.78
<b>Agriculture</b>	3.0	4.2	3.6	4.4	4.0	3.7	3.8	4.1	1.8	2.7
<b>Industry &amp; Construction</b>	10.4	9.5	10.5	10.2	10.7	10.4	10.2	6.1	5.5	7.0
<b>Services</b>	6.1	6.5	6.5	7.3	8.5	8.3	8.9	7.2	6.6	7.5

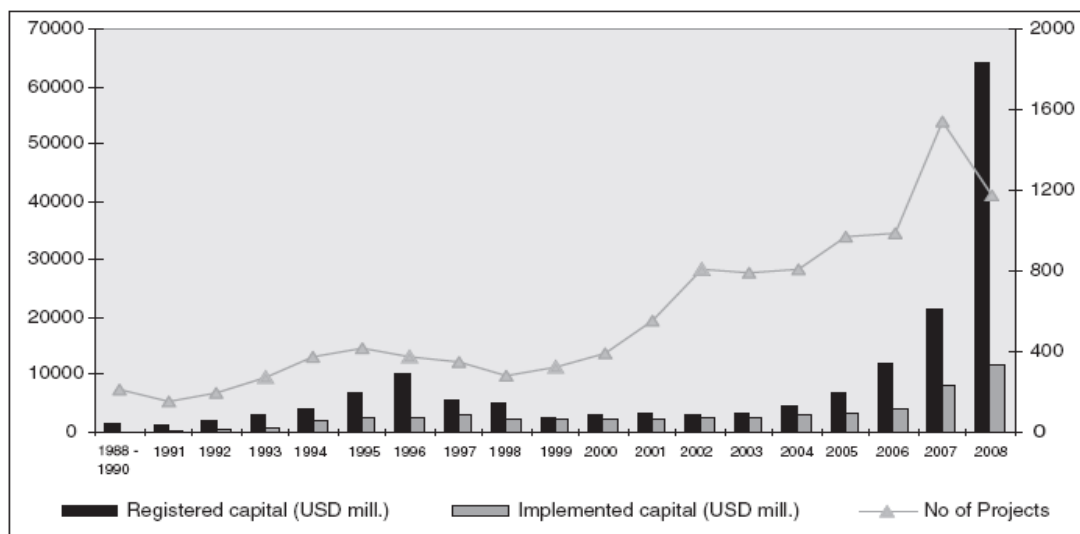
Sources: GSO, 2010

## APPENDIX 5 : GDP growth of Vietnam from 1984-2008



Source: General Statistic Office (1990, 1995, 2000, 2008)

## APPENDIX 6 : FDI inflow in Vietnam from 1988-2008



Source: OECD, 2009

**APPENDIX 7 Number of enterprises in different ownership sectors**

<b>Year</b>	<b>1990</b>	<b>2000</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
<b>Total</b>		<b>42288</b>	<b>72012</b>	<b>91756</b>	<b>112950</b>
State sector	12300	5759	4845	4597	4086
Non state sector	332	35004	64526	84003	105167
Foreign investment sector	0	1525	2641	3156	3697
<b>Year</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>%</b>
<b>Total</b>	<b>131318</b>	<b>155771</b>	<b>205668</b>	<b>248847</b>	<b>100</b>
State sector	3706	3494	3328	3369	<b>1.3</b>
Non state sector	123392	147316	196779	238932	<b>96</b>
Foreign investment sector	4220	4961	5625	6546	<b>2.7</b>

Source: General Statistic Office 2011

**APPENDIX 8 : Number of enterprise by size of the employees and types of enterprises**

	<b>Total</b>	<b>Under 10 employees</b>	<b>10-49 employees</b>	<b>50-199 employees</b>	<b>200-299 employees</b>
<b>SOEs</b>	3287	55	576	1180	2145
<b>Non state enterprises</b>	196776	114256	67467	11847	1319
<b>FDI enterprises</b>	5626	617	1669	1741	430
		<b>300-499 employees</b>	<b>500-999 employees</b>	<b>1000-4999 employees</b>	<b>Above 5000 employees</b>
<b>SOEs</b>	3287	1751	1311	956	91
<b>Non state enterprises</b>	196776	941	591	311	17
<b>FDI enterprises</b>	5626	399	387	342	41

