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## Who Drives Economic Reform in Vietnam's Provinces?

Hubert Schmitz, Dau Anh Tuan, Pham Thi Thu Hang and Neil McCulloch

June 2012

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Photo caption: Ho Chi Minh City (Saigon), Vietnam. Small boats on the Saigon River passing the city centre with its new high-rise buildings.

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Institute of Development Studies  
Brighton BN1 9RE, UK  
Tel: +44 (0) 1273 915637  
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# Summary

Vietnam keeps surprising the world with the speed and depth of its economic transformation. This research report suggests that the decentralisation of certain economic powers from central to provincial government has contributed to this success. Allowing provinces to find their own way forward was central to Vietnam's progress in institutional and economic development. Decentralisation brought about a number of inefficiencies, but these are outweighed by the gains resulting from policy experimentation at the provincial level.

The main question of the report is who drives the economic reform process in the provinces, exploring the role of business and government and alliances between the two. This is a difficult undertaking because it involves dipping into sensitive issues of state-business relations and because there are enormous variations between provinces and over time. Key to the feasibility of this project was the collaboration of IDS with the Vietnam Chamber of Commerce and Industry (VCCI). VCCI is an influential organisation with strong connections to business, government and the Communist Party. These connections are essential for access to political and business leaders and for understanding the economic reform process from private and public perspectives.

Provincial government is by necessity involved in the economic reform process, but who is actually driving it? The research shows that in those provinces which are making most progress in economic reform, the private sector played an important role. Not against government but with government. There was no formal public-private coalition but the dynamic was one of proactive government seeking the input from the private sector, and the latter lobbying for and contributing to responsive and effective government. Both national and foreign enterprises played a role but small enterprises tended to be marginalised from the process. Some of the best insights come from comparing provinces and observing how different alignments of interest influenced the reform process.

**Keywords:** investment climate; economic reform; economic governance; private sector; state business relations; decentralisation; provincial government; Vietnam

**Hubert Schmitz** is Professor at the Institute of Development Studies (IDS), University of Sussex. He is the coordinator of the project on which this research report is based.

**Dau Anh Tuan** is Deputy Director of the Legal Department of Vietnam Chamber of Commerce and Industry (VCCI), Ha Noi. He has coordinated Vietnam's Provincial Competitiveness Survey since its inception in 2005.

**Pham Thi Thu Hang** is Secretary General of the Vietnam Chamber of Commerce and Industry (VCCI). As Director of the Enterprise Development Foundation she is in charge of VCCI research.

**Neil McCulloch** is Lead Economist of the Australian Aid Programme in Indonesia. He was formerly a Fellow of IDS and Leader of its Globalisation Team.



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The responsibility for everything said in this report lies with the authors.

## Note

The Vietnamese version of this research report is published simultaneously by the Vietnam Chamber of Commerce and Industry in Ha Noi ([www.vcci.com.vn](http://www.vcci.com.vn)).

## Acronyms

CASEP	Ca Mau Association of Seafood Exporters and Producers
CIDA	Canadian International Development Agency
DAI	Development Alternatives, Inc.
DANIDA	Danish International Development Agency
DFID	Department for International Development
DPI	Department of Planning and Investment
ESRC	Economic and Social Research Council
FDI	Foreign Direct Investment
GIZ	German Agency for International Cooperation
GSO	General Statistical Office
GTZ	German Agency for Technical Cooperation
IDS	Institute of Development Studies
IFC	International Finance Corporation
ILO	International Labour Organization
PCI	Provincial Competitiveness Index
PPC	Provincial People's Committee
SIDA	Swedish International Development Cooperation Agency
SME	Small and medium-sized enterprise
SOE	State-owned enterprise
UNIDO	United Nations Industrial Development Organization
USAID	US Agency for International Development
VASEP	Vietnam Seafood Exporters and Producers Association
VCCI	Vietnam Chamber of Commerce and Industry
VNCI	Vietnam Competitive Initiative
VND	Vietnamese dong
WTO	World Trade Organization

# 1 Introduction

Success commands attention. Vietnam continues to surprise the world with high rates of economic growth and a strong capacity to reform its economy. While the central government is in overall charge, provincial governments have considerable room to manoeuvre. This report analyses the forces that drive economic reform in the provinces. The central question is who drives the improvement in the quality of local economic governance? We are particularly interested in whether and how the private sector plays a role in the reform process. Who initiates the reform process in the provinces? Who drives it forward? What are the roles of big investors, small investors, business associations, provincial government agencies, provincial leaders and central government? Is there active cooperation between government and business people? What form does it take? Is it formal or informal? Who tries to slow down the process? We examine these questions for four provinces, two provinces in the North and two in the South. They are located in the Red River and Mekong River Delta respectively. In each pair, one province is successful in reforming its investment climate and one is less successful. We try to understand each province in its own right but also learn from comparing them.

In seeking answers to the above questions, we focus on the provinces but do not look at them in isolation. We ask how the provinces are conditioned by 'The Centre', notably the central government and the Communist Party. Seeking to understand how the Centre influences what happens in the provinces had an unexpected consequence. It opened our eyes to a bigger story with a clear message: the empowerment of the provinces is central to Vietnam's success. This is a controversial story to tell at a time when decentralisation is criticised for leading to wasteful investment. We agree that such criticism is valid in particular instances, but we believe that it fails to grasp the bigger picture: Vietnam is a big laboratory and has been a big laboratory for the last 25 years. The challenge was first the transition from a centrally planned to a market economy and then the integration into the world economy. Under the political control of the Communist Party, the market was allowed to play an increasing role and propel the economy forward. The economic transformation was deep and fast, but was in fact based on experimentation. Ceding powers over the investment climate to the provinces is part of this experimentation. Provinces have used the policy spaces granted to them in many different ways, unleashing unexpected dynamics within and between provinces.

Understanding these dynamics is what we seek to do. Our initial intention was more modest, namely to understand who drives the investment climate reform in the provinces. As it turns out, precisely because we have started in the provinces (outside Ha Noi and Ho Chi Minh City), we begin to see processes which have escaped the attention of most observers but are central for understanding the economic transformation of the country. The insights we learn from Vietnam finally lead us to ask what lessons there are for other countries.

The report is structured as follows: Chapter 2 sets out briefly what the literature tells us about the drivers of investment climate reform. A wealth of research and

advice is concerned with what governments should do but is much less concerned with the political processes of making it happen, in particular the forces which bring about the required reform. Chapter 2 pulls together what we know and specifies what we do not know. Chapter 3 sets out the national context showing how the political and policy framework affects (dis)incentives for reform in the provinces. Chapter 4 explains the data sources and methods used in our own new research in the provinces: how we selected the provinces, what primary and secondary sources we used, and how we went about our interviews in the public and private sectors. The subsequent chapters present the findings for the Northern provinces of Bac Ninh (Chapter 5) and Hung Yen (Chapter 6), and for the Southern provinces of Dong Thap (Chapter 7) and Ca Mau (Chapter 8). The comparison of similarities and differences between these provinces is presented in Chapter 9.

Chapter 10 then tests to what extent our findings are backed up by quantitative evidence from all of Vietnam's 63 provinces. To this end we draw on a five-year panel of data on the quality of economic governance captured in the Provincial Competitiveness Index (PCI). This composite index measures different aspects of economic governance at the provincial level based on the responses from a random sample of firms in each province. When combined with data on other provincial characteristics, this allows us to test a range of hypotheses about the determinants of provincial governance reform.

The final Chapter 11 pulls together our findings and their significance for research and policy. It specifies how the findings advance the literature and it brings out their practical relevance for both business and government.

## 2 What do we know and what do we need to find out?

In the academic literature on economic development and in the policy debate on promoting economic development there is a strong view that good economic governance and strong economic growth go together. Indeed, a close look at the advanced countries of North America, Western Europe and Japan – particularly over the period from 1950 to 2000 – confirms this view. This experience has been the bedrock for advice to latecomer countries: improving the investment climate is seen as essential for economic development.<sup>1</sup> Latecomers are offered a lot of advice on what measures they should take but little advice on how to get there. Who would bring about the reform in laws and regulations? The widely held assumption is that government drives the process. The assumed dynamic is: government undertakes the governance reform and private investment follows. This seems plausible but is it right?

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1 For a review of the investment climate debate, see Moore and Schmitz (2008).

Examining this question is of relevance for many countries that seek to accelerate growth and transform their economies. So as to make this debate relevant for them it is important to concentrate on the starting point and not the end point of the journey they seek to undertake. In other words, the relevant question is how to get from ineffective to effective economic governance.

Countries which have made this journey in recent decades – characterised by rapid globalisation – are more likely to provide insights than countries that have been prosperous for some time. The experience of the rapidly growing countries of East Asia, notably China and Vietnam, is particularly interesting in this respect. Both countries challenge the dominant view. When they embarked on their reform process, they did not have in place the key elements of a good investment climate: property rights, legally enforceable contracts and regulation of business activity which is transparent and fast.