Sources: GSO 2009

**APPENDIX 9 : Number of enterprises by size of capital and ownerships.**

	<b>Total</b>	<b>Under £30000</b>	<b>£30000 – £150,000</b>	<b>£150000 – £300,000</b>	<b>£300000 – £1,500.000</b>
<b>SOEs</b>	3287	43	226	1180	968
<b>Non state enterprises</b>	196776	48899	94935	25257	21811
<b>FDI enterprises</b>	5626	247	712	646	1949
		<b>£1,500,00- £6,000,000</b>	<b>6,000,000- 15,000,000</b>	<b>Above £15,000,000</b>	
<b>SOEs</b>	3287	966	425	393	
<b>Non state enterprises</b>	196776	4585	866	423	
<b>FDI enterprises</b>	5626	1283	446	343	

Sources: GSO 2009

**APPENDIX 10 : Process of equitised SOEs in Vietnam**

<b>Year</b>	<b>Number of equitised SOEs</b>	<b>Total number of equitised over the years</b>	<b>Year</b>	<b>Number of equitised SOEs</b>	<b>Total number of equitised over the years</b>
<b>1992</b>	Started	0	<b>2000</b>	212	577
<b>1992 - 1995</b>	3	3	<b>2001</b>	149	726
<b>1996</b>	5	8	<b>2002</b>	164	890
<b>1997</b>	7	15	<b>2003</b>	532	1422
<b>1998</b>	100	115	<b>2004</b>	753	2175
<b>1999</b>	250	365	<b>2005</b>	754	2929

Sources: PWC, 2008

## APPENDIX 11 Average Tariffs by sectors

Specific sector	Number of tariff lines	MFN Commitment (%)	Bound rate at date of accession (%)	Final Bound (%)	Concession compared to the present MFN rate (%)	WTO commitments Of China (%)
Agricultural products	1,219	23.5	25.2	21.0	10.6	16.7
Fish, Fish products	176	29.3	29.1	18.0	38.4	8.9
Oil and gas	37	3.6	36.8	36.6		4.6
Wood, paper	630	15.6	14.6	10.5	32.8	5.3
Garment and textile	1,159	37.3	13.7	13.7	63.2	11.6
Leather, rubber	341	18.6	19.1	14.6	21.5	13.0
Metal	1,201	8.1	14.8	11.4		7.3
Chemical	1,579	7.1	11.1	6.9	2.8	7.7
Transportation equipment	1,026	35.3	46.9	37.4		17.1
Mechanic machinery and equipment	1,436	7.1	9.2	7.3		7.8
Electric machinery and equipment	766	12.4	13.9	9.5	23.5	7.9
Mineral	396	14.4	16.1	14.1	2.3	9.5
Other manufacturing products	723	14.0	12.9	10.2	26.9	11.1
<b>Total</b>	<b>10,689</b>	<b>17.4</b>	<b>17.2</b>	<b>13.4</b>	<b>23.0</b>	<b>10.1</b>

Source: Ministry of Trade 2007



**APPENDIX 12 : NRP and ERP estimate of Vietnam tariff from 1997-2003**

	1997		2001		2003	
	NRP	ERP	NRP	ERP	NRP	ERP
<b>Weighted average</b>						
<b>Agriculture</b>	8.12	<b>7.74</b>	6.28	<b>7.43</b>	11.06	<b>12.52</b>
<b>Mining</b>	9.42	<b>6.05</b>	8.91	<b>16.39</b>	3.55	<b>-0.03</b>
<b>Manufacturing</b>	30.63	<b>121.47</b>	25.28	<b>95.97</b>	29.23	<b>43.94</b>
<b>Total tradable</b>	20.95	<b>72.22</b>	17.92	<b>58.46</b>	18.2	<b>24.87</b>
<b>Simple average</b>	23.32	<b>59.54</b>	20.14	<b>54.1</b>	19.98	<b>26.23</b>
<b>CV</b>	133.81	<b>156.01</b>	149.9	<b>172.34</b>	106.51	<b>134.93</b>

Source: Athukorala. 2005

**APPENDIX 13 : Nominal and Effective Rate of Protection under the WTO commitments (%)**

<i>Year</i>	<i>Agriculture and seafoods</i>		<i>Mineral, oil and gas</i>		<i>Manufacturing</i>		<i>Whole economy</i>	
	<i>ERP</i>	<i>Tariff</i>	<i>ERP</i>	<i>Tariff</i>	<i>ERP</i>	<i>Tariff</i>	<i>ERP</i>	<i>Tariff</i>
<b>2005</b>	7,40	6,10	4,39	3,85	40,38	19,45	<b>21,43</b>	<b>11,12</b>
<b>2006</b>	6,42	5,37	4,33	3,84	38,93	18,69	<b>20,43</b>	<b>10,53</b>
<b>2007</b>	6,20	5,17	4,38	3,84	31,21	15,25	<b>16,93</b>	<b>9,04</b>
<b>2008</b>	5,50	4,72	4,41	3,84	29,58	14,45	<b>15,97</b>	<b>8,54</b>
<b>2009</b>	5,00	4,39	4,43	3,83	28,00	13,71	<b>15,10</b>	<b>8,11</b>
<b>2010</b>	4,59	4,13	4,45	3,83	26,78	13,14	<b>14,41</b>	<b>7,78</b>
<b>2011</b>	4,20	3,88	4,46	3,83	25,53	12,53	<b>13,72</b>	<b>7,43</b>
<b>2012</b>	3,92	3,72	4,48	3,83	24,57	12,05	<b>13,20</b>	<b>7,18</b>
<b>2013</b>	3,85	3,67	4,49	3,83	24,08	11,80	<b>12,96</b>	<b>7,05</b>
<b>2014</b>	3,85	3,67	4,49	3,83	24,05	11,77	<b>12,95</b>	<b>7,04</b>
<b>2015</b>	3,51	3,25	-0,29	0,17	21,14	10,65	<b>10,57</b>	<b>5,64</b>
<b>2016</b>	3,51	3,25	-0,29	0,17	21,13	10,64	<b>10,56</b>	<b>5,63</b>
<b>2017</b>	3,50	3,25	-0,28	0,17	21,12	10,64	<b>10,56</b>	<b>5,63</b>
<b>2018</b>	3,35	3,11	-0,33	0,13	21,01	10,51	<b>10,44</b>	<b>5,52</b>
<b>2019</b>	3,35	3,11	-0,33	0,13	21,00	10,51	<b>10,44</b>	<b>5,52</b>
<b>2020</b>	3,36	3,11	-0,32	0,13	20,76	10,30	<b>10,34</b>	<b>5,43</b>

Sources: Tuyen et al, 2011

**APPENDIX 14 : Anti-dumping case against Vietnam export products since 1994**

<b>Year</b>	<b>Products</b>	<b>From country</b>	<b>Year</b>	<b>Products</b>	<b>From country</b>
<b>1994</b>	Rice	Columbia	<b>2007</b>	Gas lighter	Turkey
<b>1998</b>	Glutamate	EU		Fluorescent lamp	India
	Footwear	EU		CD-R	India
<b>2000</b>	Gas lighter	Poland	<b>2008</b>	Uncovered Innerspring	US
<b>2001</b>	Garlic	Canada		Flat Yarn of Polyester	India
<b>2002</b>	Water proof Footwear & sole	Canada		Siluriformes	EU
	Gas lighter	EU		Leather footwear	EU
	Gas lighter	Korea	<b>2009</b>	Waterproof Rubber Footwear	Canada
	Catfish	US		Polyethylene Retail Carrier Bags	US
<b>2003</b>	Oxide zinc	EU		Air-conditioner	Turkey
	Shrimp	US	<b>2010</b>	Air-conditioner	Argentina
<b>2004</b>	Metal ring	EU		Steel Wire Garment Hangers	US
	Tyre	Turkey	<b>2011</b>	Cold Rolled Coil	Indonesia
	Bicycle	EU		Yarn	Brazil
	Steel type	EU		Footwear	Brazil
	Stainless fastener	EU		Certain Steel Pipe	US
	Fluorescent lamp	EU	<b>2012</b>	Steel Wire Garment Hangers	US
	Surfboard	Peru		Utility Scale Wind Towers	US
<b>2005</b>	Leather Footwear	EU		Flat-rolled Stainless Steel	Brazil
	Fluorescent lamp	Egypt		Motorcycles	Brazil
	Spokes	Argentina			
<b>2006</b>	Driving belt	Turkey			
	Fabric Footwear	Peru			