Yet both countries have grown rapidly and transformed their economies over the last 35 and 25 years respectively. And both countries have gradually transformed their legal and regulatory frameworks. Clearly the dynamic was not one of investment following governance reform, but was it one of investors leading governance reform?

The official view in both countries is to attribute leadership in the reform process to the Communist Party and central government. Indeed they have retained overall control, setting the direction and boundaries for reform but – as we shall see later – the boundaries can be challenged and there is political space for other actors. This report examines what happened in this space in the case of Vietnam. Before presenting the findings of our research, this chapter sums up what we can learn from the literature.

We start with a quote which expresses in stark terms the issues we are concerned with. It comes from research on the legal and institutional reform in post-communist countries of Eastern Europe and the former Soviet Union:

Foreign investors... are not passive bystanders in the legislative and institutional reform process, as is widely assumed. Rather, foreign investment is a dynamic force in the forefront of the push for change and an agent for such reform. This phenomenon has been largely misunderstood by the international development community and ignored in the prevailing literature.

(Hewko 2003: 72)

In other words, trying to find the drivers of reform within the public sector alone would miss an essential part of the picture. The role of the private sector needs attention.

This precisely is the focus of Edmund Malesky's (2004a, 2008) research on the politics of economic reform in Vietnam. He demonstrates how a coalition of foreign investors and provincial officials induced far-reaching economic reforms. His research concentrates on the 1990s and early 2000s and on key issues of the reform debate at that time: opening up to the international system, reducing the role of state-owned enterprises, and decentralising government authority. Malesky depicts the power struggles going on in the Centre but concludes that the reform

battle was in fact won in the provinces. By working with foreign enterprises, provincial leaders could obtain fiscal room to manoeuvre. Direct and indirect tax income from foreign direct investment was key. Some of the daring provinces were able to exceed the fiscal targets set by the Centre and keep the surplus revenue. Provincial officials thus had an incentive to attract foreign investment and in order to do this they experimented by modifying regulations and introducing new measures.

This came to be known as ‘fence breaking’ because the provinces took initiatives which were – at that time – beyond their remit, meddling with things that were under the jurisdiction of the central government.<sup>2</sup> The fence breaking and experimentation in the provinces caused a lot of controversy in the Centre. The outcome was that some provinces were disciplined but others were allowed to get away with it because their attraction of foreign investment showed results on the ground: increases in economic growth and jobs. More than that, some of the provincial policy reforms – worked out in conjunction with foreign enterprises – were eventually adopted into national-level legislation (Malesky 2004a, 2008).

We have referred to Malesky’s research in detail because it provides exceptionally robust quantitative and qualitative evidence for the role which foreign investors (especially export-oriented investors) have played in Vietnam’s reform process. His subsequent work shows that foreign investors were also agents of change in other transition economies (Malesky 2009). To be precise, his research covers export-oriented foreign investors and the early phase of the transition process. Our research is concerned with the later phase of the transition process – or what is referred to in Vietnam as the second wave of reforms. We are particularly concerned with the reforms from 2005 onwards when all provinces were formally empowered to determine their own investment climate. Most provinces embraced with enthusiasm their new policy space and many of them were able to make substantial changes in the rules and regulations governing business activities.

As set out in the introduction we are particularly interested in the role of the private sector in influencing the recent reform process, not just foreign enterprises but also domestic enterprises. Very little is known about whether and how domestic enterprises have played a role in the reform process. This is hardly surprising for the first wave of policy reforms. At the start of the transition there was no class of private domestic investors. But then such a class emerged rapidly, often from the upper ranks of the Communist Party. In the words of Gainsborough (2010: 16):

In Vietnam, the reform years have certainly seen the emergence of a new business elite. However, while this elite is new in terms of its business interests, it is in fact rather old in terms of its political ties. That is, many of the new entrepreneurs have emerged from within the existing system, are currently serving or former officials, or are the children of the political elite.

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2 The term ‘fence breaking’ goes back to Vietnam’s early reform years and was introduced into the academic debate by Fforde and de Vylder (1996).

The implication is that discerning the role of domestic business in the early reform process would have been both difficult and sensitive. Difficult because it did not (yet) constitute a separate social grouping, sensitive because acknowledging that there was a private entrepreneur in the family was ideologically painful. Membership of the Communist Party was a condition for success in public office but private entrepreneurs were not allowed to join the party.

Discerning the role of national entrepreneurs in the second wave of reforms has become less difficult for several reasons: the entrepreneurs are seen as more legitimate, there are more of them and they have had a chance to organise. This does not mean that it is an easy topic to explore. The main problem is no longer ideology but corruption. Both business people and public officials fear that by talking openly about the connections between them they will be suspected of corrupt practices. In this respect, present-day Vietnam is no different from most other places in the world. And in line with most other places, there are instances of corruption, but it is by no means a defining characteristic of close relationships between public officials and private investors. On the contrary, as we shall see later, in the provinces where the two sides work best together for the common good, focusing on corruption would prevent us from understanding the dynamics of the reform process forward.

In analysing whether the public or private sector drives the reform process we will distinguish on the public side between the Communist Party and the government and within government between the policymakers and the bureaucracy. On the business side we will distinguish between foreign and domestic business, between big and small business and between individual business leaders and collective organisations such as business associations. We will look for alliances between public and private actors, always asking questions about their incentives for being against or in favour of specific reforms.

Before presenting our findings, we provide the national context for the province-level analysis (Chapter 3) and then set out how we conducted our research and where the information comes from (Chapter 4).

### 3 The national framework for economic reform in the provinces

In order to understand the incentives for actors in the provinces we need to understand how they are influenced by the Centre. There are many ways in which the Centre affects the economic reform process in the provinces. For our purposes, the most important influences are:

- Administrative: formal decentralisation;
- Economic: joining the WTO;
- Political: maintaining control through the Party.

### 3.1 Administrative decentralisation

Historically, Vietnam's state apparatus has been centralised. Formal decentralisation has occurred in recent years but *de facto* decentralisation started in the 1990s. As mentioned earlier, some provinces wanted to accelerate the transition from central planning to market economy more quickly than the Centre. Above all they were trying to attract enterprises and in order to do so they encroached on the Centre's legal space, bending rules and offering incentives to enterprises. It remains controversial whether this made economic sense. For example, Vu Thanh Tu Anh *et al.* (2007) conclude that 'the extralegal investment incentives provided by 32 provinces over the last five years (2000–05) not only did not help them attract more FDI but also increased their fiscal burden. As a result, competition among these provinces has indeed become a "race to the bottom"...' (p28). This study focused specifically on tax incentives and the economic pay off. In contrast, Malesky (2004b) asked whether there was a political pay-off. He looked at tax incentives and ways of making the regulatory environment more business-friendly. His conclusion was that breaking fences had a political pay-off in that it paved the way for greater formal autonomy by the provinces.

In our own research we tried to ascertain why formal administrative decentralisation was eventually agreed upon in 2004. We interviewed a number of advisors and former officials who had participated in the preceding debate and decision-making process. It seems that the main reason was a pragmatic one: the Centre could not cope. Regulating the private sector in a way which is efficient for both sides requires procedures, skills, and expertise which the government did not have. Business–government interactions are many: registering a business, closing a business, providing infrastructure, health and safety clearance or customs clearance. Particularly challenging are the effective collection of taxes, the allocation of land and issuing licences to foreign enterprises. Business people were queuing in Ha Noi ministries for negotiation and approval of new projects and the queues were getting longer because interest in Vietnam was increasing.

The solution was obvious: shifting a lot of this administrative work to the provincial governments and letting them work out how best to deal with it. But it was not just an administrative issue. It was also a political issue. Central agencies resisted. Decentralisation meant giving up power in Ha Noi and reducing and re-organising the cadres of officials in the Centre, in particular the Ministry of Planning and Investment. Our interviewees stressed that this was painful and caused problems in the transition. But they also said that the Centre was happy to diffuse the political responsibility for working with private enterprises. The political risk of approving big projects comes to light when such projects go wrong. According to some of our respondents, failed projects contributed to the willingness of central government to cede more powers to the provinces.

Reflecting the difficult political process, formal decentralisation was not a result of one legal act but contained in several laws and spread over several years (including a pilot). The key step was Government Resolution 08/2004/NQ-CP which decreed administrative decentralisation to provincial government, in particular the transfer of decision-making and public management tasks relevant for private sector development. The authority to approve foreign investment projects was given to provincial governments step by step, culminating in the Unified



Investment Law, which came into effect in 2006 and enshrined equal treatment for domestic and foreign investors. Decree 108/2006/ND-CP provides additional specification of provincial government power and reserves for central government the approval of certain infrastructural and mining projects.<sup>3</sup>

Provincial agencies to which powers have been transferred can only carry out their tasks when they have the necessary resources and authority to make spending decisions. The extent and way in which fiscal decentralisation has occurred is therefore of key relevance. The Budget Law of 2002 (further specified in Decree 60/2003/ND-CP) was critical here in giving provincial governments more power over taxing and spending. The formula for sharing public revenue between central and provincial governments is complicated and has been modified over time but the essence of the Budget Law is clear. Provincial governments have an incentive for attracting enterprises and promoting their growth. Success in doing so means greater revenue – from certain taxes and fees – for the province.