Sources: Adapted from LE Thi Thuy Van & Tong (2009) and VCCI (2012) <URL: <http://antidumping.vn/page/cases/anti-dumping/Viet-Nam>><Accessed 1<sup>st</sup> June 2012>.

**APPENDIX 15 Number of new registered non-state business and total number of business from 2006-2010**

	<i>2005</i>	<i>2006</i>	<i>2007</i>	<i>2008</i>	<i>2009</i>	<i>2010</i>
<b>Total number of business</b>		254.2	312.4	377.7	454.1	547
<b>Newly registered business</b>		46.6	58.2	65.3	84.5	85

Source: CIEM, 2010 and Government Office, 2010

**APPENDIX 16 GDP growth after the WTO accession**

<i>Year</i>	<i>2005</i>	<i>2006</i>	<i>2007</i>	<i>2008</i>	<i>2009</i>	<i>2010</i>	<i>2011</i>
<b>GDP Growth %</b>	8.44	8.23	8.46	6.31	5.32	6.78	5.89

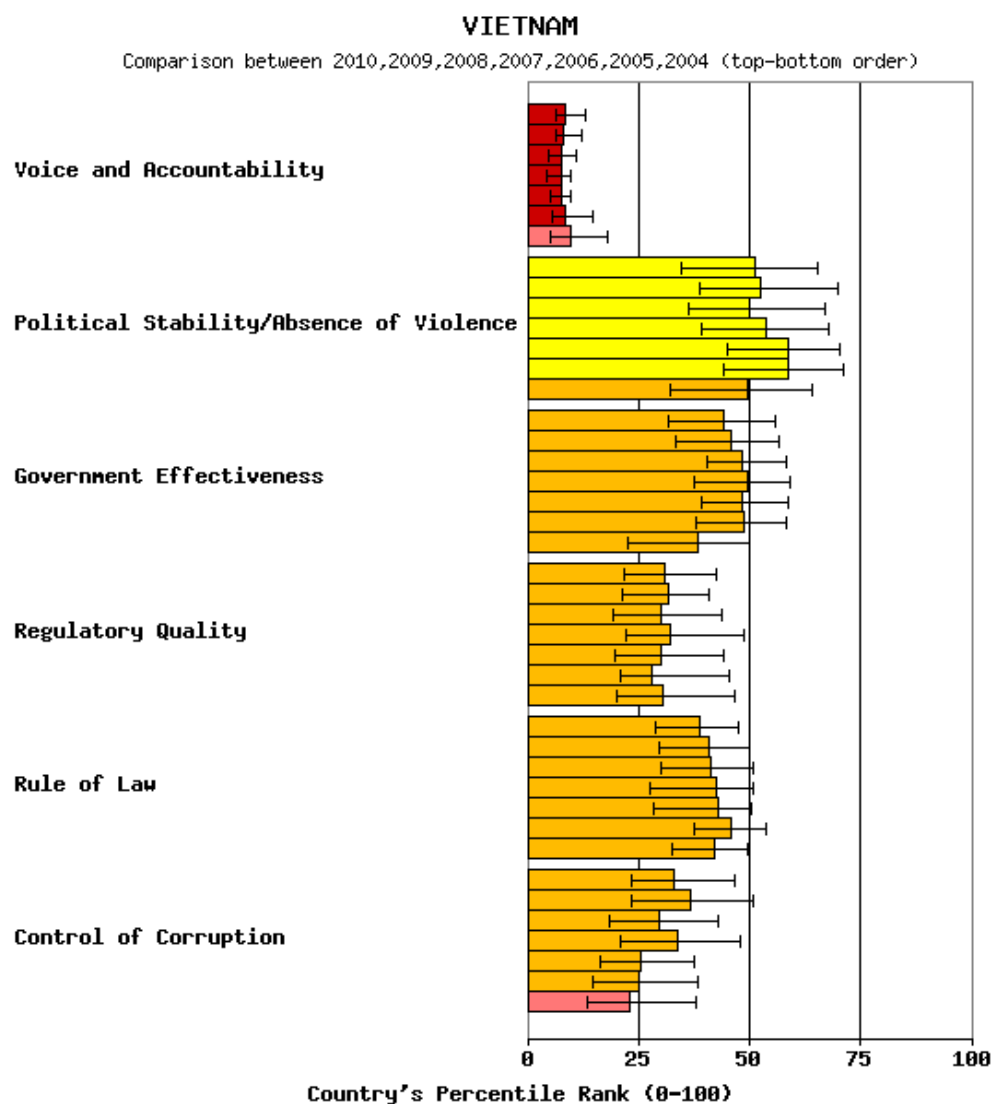
Source: GSO, 2011

**APPENDIX 17 : FDI, Export and import value after the WTO accession (billion USD)**

<i>Years</i>	<i>2005</i>	<i>2006</i>	<i>2007</i>	<i>2008</i>	<i>2009</i>	<i>2010</i>
<b>FDI Commitments</b>	6.83	12	21.34	71.7	21.1	18.6
<b>Implemented FDI)</b>	3.31	4.1	8.03	11.5	10	11
<b>Total export value</b>	32.44	39.82	48.56	62.69	57.1	72.23
<b>% Increase</b>		22.74	21.93	29.09	-8.92	26.52
<b>Total import value</b>	36.76	44.89	62.77	80.71	69.95	84.84
<b>% Increase</b>		22.12	39.82	28.60	-13.34	21.29

Source: GSO, 2010; 2011

## APPENDIX 18 : Aggregate institution indicators of Vietnam



Source: Kaufmann D., A. Kraay, and M. Mastruzzi (2010), The Worldwide Governance Indicators: Methodology and Analytical Issues

Note: The governance indicators presented here aggregate the views on the quality of governance provided by a large number of enterprise, citizen and expert survey respondents in industrial and developing countries. These data are gathered from a number of survey institutes, think tanks, non-governmental organizations, and international organizations. The WGI do not reflect the official views of the World Bank, its Executive Directors, or the countries they represent. The WGI are not used by the World Bank Group to allocate resources.

**APPENDIX 19 World position of several Vietnamese agricultural products**

<i>Commodity</i>	<i>World Export Position 2001</i>	<i>World Export Position 2011</i>
<b>Rice</b>	3 <sup>rd</sup> (after Thailand and India)	2 <sup>nd</sup> (after Thailand)
<b>Coffee</b>	2 <sup>nd</sup> (after Brazil); 1 <sup>st</sup> for Robusta coffee	2 <sup>nd</sup> (after Brazil), 1 <sup>st</sup> for Robusta with 18% of world export volume
<b>Pepper</b>	9.1.1	1 <sup>st</sup> since 2004 accounting for 30% of the world pepper trading
<b>Cashew Nut</b>	2 <sup>nd</sup> (after India)	2 <sup>nd</sup> (after India)
<b>Tea</b>	7 <sup>th</sup>	7 <sup>th</sup>
<b>Rubber</b>	9.1.2	4 <sup>th</sup> (after Thailand, Indonesia and Malaysia)