The laws and decrees which regulate provincial autonomy have been and continue to be debated intensely, some arguing that they go too far and others that they do not go far enough. Not surprisingly many provinces seek additional powers, evidenced by their defiance of laws and decrees and continued fence breaking (documented in Vũ Xuân Thuýn 2010). Our report is not concerned with the contested margins of decentralisation. We are concerned with the core policy space which the decentralising laws and decrees provide to the provinces. There are many ways in which this space can be used and in which the economic reforms are carried out. We seek to understand who drives this process, concentrating on the period from 2005 onwards.

### 3.2 Joining the World Trade Organization (WTO)

The boundaries of the policy space which the Centre conceded to the provinces and the way the space is used have been influenced by the decision to join the WTO. This was more than a legal act. It was a symbol, intended to show that Vietnam was serious about integrating in the global economy. The message to people in the state-owned enterprises was that they can no longer count on the privileges of the past and need to compete internationally. The message to people in government was that they need to change their way of thinking from controlling private enterprise to promoting private enterprise. The decision to join the WTO meant there was a target date for changing rules and mindsets. The change in mindset, however, was very slow in the state-owned enterprise sector, fast in the private enterprise sector and uneven in the government sector (MPI 2010).

Vietnam was formally admitted to the WTO in January 2007, but it was the preparation for joining that brought about many changes of concern to us: the realisation that business registration and customs clearance is too complicated and

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<sup>3</sup> These were the culmination of earlier reforms. For overviews, see Malesky (2004b) and Vu Thanh Tu Anh *et al.* (2007).

time consuming for enterprises competing globally, that industrial zone models and one-stop shop models tried out in some provinces might have wider relevance, and that separate legal frameworks for foreign and local enterprises are not tenable. All this contributed indirectly to giving provincial governments greater powers, even though the WTO is not concerned with decentralisation of authority. The unified Investment Law of 2006, giving equal treatment to domestic and foreign investors and, *by implication*, authorising provincial government to approve all projects, was to some extent an outcome of preparing for full membership of the WTO.<sup>4</sup>

It also changed the incentives for provincial policymakers. Joining the WTO and corresponding internal legal changes signalled greater openness to the outside world and the need to compete in the global economy. Provincial leaders and government officials could enhance their career prospects by improving the investment climate. As we shall see later, this had a substantial effect on what provincial governments did and how they wanted to be seen.

### 3.3 Political control through the Communist Party

Vietnam's transition from centrally planned to market economy started in 1986. The first phase laid the institutional basis for private enterprise culminating in the enterprise law of 1999. However, the second wave of reform, coinciding with the first decade of the century, brought about an important qualitative difference. Powerful centrifugal forces were unleashed:

- The integration into the world economy: foreign investment increased in importance and local enterprises integrated into global value chains from outside the country.
- The decentralisation of the national productive sector (agriculture, industry and services): the number of formally registered private enterprises increased 15 times from 31,000 enterprises in 2000 to over 500,000 enterprises in 2010 (Le Duy Binh and Dau Anh Tuan 2010). In contrast, the number of state-owned enterprises (SOE) plummeted.<sup>5</sup>
- The decentralisation of government: as explained above, central government ceded considerable fiscal and administrative powers to provincial governments.<sup>6</sup>

With so many economic decisions taken outside the country and the multiplication of decision-making units inside the country, how could fragmentation be avoided and how could the ensemble be made to work for the country?

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4 The US–Vietnam bilateral trade agreement of 2000 had paved the way for the equal treatment of foreign and domestic enterprises.

5 This occurred partly because SOEs merged into conglomerates and thus retained influence.

6 A third phase seems to have started in 2011, characterised by taking stock of achievements and excesses and modifying the rules which govern the public and private sectors.

Vietnam is not the only country facing this situation. In many parts of the world, the solution would be seen in a combination of central government setting the overall framework and the market providing the coordinating and disciplining mechanism. This applies also to Vietnam but there is an additional political force which seeks to provide cohesion: the Communist Party. It retains the power of setting the directions of economic policy and approving key public appointments. Throughout the transition period it has shown a capacity for big debates and radical change.

While all public executives are members of the Party, it is important to distinguish between the public management and the political system both at national and provincial level. The chairman of the People's Committee is the chief executive officer of the province. The vice-chairmen and all heads of department report directly to the chairman. Their relationships with the provincial party secretary are important when controversial reform issues are confronted. In the provincial political system, the party secretary is the top position.<sup>7</sup> Transfer from chairman of the Provincial People's Committee to secretary of the Provincial Party is seen as a considerable promotion. The party secretary is usually a member of the Central Committee of the Communist Party at national level.

The Communist Party has thus political reach into the provinces and this matters for answering our central research question: who drives the reform process in the provinces? Playing a leading role in the reform process often means taking on controversial issues. It entails risks. The willingness and ability to take on risks is influenced by the position in the Communist Party and/or connections to key people in the Party. An insightful account of the first wave of reforms and the early fence breaking experiments suggests that 'the local leaders who launched this dynamic were actually high in the Party structure... Many of them were party secretaries at the provincial level' (Rama 2008: 27). As we shall see later on, the quality of relationships with(in) the Party continues to matter in the second wave of reform. They matter not in a day-to-day fashion but in terms of giving green or red lights for new initiatives.

In conclusion, the purpose of this chapter was to show how the national political and policy framework influences the space in which provinces operate. The aim was not to provide a complete list. For example, the Centre continues to intervene with specific old and new directives which are meant to provide guidance but sometimes create ambiguities and uncertainties in the provinces. We have concentrated on the key factors which define and influence the space for provincial level reform. Chapters 5 to 8 show how the provinces have used this space. The next chapter explains where the data for this analysis comes from.

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7 This is not to suggest that the party secretary alone can decide controversial issues. The Party has a principle of collective leadership. The final decision lies normally with the Party Standing Committee which includes the party secretary, the chairman of the People's Committee, the chairman of the People's Council and other provincial leaders. Alliances matter.

## 4 How we conducted our research: methods and sources

In order to unravel who drives economic reform in the provinces we combine economic and political analysis and draw on quantitative and qualitative information.

The assessment of improvements (and deterioration) in economic governance is based on panel data available for all provinces and for five years. The Provincial Competitiveness Index (PCI) captures the perceptions of domestic private investors about governance at the provincial level.<sup>8</sup> This index is available for each year from 2006 to 2010 in a disaggregated form by province and governance component.<sup>9</sup> Where appropriate and possible we draw on additional quantitative and qualitative information relating to earlier years.

The research on who drives these improvements in governance is based primarily on qualitative research in four provinces, two in the North and two in the South. We picked provinces which made substantial and sustained improvements, since the objective was to identify the contributions of the various actors to the improvement. The bigger the improvements the greater is the chance of identifying these contributions and capturing the political dynamic behind the change. In order to identify factors critical for success and failure we compared the successful provinces with provinces which were less successful.

Comparability is an issue because there are many factors that can influence improvements in governance. Propensity Score Matching helped us to identify provinces with similar endowments: human capital, infrastructure (roads and telephones), and distance from major cities (Malesky 2011). These steps led us to the selection of two pairs of provinces: Bac Ninh and Hung Yen in the North and Dong Thap and Ca Mau in the South. The selected Northern provinces are both in the Red River Delta and the selected Southern provinces are both in the Mekong River Delta.

The 2010 ranking of our four provinces shows clear differences in governance performance. The positions which they occupied in the total of 63/64 provinces were as follows: Dong Thap no. 3, Bac Ninh no. 6, Ca Mau no. 51 and Hung Yen no. 61. But as can be seen in Table 4.1, their rankings changed over time and it is these improvements (or deteriorations) we want to understand. Figure 4.1 visualises the changes over time.

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8 The Index is constructed by asking firms in every province questions about nine different aspects of the investment climate: Entry costs; Land access and tenure security; Transparency; Time costs of regulatory compliance; Informal charges; Proactivity of the provincial government; Business support services; Labour training; and Legal institutions. Sub-indices are constructed for each of these components and then combined to provide an overall indication of the quality of economic governance. See Chapter 10 for more details.

9 Both the collection and the processing of the data were carried out to high standards, conducted by the Legal Department of the Vietnam Chamber of Commerce and Industry and led by Dau Anh Tuan. The PCI was designed by Edmund Malesky who is an advisor of our research team.

**Table 4.1 PCI scores and rankings of four selected provinces, 2006–2010**

Province	PCI				
	2006	2007	2008	2009	2010
Bac Ninh	54.79	58.96	59.57	65.70	64.48
Ca Mau	43.99	56.19	58.64	61.96	53.57
Dong Thap	58.13	64.89	66.64	68.54	67.22
Hung Yen	55.97	57.47	57.53	61.31	49.77

Province	Ranking				
	2006	2007	2008	2009	2010
	(64 provinces)			(63 provinces)	
Bac Ninh	22	20	16	10	6
Ca Mau	57	29	18	22	51
Dong Thap	11	9	5	4	3
Hung Yen	16	26	20	24	61

Note: The PCI ranges from 0 to 100 with higher scores indicating better economic governance.