Source: Thuy Hai, 2011

**APPENDIX 20 : Vietnam's commitments on tax cut of some major agricultural products**

<b>No</b>	<b>Items</b>	<b>MFN tax</b>	<b>WTO Commitment</b>		
			<b>Tax at accession</b>	<b>Final tax</b>	<b>Implementation time (years)</b>
<b>1</b>	<b>Beef</b>	20	20	14	5
<b>2</b>	<b>Pork</b>	30	30	15	5
<b>3</b>	<b>Milk materials</b>	20	20	18	2
<b>4</b>	<b>Finished Milk</b>	30	30	25	2
<b>5</b>	<b>Processed meat</b>	50	40	22	5
<b>6</b>	<b>Confectionary</b>	39.3	34.4	25.3	3-5
<b>7</b>	<b>Beer</b>	80	65	35	5
<b>8</b>	<b>Alcohol</b>	65	65	45-50	5-6
<b>9</b>	<b>Cigarettes</b>	100	150	135	3
<b>10</b>	<b>Cigars</b>	100	150	100	5
<b>11</b>	<b>Castle feeds</b>	10	10	7	2

Sources: NCIEC, 2007

**APPENDIX 21 % Growth of agricultural sector year by year from 2003-2011**

Year	2003	2004	2005	2006	2007	2008	2009	2010	2011
<b>Total</b>	<b>4.5</b>	<b>4.1</b>	<b>3.2</b>	<b>4.1</b>	<b>3.6</b>	<b>6.9</b>	<b>2.8</b>	<b>4.7</b>	<b>4.9</b>
<i>Cultivation</i>	3.8	4.6	1.4	3.4	3.4	6.9	0.9	4.3	4.7
<i>Livestock</i>	8.1	2.3	11.4	6.9	4.6	7.3	10.5	6.3	5.7
<i>Service</i>	2.3	2.3	2.6	2.7	2.7	3.5	3.3	3.1	3.3

Source: GSO, 2008; 2011

**APPENDIX 22 Export of the agriculture products of Vietnam over the years (million USD)**

Year (95-02)	1995	1996	1997	1998	1999	2000	2001	2002
<b>Agriculture</b>	1745.8	2159.6	2231.4	2274.3	2545.9	2563.3	2421.3	2396.6
<b>Forest</b>	153.9	212.2	225.2	191.4	169.2	155.7	176	197.8
<b>Aqua</b>	621.4	696.5	782	858	973.6	1478.5	1816.4	2021.7
<b>Total</b>	<b>2521.1</b>	<b>3068.3</b>	<b>3238.6</b>	<b>3323.7</b>	<b>3688.7</b>	<b>4197.5</b>	<b>4413.7</b>	<b>4616.1</b>
<i>% change</i>		<i>21.7</i>	<i>5.6</i>	<i>2.6</i>	<i>11.0</i>	<i>13.8</i>	<i>5.2</i>	<i>4.6</i>
Year (03-10)	2003	2004	2005	2006	2007	2008	2009	2010
<b>Agriculture</b>	2672	3383.6	4467.4	5352.4	7032.8	9239.6	8352.8	11799.6
<b>Forest</b>	195.3	180.6	252.5	297.6	408.4	468.7	463.4	
<b>Aqua</b>	2199.6	2408.1	2732.5	3358	3763.4	4510.1	4255.3	
<b>Total</b>	<b>5066.9</b>	<b>5972.3</b>	<b>7452.4</b>	<b>9008</b>	<b>11204.6</b>	<b>14218.4</b>	<b>13071.5</b>	<b>16815.9</b>
<i>% Change</i>	<i>.77</i>	<i>7.87</i>	<i>4.78</i>	<i>0.87</i>	<i>4.38</i>	<i>6.90</i>	<i>8.07</i>	<i>8.65</i>

Source: GSO 2012

**APPENDIX 23 Total investment and its growth on extended agriculture products over the year**

<b>Year</b>	<b>2000</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
Agriculture, forestry and aquatic	20933	22963	25715	30087	33907	39697	44309	51071
<i>% Change year by year</i>			<i>11.98</i>	<i>17.00</i>	<i>12.70</i>	<i>17.08</i>	<i>11.62</i>	<i>15.26</i>