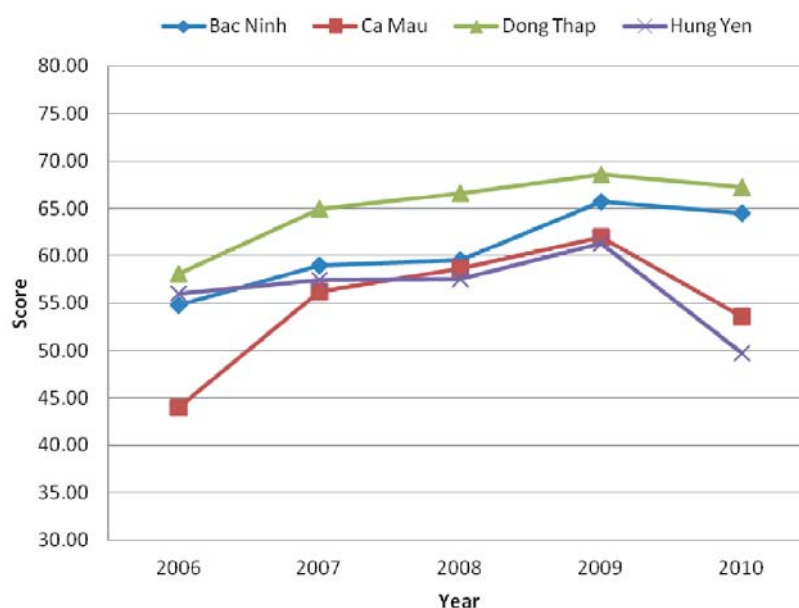
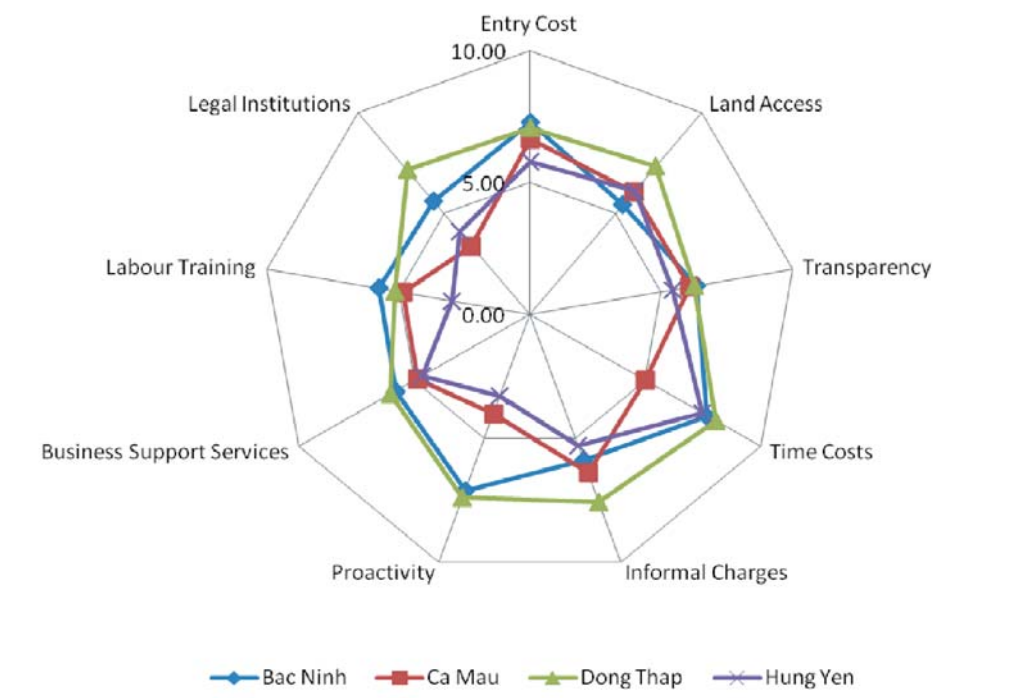
**Figure 4.1 PCI scores of four provinces, 2006–2010**

Table 4.1 and Figure 4.1 show the aggregate index. For each province and each year, we can decompose the picture and focus on particular components of the index.<sup>10</sup> For example, Figure 4.2 shows how the four provinces differed in 2010.

<sup>10</sup> The PCI components (sub-indices) are explained in detail in each year's PCI Report. See, for example, pages 3–4 of VCCI (2010). [www.pcvietnam.org/uploads/report/PCI%202010%20final%20report.pdf](http://www.pcvietnam.org/uploads/report/PCI%202010%20final%20report.pdf) (accessed 12 October 2011).

**Figure 4.2 Disaggregated PCI for four provinces in 2010**



Although Figure 4.2 confirms the good performance of Bac Ninh and Dong Thap, it shows that performance can vary considerably by component. For example, Ca Mau scores poorly on the quality of its legal institutions and the proactivity of its government, but its entry costs, transparency, labour training and lack of informal charges are similar to better performing provinces.

Unravelling the drivers of change was based on interviews. Careful selection of informants was important. The principle was that on most issues we would need to hear both the public and private sector and cross-check information within and across public and private sectors. In each province we talked to roughly similar numbers of government officials and business leaders, conducting a total of 121 interviews. Table 4.2 gives the breakdown according to ‘sector’: public, private, donor, media, experts. Table 4.3 gives the breakdown by province. It also includes the number of interviews carried out in Ha Noi – where we cross-checked information received in the provinces and gathered information on the Centre’s influence on the provinces.

**Table 4.2 Interviews by category**

Category	Quantity
Government	47
Enterprises	58
Associations	8
Experts	4
Donors	2
Media	2
<b>Total</b>	<b>121</b>

**Table 4.3 Interviews by province**

Province	Quantity
Bac Ninh	26
Hung Yen	26
Dong Thap	31
Ca Mau	24
Ha Noi	14
<b>Total</b>	<b>121</b>

The respondents are listed in the appendix but the report does not specify which person says what. We promised confidentiality in order to have a free discussion. And we did not use tape recorders. As a result most informants opened up but some more so than others. This is not surprising because the interviews probed into sensitive issues. Covering the period 2005–07 was much more difficult than discussing what happened during 2008–10 because of changes in leadership in both government and business.

Our interviews were conducted in the form of an open discussion but were structured around interview schedules which are included in the appendix. Each interview team had one person asking the questions and another taking notes and sometimes swapping roles in the process. In some cases the interview team included four people. Interviews led by Hubert Schmitz and Neil McCulloch had professional translators. Most interviews were led by the Vietnamese team members. The composition of the interview teams varied but overlapped both within and across provinces in order to share experiences and insights.

While the interviews are our prime and main source of information for understanding the differences between provinces and changes over time we have also drawn on secondary material which is referred to in the course of the report. The following four chapters show the findings for each of the four selected provinces. Subsequent chapters then compare and draw overall conclusions.

## 5 Findings from Bac Ninh

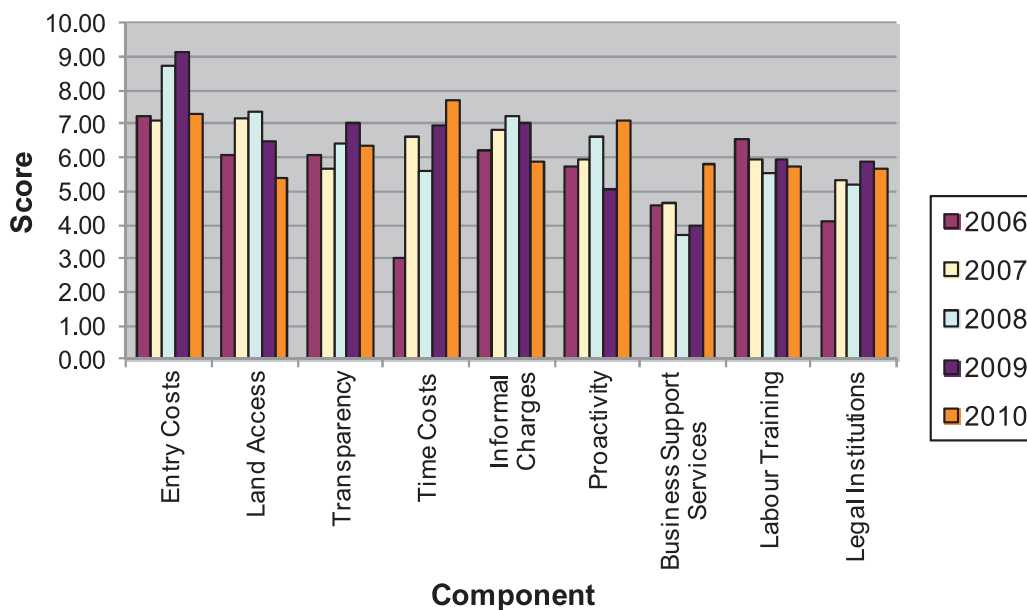
This province is located in the Red River Delta, bordering Ha Noi on the north-eastern side. We selected Bac Ninh because – if one wants to understand the drivers of reform – it is good to concentrate on a success story. Section 5.1 documents this success, Section 5.2 provides background information on the province and Sections 5.3 to 5.6 then discuss the drivers of economic reform in this province. Subsequent chapters on the other provinces follow the same structure.

### 5.1 Governance – the PCI scores

Bac Ninh's economic governance has improved steadily in the second half of the 2000s. Table 5.1 shows the aggregate changes and Figure 5.1 indicates how each component of the PCI changed over the years 2006–10.

**Table 5.1 Bac Ninh PCI: aggregate scores and ranking, 2006–2010**

	2006	2007	2008	2009	2010
PCI score	54.79	58.96	59.57	67.70	64.48
Ranking	22	20	16	10	6

**Figure 5.1 Bac Ninh: disaggregated PCI scores, 2006–2010**

The improvement of this province comes out more dramatically when it is seen in comparison with other provinces. The PCI ranking has improved year on year. Amongst the 63/64 provinces in Vietnam, Bac Ninh moved steadily up the ranks from no. 22 in 2006 to no. 6 in 2010 (Table 4.1).

## 5.2 Economic development

These reforms seem to have contributed to Bac Ninh's economic performance.<sup>11</sup> Table 5.1 shows the trends in economic growth and investment over the period.

**Table 5.2 Economic growth in Bac Ninh**

	2000	2001	2005	2006	2007	2008	2009	2010
Growth rates GDP (%)			n/a	15.1	15.7	16.2	12.5	15
Ranking GDP growth			n/a	7	7	4	7	5
Number of operating enterprises	363		1,120	1,273	2,394	2,162	2,394	2,652
Growth rates of taxes paid by enterprises (%)		7	38	22	91	23	91	52

Source: General Statistical Office.

<sup>11</sup> Another component of our project is examining the direction of causality between governance reform and economic growth (McCulloch and Nguyen, forthcoming).



Table 5.1 shows that Bac Ninh has had a high average annual growth rate of around 15 per cent over the period 2006–10.<sup>12</sup> The ranking of Bac Ninh – in terms of GDP growth – varied slightly over these years but moved up over the period from 7 to 5. The period 2000–10 witnessed impressive growth in the number of registered enterprises with around 100 enterprises in the year 2000, and then 40 times that number ten years later, reaching 4,300 registered enterprises in 2010 with registered capital of 22.6 trillion VND. Registered capital per enterprise more than doubled over the period 2006–10.<sup>13</sup>

Bac Ninh is also successful in attracting foreign direct investment. In 2010, the province ranked 13th out of 63 provinces nationwide and 6th in new licensed projects.<sup>14</sup> For the period from 1997 to September 2011 the province has had 312 foreign direct investment (FDI) projects, of which 308 are operative with total registered capital of 3,541.9 million US\$. The province has attracted foreign corporations such as Canon and Sumitomo from Japan; Samsung and Orion from Korea; Foxconn from Taiwan; Tyco Electronics from the United States; ABB from Sweden and most recently, a subsidiary of the Nokia Group from Finland. The FDI share in Bac Ninh's GDP increased from 7.7 per cent in 2001 to 9.7 per cent in 2006 and to 28.2 per cent in 2010. Its share in industrial production reached 49.8 per cent in 2010.<sup>15</sup> To attract local and foreign investment, Bac Ninh has planned 15 industrial parks and clusters with 7,525 hectares of land, of which ten parks and clusters were in operation in 2011.

In terms of sectors, Bac Ninh has a diversified economy but two sectoral specialisations have emerged. Foreign enterprises have invested mainly in the electronics sector as can be seen from the companies mentioned above. Local enterprises are particularly numerous in the handicraft sector.

### 5.3 Main driver of reform in the early stage

We seek to understand the forces which drive the reform process, primarily on the basis of interviews in the selected provinces. In Bac Ninh we focused these interviews mainly on the PCI component in which most progress was made: 'time costs of regulatory compliance'.

The interviews with business leaders confirm the big reduction in time costs. Our informants provided examples of how the time spent on complying with regulations, and the speed with which government officials responded to queries, has shortened over the years. Those informants with direct experience in other provinces also stressed that Bac Ninh was superior in this respect and that this influenced their investment decision in favour of Bac Ninh.

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12 In earlier years, Bac Ninh had also achieved stable and high growth. During 2000–03, GDP growth averaged around 14 per cent (Vo Trinh *et al.* 2005: 22).

13 Report by Bac Ninh People's Committee on 'Bac Ninh Development for the period 2006–2010'.

14 Source: MPI, Foreign Investment Agency.

15 Source: DPI Bac Ninh – <http://bacninhbusiness.gov.vn/Index.aspx>.

Views differed on the question of who initiated this process of reform. Some respondents stressed that the change came from within the government. Others felt that the change came from outside, notably the business side. And then there were those who felt that the public and private sector together brought about the changes. At first sight, some of these responses seem difficult to reconcile but by digging deeper we found that the responses were by no means contradictory. They reflect the different time periods which the respondents had in mind. In this section, we concentrate on the years 2005–06 when major reforms were initiated.

One of the department leaders with long and direct experience in the big decision-making processes emphasised that the business leaders played a critical role in initiating the reform process and pushing it forward. Informants from the private sector confirmed this. Interviews and discussions with a local business leader and with the president, vice-president and secretary of the Business Association helped us to understand what went on at the time. The private sector influence did not just take the usual form of business people lobbying or complaining individually. The provincial Business Association of Small and Medium Enterprises (SME) played an effective role in bundling the voices of its members and in channelling these voices into the governmental apparatus and processes. The critical institutional innovation was the establishment – by the Association – of an advisory committee which included both government and business people. Through this advisory committee, introduced in 2005, government officials were brought into the discussions with business people on a regular basis. And through this committee, business found a way of exerting influence on the direction, speed and contents of the reform.

For such committees to work effectively, both sides must have a direct interest in the outcome of the discussions. The interest of the business people is clear: they stand to gain from policies and regulations which provide clarity and increase speed. The interest of government officials in such reform is less obvious. The old rules and regulations might have given them power and the potential of ‘informal income’, but such incentives were soon superseded. The incentives for provincial leaders and government officials changed in Vietnam in 2005/6. As shown in Chapter 3 of this report, central government introduced changes in legislation which signalled greater openness to the outside world, underlined the need to compete in the global economy and brought provinces greater autonomy in economic regulation and taxation. Provincial leaders and government officials could enhance their career prospects and promotion prospects by promoting investment and supporting business in constructive ways. It seems that this new spirit influenced the provincial leader and government of Bac Ninh in 2005 and has continued to do so since then.

In summary, the decisive push in the early period came from the private sector, but – given the policy changes made by central government and embraced by the provincial government of Bac Ninh – the private sector did not have to push hard.

#### **5.4 The role of the provincial government**

Those informants who did not experience the changes in the middle of the decade and/or arrived later in Bac Ninh put more stress on the government as the driving force of the reform. They encountered a government which had already changed

and went out of its way in adopting an approach which stressed speed and flexibility. The most notable example was the manager of a Korean multinational company who stressed that, once the decision had been taken to invest in Vietnam, the attitude of the provincial government played an important role in opting for Bac Ninh. With only three years of experience in this province, he did not realise that the local (domestic) entrepreneurs had played a major role in earlier years in initiating the changes in attitude and regulation of the provincial government.

Distinguishing between periods of the reform process is clearly important. In the more recent years 2007–10, the provincial government has emerged as the main driver of reform. Interviews in both the public and private sector support this conclusion. It is particularly striking that in Bac Ninh all government departments have embraced the view that reform is never finished and that it requires continuous improvement. Business leaders testify to the enthusiasm and dynamism of the province's chairman and secretary.

Amongst the department leaders we noticed that some, notably the leaders of the Department of Planning and Investment (DPI) and the Management Board of Industrial Parks, push the process forward, whereas others see it as their responsibility to implement the orders given from above. The latter did not seem reluctant implementers. It was striking that across the many interviews we carried out in a range of government departments (detailed in Appendix 3) there were no dissenting voices. As we shall see later, they recognised problems in the implementation process but such observations did not question the direction of reform. Responses to our follow-up questions showed that, where problems arose, they did not lead to questioning the direction of reform; the efforts went into solving the problems. While some department leaders exerted more influence than others, partly due to position, partly due to personality, they seemed united in advancing the reform.

Such unity in government is not what we expected. For example, Martin Gainsborough (2010: 180) who studied provincial government in some detail, stresses:

Perhaps the first thing to note about the state in Vietnam is the highly particularistic nature of different institutions, offices and personnel which we commonly regard as comprising 'the state'. That is, what comprises 'the state' rarely moves in the same direction, rarely works together, and rarely sings from the same hymn sheet.

This is not what we found in Bac Ninh province. One of the reasons for this relative unity in Bac Ninh seems to lie in the way in which the Communist Party binds together the players relevant for this province. We heard frequent references to the constructive ways in which the Communist Party, the People's Committee and local government departments overlap and interact in this province.