Sources: GSO 2008; 2009; 2012

**APPENDIX 24 FDI in agricultural and aquatic products since WTO accession**

<b>Year</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
<b>No. of project</b>	16	23	29	12
<b>Registered capital</b>	58.6	223.5	134.5	36.2

Source: GSO 2012

**APPENDIX 25 Number of Banks from 1991 to 1999**

	<i>1991</i>	<i>1992</i>	<i>1993</i>	<i>1994</i>	<i>1995</i>	<i>1996</i>	<i>1997</i>	<i>1998</i>	<i>1999</i>
<b>SOCBs</b>	4	4	4	4	4	4	5	5	5
<b>Urban Joint Stock Banks</b>	4	16	25	29	29	31	31	31	28
<b>Rural Joint Stock Banks</b>	0	6	16	16	19	20	20	20	20
<b>Joint Venture Banks</b>	1	2	3	3	4	4	4	4	5
<b>Foreign Banks</b>	0	5	8	9	18	22	24	25	26

Source: Kovsted et al, 2005

**APPENDIX 26 : Number of banks by different types of ownership after WTO accession**

<i>Category</i>	<i>2006</i>	<i>2007</i>	<i>2008</i>	<i>2009</i>
<b>Joint stock banks</b>	35	35	36	37
<b>Joint venture banks</b>	5	5	5	6
<b>Foreign bank branches</b>	27	35	37	37
<b>100% foreign owned banks</b>	0	0	5	5
<b>SOCBs</b>	5	5	5	5
<b>Policy banks</b>	2	2	2	2

Source: Linh, 2011



**APPENDIX 27 : Foreign banks' stake in domestic banks in 2010**

<b>Domestic Banks</b>	<b>Foreign Banks</b>	<b>Stake</b>	<b>Note</b>
<b>ACB</b>	Standard Chartered (SCB)	11.47%	Include 4.13% stake of SCB and 7.34% stake of its subsidiary, SC APR
<b>Sacombank</b>	ANZ	9.78%	
<b>Eximbank</b>	Sumitomo Mitsui	15%	
<b>Techcombank</b>	HSBC	20%	
<b>SEABank</b>	Societe Generale	20%	
<b>Southern Bank</b>	UOB	19.99%	
<b>Orient Commercial Bank</b>	BNP Paribas	15%	
<b>VIB</b>	Common Wealth	20%	
<b>Habubank</b>	Deutsche Bank	10%	

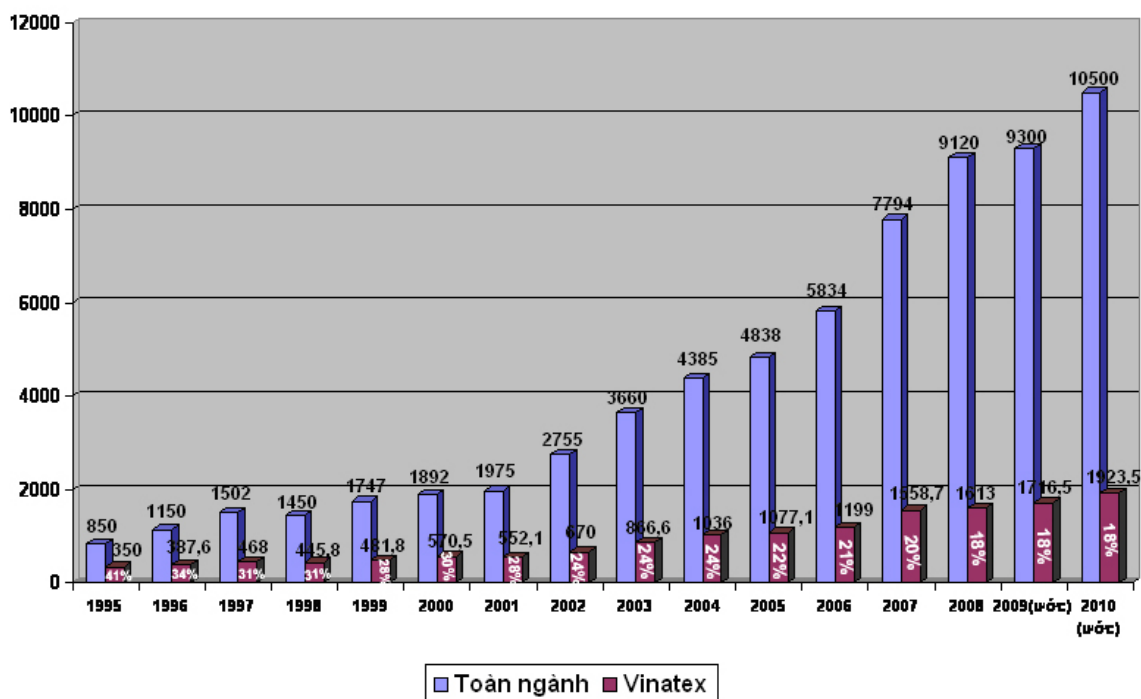
Source: Linh, 2011.