There are two aspects to the role of the provincial government in Bac Ninh which deserve highlighting. The first concerns the continuity in personnel. Since 2005, the province has had only two chairmen of the provincial committee and the current chairman was previously deputy chairman. The second feature concerns the way they carried out their work: they made the pro-business direction of

reform very clear and maintained a hands-on approach. They did not issue many legal documents and were not afraid of using discretion. According to themselves and others who observed them, they were not afraid of change, were open to suggestions from business, and willing to take risks. In the words of the chairman of the People's Committee, the changes in the business environment of Bac Ninh are driven by 'the ambition of provincial leaders, but under pressure from business'.

As mentioned earlier, the greatest progress was made in the 'time costs of regulatory compliance'. These improvements seem to have benefited from support provided by the International Finance Corporation (IFC) for streamlining administrative procedures. IFC projects focused on the simplification and transparency of the process of business registration, unification and simplification of procedures for land access, investment and construction. While it is difficult to determine how much difference this external support made on the ground, the willingness to take part in this IFC project is a further indicator of the government's reform ambition.

## **5.5 The role of business in the reform process**

Local enterprises, through their business association, were a driving force in the reform process in the early period, namely 2005–06. This was set out in section 5.3. In this section we discuss the years since then. In these more recent years, a more complicated picture has emerged. To some extent this is unavoidable since some formerly small local enterprises have become large and other large enterprises have come from other provinces and other countries. We know from the international experience that increasing differentiation between enterprises in terms of size and sector makes collective representation more difficult. Participation in the reform process therefore does not occur in a uniform way. This became clear in the interviews. When large enterprises want government support, their owners or managers speak directly with the directors of the relevant department – or even the (vice-) chairman of the People's Committee.

Informal contact between big business and government leaders is common, taking place over the phone, or face to face in the office of the government official and sometimes followed up over lunch or dinner in a restaurant. Both sides talked about these interactions openly. For government it was a way of finding out what mattered to business and for business it was a way of resolving their problems quickly. Such informal discussions – often arranged at short notice – were thought to be more effective than formal occasions. In spite of this easy and direct access to government, large enterprises are not the dynamo of the reform process. Their role is one of making suggestions and requests, some of which might contribute to general improvements. They recognise that they are dealing with a government which has a clear vision and is in the driving seat.

The direct and informal route is not open to small enterprises. Their access to government is different in two respects. First, they need to work through their local association. Second, when they have direct contact with government officials they meet with lower ranking officials. Let us explain.

The business association, which was so important in the early stage, no longer plays a major convening role. It continues to bundle the suggestions and concerns of small and medium enterprises and discuss them with the provincial government but its influence is hard to judge. The vast majority of enterprises can only make their influence at the district level. Their association is organised at district level. In turn the district-level association deals with the district-level government. In many respects this is entirely appropriate. Many issues concerning the small enterprises' business environment are best resolved at district level. However, it is striking that large enterprises tend to take their concerns straight to the (more powerful) provincial level government and the leaders of the People's Committee or department.

In contrast, small enterprises, if they have direct access at all, deal with lower or middle-ranking government officials. The latter are often less business-friendly, are less good at listening and less willing to explore mutually acceptable solutions. Department leaders are aware that their lower ranks do not necessarily embrace the leaders' views and practices. When asked about forces which slow down the progress of reform, some department leaders admitted that lower ranks of their own departments are sometimes the main problem. They admitted that they needed to invest more in training and changing the outlook of the lower level officials. Small enterprises seem to suffer from this more than the large ones do. This explains why small enterprises are more critical of the reform efforts of government and see little chance of influencing the pace or content of reform. In the words of the owner of one small business, the biggest drawback to the business environment in Bac Ninh is 'the difference between the ambitions of the leaders and the performance of subordinate staff'.

It seems important to acknowledge this difference in current perceptions and difference in current roles of small versus large enterprises. Government likes to portray the view that the investment climate has improved for all enterprises and that all enterprises have a way of contributing to this improvement through dialogue and pressure. Interviews in the private sector indicate that this is not quite how it works and how it is seen. This is also borne out by the 2010 PCI survey. Of the 101 respondents in Bac Ninh, 43.6 per cent felt that the provincial government prioritised FDI attraction over private sector development.<sup>16</sup>

## 5.6 Divisive issues

The unevenness and difference became even clearer when discussions turned to the issue of access to land. The 2010 PCI survey indicates that 70.4 per cent of Bac Ninh respondents felt that government favoured foreign enterprises in the allocation of land. Our interviews suggest that the bias extends to large national enterprises whereas small enterprises lose out. In order to attract large investors, the provincial government made land available at favourable prices. Often this involved taking land away from local farmers who would receive only modest

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<sup>16</sup> Source: PCI database of VCCI.

compensation. While this in itself created tension, the tension mounted when the buyers of this land did not make the promised investment and did not create the promised jobs. According to the Justice Department, such cases lead to difficulties in implementing clearance policies in the future. In this way, some large investors are holding back rather than moving the process of reform forward.

This sensitive land question brings up a wider issue. The case of Bac Ninh shows that reform is an ongoing process which requires cooperation between government and business. In the early period, business was the main driver and in the later period the government was the main driver. For the process to continue, both sides need to keep their promises. There is a deal. Government improves the conditions for business and business is expected to improve the conditions for government to do its job. What matters most for government is public revenue that comes from taxes paid by business. This is where the deal breaks down sometimes. A number of enterprises have been able to avoid or minimise tax payments. In particular, some foreign enterprises have paid little tax in spite of high profitability. They have been able to do this by shifting costs and profits between subsidiaries/headquarters (transfer pricing) and other mechanisms. Such practices have attracted a good deal of attention in Vietnam generally, and in Bac Ninh province in particular.<sup>17</sup> SME owners expressed strong misgivings during the interviews, stressing that this taxation issue – like the land question – has increased the tension between foreign and local enterprises. Similarly, some government officials felt that the tax avoidance by foreign enterprises undermines the business-friendly reforms that government has been pushing forward energetically.

In summary, we heard from both the public and private sector in Bac Ninh that business continues to play a constructive role in the reform process by drawing attention to problem areas. This takes the form of complaining, lobbying and frequent dialogue with government leaders and officials. However, some enterprises are abusing the business-friendly reforms by hoarding land acquired on preferential terms or by avoiding taxation in spite of successfully operating in Bac Ninh. This leads to tension between local and non-local enterprises and tension between government and enterprises. It threatens to undermine the reform process.

It is already leading to the perception amongst local small enterprises that the provincial government is too close to large enterprises, in particular foreign enterprises. We heard of suspicions of corruption but find it difficult to make a judgement of how important this is in the differential treatment of large and small enterprises. The disaggregate PCI data suggests that there is a problem of enterprises paying 'informal charges'. While Bac Ninh's overall rank in 2010 was no. 6, in the sub-index 'informal charges' Bac Ninh ranked no. 47. And with regard to land policy it ranked no. 46. These low rankings in the sub-indices confirm the concerns expressed above.

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17 See, for example <http://vietnamnews.vnagency.com.vn/Economy/Business-Beat/197649/foreign-firms-post-losses-to-avoid-taxes.html> <http://vietnamnews.vnagency.com.vn/Economy/Business-Beat/197649/foreign-firms-post-losses-to-avoid-taxes.html> (accessed 15 April 2012).

## 6 Findings from Hung Yen

Like Bac Ninh, this province is located in the Red River Delta, but it borders Ha Noi on the Southern side. We selected Hung Yen, because in its structural characteristics<sup>18</sup> it is comparable with Bac Ninh. Hung Yen's PCI scores, however, developed differently, starting off better than Bac Ninh but then declining (see Table 6.1). The expectation was that this contrast would yield new insights.

### 6.1 Governance – the PCI scores

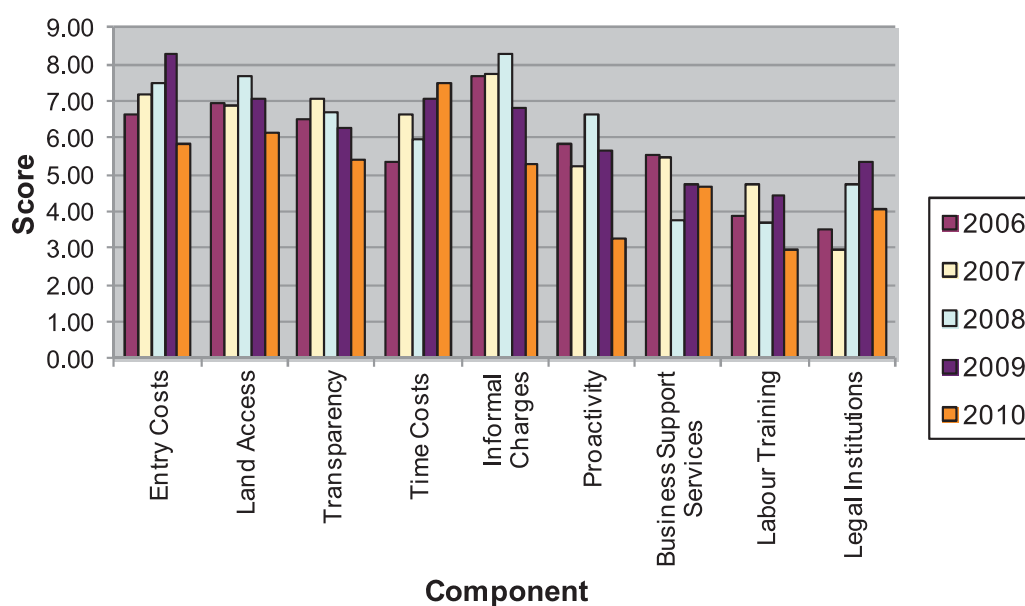
Hung Yen's PCI scores were comparatively good in 2006, ranked 16th in Vietnam and second in the Red River Delta, higher than Bac Ninh. This was not a one-off, similarly good results had been achieved in 2005 (TAF-VCCI 2005a). However, the ranking declined in subsequent years, slumping to 61st (out of 63 provinces) in 2010. This suggests an alarming recent decline – as perceived by business – which we will seek to explain in this section.

**Table 6.1 Hung Yen PCI: aggregate scores and ranking, 2006–2010**

	2006	2007	2008	2009	2010
PCI score	55.97	57.47	57.43	61.31	49.77
Ranking	16	26	20	24	61

Table 6.1 shows the aggregate PCI score for the years 2006–10 and Figure 6.1 shows that the poor performance in 2010 did not extend to all PCI components. There were considerable variations. As in Bac Ninh, Hung Yen's best performance in 2010 was in 'time costs' which meant rank no. 3 in the Red River Delta.

**Figure 6.1 Hung Yen: disaggregated PCI scores, 2006–2010**



<sup>18</sup> These structural characteristics include initial wealth, population size and density, urbanisation, education, infrastructure, distance from major cities, and economic structure of the region in which the province resides (Malesky 2011).

## 6.2 Economic development

Economic growth in Hung Yen has been remarkably stable over a long period. During 1998 to 2003, the GDP growth rate was about 12 per cent (Vo Tri Thanh *et al.* 2005: 63). It continued at an average of 12 per cent over the period 2006–10 but dipped to 7 per cent in 2009. The ranking of Hung Yen – in terms of GDP growth – declined from 12 to 25 (see Table 6.2).

**Table 6.2 Economic growth in Hung Yen**

	2000	2001	2005	2006	2007	2008	2009	2010
Growth rates GDP (%)			n/a	13.7	13.8	12.3	7.0	12.1
Ranking GDP growth			n/a	12	15	16	38	25
Number of operating enterprises	224		719	809	1,080	1,355	1,605	1,847
Growth rates of taxes paid by enterprises (%)		-50	40	-20	131	61	-3	87

Source: General Statistical Office.

Starting as a largely agricultural province, Hung Yen has restructured fast over the period 2000–10, with industry, services and agriculture accounting for 45 per cent, 31 per cent and 24 per cent of GDP respectively.

Like Bac Ninh, Hung Yen had around 4,000 *registered* enterprises by the end of 2010. Considering that the province had only 90 enterprises in 1997, this suggests rapid growth. In terms of attracting foreign direct investment, Hung Yen ranked 14th in 2010 (compared with Bac Ninh 13th – according to FDI data of the GSO). By the end of 2011, Hung Yen had 213 FDI projects in operation with total registered capital of 1,880 million US\$ of which 550 million US\$ were outside industrial parks and 1,330 million US\$ in industrial parks.<sup>19</sup> The province has attracted big foreign companies such as Sumitomo, Canon, Pulpy Corelex from Japan and Cargill from the USA. The biggest number of FDI investors were from Japan (35 projects with total registered at 808 million US\$), the second biggest was Korea (29 projects), followed by the Netherlands and China. In the early 2000s, Hung Yen was renowned for attracting large-scale domestic investment from other provinces.

## 6.3 Ups and downs in reform

Before analysing the process of economic reform in this province, let us be clear about what we are trying to explain. As shown above, Hung Yen did well in the PCI of 2005 and 2006 and then lost out in subsequent years. In other words, we need to explain both the early success and later decline.

<sup>19</sup> Source: <http://hungyen.gov.vn/vi-vn/Pages/Article.aspx?ChannelId=354&articleID=10833> (accessed 15 April 2012).



Figure 6.1 suggests that there is no absolute collapse in the quality of economic governance. The contours of Hung Yen's PCI performance are fairly similar over the years. (The partial exception is 2010 when the scores for some PCI components were visibly lower than in previous years, but this poor performance has its own exception, namely the improvement in the component 'time costs' which results in Hung Yen being on a par with Bac Ninh.) The key point is that Hung Yen has declined relative to other provinces. The strength of the PCI data set for 2006–10 is that – in addition to tracing absolute changes within each province – we can observe how each province is doing in relation to others. This is where the alarm bells go off because Hung Yen has slumped to 61st out of 63 in 2010.

This is in stark contrast to half a decade earlier. Hung Yen was a strong performer in 2006. This strong early performance is supported by data for 2005 when a pilot study of the PCI was carried out. Out of nine provinces in the Red River Delta (all within a three-hour car drive from Ha Noi), Hung Yen occupied second place (TAF-VCCI 2005a). Further evidence of a qualitative kind comes from a study of best practices carried out by Edmund Malesky and Dau Anh Tuan in 2005 (TAF-VCCI 2005b). Several of the examples of best practice (exemplary at that time) came from Hung Yen. These included: discarding superfluous procedures in business registration, clear posting of registration procedures, expediting customs procedures, experiments in land allocation, clear documents on various aspects of provincial financial and land clearance policies, openness about likely future changes in policy, inter-departmental coordination of factory inspections, working with the media to make information on legislative and policy changes accessible (TAF-VCCI 2005b). Many problems remained (some of them inherited from the era of state socialism) but Hung Yen was one of the pioneers in reforming the investment climate in the first part of the decade. Our task in this section is to understand who was behind this reform. Who drove it forward? And who or what caused the relative decline?

Explaining the early success turned out to be more difficult than explaining the subsequent decline. The reasons are first, there was a high turnover of provincial and department leaders which made it difficult to identify government officials directly involved in the reform process in the early years. Second, the private sector was not well organised and memory of the private sector role was weak. Third, foreign technical assistance played a role in the early success but the foreign experts involved have dispersed around the globe. Nevertheless, we can piece together a picture of what happened based on interviews and supporting material.

#### **6.4 The role of government**

Most respondents in the public and private sector suggested that the central government played an important role in providing 'overall orientation'. In other words, central government gave overall direction and set boundaries. The direction was clear: Vietnam should integrate into and compete in the world economy, the private sector should play a key role in this process, and provincial governments should find effective ways of supporting the private sector. We have set out in Chapter 3 how this influenced the motives and incentives for provincial leaders

and department heads. These changes in the overall political framework and incentive structure, carried out mainly in the first half of the decade, applied to all provinces in Vietnam, so they cannot explain why Hung Yen did particularly well in 2005–06.

The interviews suggest that at that time the provincial leader and head of the Department of Planning and Investment were particularly dynamic and played an important role. They provided leadership in the reform process. It seems that the political space provided by this leadership was filled with reforms on the ground partly because a foreign assistance agency came in with financial resources and technical expertise. The foreign agency was GTZ (now renamed GIZ) from Germany and the political counterpart was the Ministry of Planning and Investment. GTZ brought in new ideas of how to promote local economic development and how to adopt a value chain lens and thus bring out the importance of making procedures more efficient and rapid.<sup>20</sup> This seems to have contributed to the reforms undertaken in 2005 and 2006 but we do not have firm evidence for this.

The problem was that the early dynamism was not maintained and disappeared by 2010. Discussing the reasons for Hung Yen's relative decline with our respondents was not difficult. Because of the poor performance in 2010 a lot of soul searching went on in Hung Yen as to why this happened. The interviews suggest that there was no single reason but confluence of several contributing factors.

First, the central government gave clear overall directions but in a number of areas the policy directives coming from the Centre are not clear or interfere with provincial policies causing confusion and slowing down the process of reform. Such problems arise because the decentralisation of economic governance from the Centre to the provinces has been pushed through politically but laws and regulations are still catching up. The resulting confusion and lack of coordination between central and provincial level is a challenge for all provinces. The question therefore is why it was not managed well in Hung Yen.

Second, the reason why this lack of clarity was not managed well lies in the frequent changes in provincial leadership. Senior personnel of the provincial government changed three times between 2005 and 2010. This meant disruption and loss of expertise at a time of rapid economic transformation and political decentralisation. Sustaining reform requires good relationships between levels of government, between departments of government, with the Party Committees and with the private sector. Frequent changes in key personnel make this difficult. The interviews make clear that the problem was not a lack of ambition or lack of ideas of those who were in charge. The problem was that they were not in power for long enough to build the support networks required to implement the changes.