**APPENDIX 28 : Market share of banking sector in Viet Nam**

<b>Banking</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
<b>State-owned Commercial Banks</b>	77	80.1	79.3	78.1	75.2
<b>Joint Stock Commercial Banks</b>	11.3	9.2	10.1	11.2	13.2
<b>Joint Venture Banks</b>	1.1	1.2	1.3	1.5	1.5
<b>Branches of Foreign Banks</b>	9.2	8.8	8.1	7.8	8.2
<b>State-owned Commercial Banks</b>	76.7	79	79.9	78.6	76.9
<b>Joint Stock Commercial Banks</b>	9.2	9.3	9.5	10.8	11.6
<b>Joint Venture Banks</b>	1	1	1.1	1.2	1.2
<b>Branches of Foreign Banks</b>	11.3	9.5	8.8	8.9	9.5

Source: MPI and UNDP, 2006.

**APPENDIX 29 : Export Volume of Vietnamese Textile and Garment industry and of Vinatex in 1995-2010**



Source: VINATEX, 2010

**Effective Rate of Protection of the Textile and garment industry (%)**

	2006	2007	2008	2009	2010	2015	2020
<b>Textile and garment</b>	124,71	34,06	34,74	35,28	35,61	33,31	28,59
<b>Thread fibre</b>	4,00	-4,97	-4,46	-4,06	-3,81	-3,10	-2,66
<b>Clothing</b>	135,70	58,02	58,44	57,72	57,48	58,26	57,83
<b>Carpet weaving</b>	56,00	25,02	25,22	25,38	25,47	19,81	20,32
<b>Embroidery (excluding Carpet)</b>	62,33	17,44	17,69	17,90	18,05	16,03	16,31

Source: Adapted from Nguyen & Dang, 2009

**APPENDIX 30 Exports turnover of Vietnamese garment and textile into the US market between 2001 and 2010 (Unit: Million USD)**

<i>US Market</i>	<i>2001</i>	<i>2002</i>	<i>2003</i>	<i>2004</i>	<i>2005</i>	<i>2006</i>	<i>2007</i>	<i>2008</i>
Exports Turnover	49.3	952	2484	2720	2881	3396	4558	5425
Growth (%)	0.99	193.2	206.9	10.95	10.48	17.8	34.22	19.02

**APPENDIX 31 : Equitisation progress of the Vinatex from 1998-2009**

<b>Year</b>	<b>Total</b>	<b>Fully Equitised</b>	<b>Partially Equitised</b>	<b>Year</b>	<b>Total</b>	<b>Fully Equitised</b>	<b>Partially Equitised</b>
<b>1998</b>	02	02	0	<b>2004</b>	15	08	07
<b>1999</b>	04	01	03	<b>2005</b>	05	02	03
<b>2000</b>	04	02	02	<b>2006</b>	19	12	07
<b>2001</b>	03	01	02	<b>2007</b>	02	01	01
<b>2002</b>	05	03	02	<b>2008</b>	01	01	0
<b>2003</b>	18	14	04	<b>2009</b>	02	02	0
				<b>TOTAL</b>	<b>80</b>	<b>49</b>	<b>31</b>

Source: Vinatex, 2010