Third, in a situation of frequent changes at the top, it becomes particularly important to have capable middle and lower cadres embracing the spirit of the reform and acting accordingly. Frontline workers need to take initiative and resolve

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20 VCCI was acting as local coordinator for the Local Economic Development and Value Chain components of this GTZ project.

issues because regulations and procedures are not yet clear (to be expected in a process of rapid reform). The interviews suggest that this was not happening. In the words of one of our respondents, they 'kicked the ball to each other' instead of finding solutions. This problem arose in particular when contributions had to come from more than one department. The interviews in both the public and private sector suggest that coordination between departments was often poor, for example, too many inspections were carried out with similar content or problems were only half resolved because staff did not liaise across departments.

Fourth, the relative decline which followed the excellent start in Hung Yen might also be due to the way the reform was conceived. This is difficult to judge but with hindsight we can say the brave initial reforms remained shallow. The policy directives sought reform but there was no plan for what to do within the new policy directives. There are various indications for this: a master plan for industrial development was missing. Investment projects were approved but not carried out by the private sector because complementary services were not provided. Infrastructure was provided along the main roads but not further inland leading to main arteries clogging up. Scheduled meetings between government and business took place just once a year whereas other provinces had such meetings every month.

## 6.5 The role of the private sector

The private sector was and remains poorly organised and has played only a very limited role in the reform process. Interviews in both the public and private sector agree on this point but suggest also some nuances to this overall picture.

We need to distinguish between local and foreign enterprises because they tend to have different channels for exerting influence. Local enterprises seek influence mainly through their business association. Foreign enterprises do this mainly through the management board of the industrial park, in which they are located, or through direct contact with government. Many participants in the 2010 PCI survey indicated that government was biased towards foreign enterprises. Of the 92 respondents from Hung Yen, 40.2 per cent felt that the provincial government prioritised FDI attraction over private sector development; and 70.2 per cent expressed that land allocation was biased in favour of foreign investors.<sup>21</sup>

The main collective organisation for local enterprises is the Hung Yen Business Association which was set up in 2004 with support from the VCCI. At the time of the fieldwork (June 2011), this association had 1,238 members, mainly local enterprises but surprisingly also some government departments, including the Department for Planning and Investment and the Industrial Zone Authority. The interviews suggest that the association arranged meetings with government officials and workshops on policies and thus provided opportunities for communication between the public and private sectors and for learning about each others' problem. However, neither public nor private sector respondents judged it to be effective in terms of influencing the reform process. The main reason, it seems, is the lack of

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21 Source: PCI database of the VCCI.

professional staff and organisation. This view from our respondents is supported by an evaluation of Hung Yen's Business Associations which compares them with associations in other provinces (GTZ-MPI 2008). The evaluation gave the Hung Yen Business Association low overall scores (using multiple criteria).<sup>22</sup> The disaggregated score provides useful additional information: the main association scored particularly poorly on 'number of staff', 'quality of staff', 'governance' and 'governmental influence'.

Foreign enterprises rarely participate in local or provincial business associations but sometimes are members of the national associations organised according to country of origin (for example, the Korean Business Association) or sector (for example, the Vietnam Steel Association). When it comes to influencing provincial level rules and policies, they tend to work through the organisation which manages the industrial zones in which they are located. For example, the 'Thang Long II' Industrial Zone is managed by Sumitomo from Japan which established a good relationship with the provincial leadership. The start up of this industrial zone was exceptionally fast. Government procedures and ground clearance were dealt with in two months whereas other zones take two years to get ready. Some national enterprises from other provinces have also invested in Thang Long II, which has become an island of effective governance for industrial development. This shows that large foreign and national enterprises can use their influence to get into the fast lane and that this influence provides advantages to a select few, not contributing necessarily to general improvement.

Overall we can conclude that the private sector contributed little to improving economic governance in the province of Hung Yen. Foreign enterprises benefited from the 'red carpet' treatment by government but this only led to selective benefits and not to general improvements in governance. Local enterprises can channel their concerns through the business association but the organisational capacity of this association was and remains too weak to exert much influence.

## 6.6 Divisive issues

There is a sense amongst small and medium-sized local enterprises in Hung Yen that their concerns are neglected by provincial and district government. In a way this is hardly surprising given that these enterprises have no effective collective voice. Their poor organisational capacity explains to some extent the neglect by government. But there are other reasons.

Respondents from within the government admit that they have given most attention to big projects proposed by big enterprises from outside the province. The reasons are easy and not specific to Hung Yen. Concentrating on attracting a few large enterprises is easier than fostering a multitude of small enterprises. Big projects promise a visible way of pushing up the tax revenue for government. The problem is that the tax revenue is often not forthcoming, either because – in the course of

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<sup>22</sup> The overall scores were even lower for other business associations in Hung Yen Province.

the negotiation – government ends up granting tax exemptions in order to fight off the competition from other provinces. Or big enterprises have ways of concealing profits by operating in multiple locations and enlisting the services of accountants who help them to minimise tax payments.

The issue that causes most resentment amongst local enterprises is the preferential access to land given to enterprises from other provinces or countries. In a number of cases the outside investors implemented the projects on a smaller scale and for a shorter period than promised in order to take advantage of opening incentives and then transferred the land to others at a highly profitable price. Such practices are not unique to Hung Yen but are particularly problematic in an environment of declining trust between local and non-local enterprises and between business and government.

## 6.7 Learning from success?

The objective of this report is not just to analyse and understand. We also look for practical ways forward arising from positive experience. In this respect, it is important to consider Hung Yen's own success story. As can be seen from Figure 6.1, Hung Yen obtained a high score in one of the PCI components, namely 'time cost'. The score of 7.47 in 2010 is very similar to that of Bac Ninh.

The interviews confirm the considerable efforts made to reduce the time cost of dealing with government. The provincial government introduced a regulation for all departments providing or withholding awards for complying with 'Scheme 30'. The government established a division focused on this piece of administrative reform in 2007.<sup>23</sup> The government of Hung Yen also published the full administrative procedures under the jurisdiction of all departments and provided online access.<sup>24</sup> These initiatives seem to have resulted in a good performance with regard to time cost.

## 6.8 Comparing Bac Ninh and Hung Yen

The comparison underlines that reform cannot be achieved by one-off jumps forward. Reform is a process of continuous improvement. It takes time for the details to come together, especially where coordination of different levels of government and different departments of government is needed. Constant improvement is needed because other provinces are also improving.

Bac Ninh had two things that were lacking in Hung Yen:

- 1 Organisational capacity of the private sector. This was decisive for getting the reform process underway. Local private enterprise was the main driver in the early phase.

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23 Decree No. 30/QĐ – TTg, dated 10 January 2007, approved the project to simplify administrative procedures in the fields of state management for the period 2007 to 2010 (Scheme 30).

24 See [www.hungyen.gov.vn/vi-VN/hdtthc/Pages/Default.aspx](http://www.hungyen.gov.vn/vi-VN/hdtthc/Pages/Default.aspx) (accessed 15 April 2012).

- 2 Continuity in leadership. This enabled Bac Ninh to turn unclear orientation from the Centre into advantage for the province.

Both Bac Ninh and Hung Yen have two problems in common:

- 1 Implementation of reform is slowed down by middle and lower-level cadres. In both provinces, there is a problem of frontline workers not always carrying through what the leaders promise.
- 2 The private sector is increasingly divided into large and small. Government has contributed to this by giving large enterprises preferential access to land and other resources and granting tax exemptions. Large enterprises exploit the reform ambitions of provinces through illegitimate land acquisition and tax avoidance.

Policy implications for the private sector:

- 1 If the private sector wants more effective governance, it needs to organise. The organisational capacity of the private sector is essential for influencing the reform process.
- 2 The activities of the SME Association of Bac Ninh during 2005–07 provide a best practice example of engaging government officials in discussions on how to improve governance and industrial policy.

Policy implications for government:

- 1 If the government wants more effective economic governance, it needs to provide better training to lower and middle-level officials.
- 2 A study should be commissioned which compares the tax burdens for small, medium and large enterprises, concentrating on actual tax payments and taking into account tax exemptions.
- 3 A study should be commissioned which examines whether and how small and medium enterprises are disadvantaged in the process of land acquisition.
- 4 Best practice of repossessing cleared land that remains un(der)used should be studied and applied.

Policy implications for the Communist Party:

- 1 There seems to be rising inequality between upper, middle and lower ranks in the civil service in terms of both training opportunities and earning opportunities. It would be useful to have a debate on whether the implementation of reform would be more effective by improving the opportunities of middle and lower level staff. Experimentation in selective provinces and departments would be particularly useful.
- 2 Provincial governments on their own cannot deal with excessive tax exemptions and land acquisition for speculative purposes. These two issues contribute to negative competition between provinces, distort competition between enterprises and diminish public revenue. Breaking out of this downward dynamic requires intervention by the Party with both punitive and educative measures.

## 7 Findings from Dong Thap

Since North and South Vietnam have different histories, we selected two Northern and two Southern provinces for in-depth research. The pair of Southern provinces is Dong Thap and Ca Mau for which the findings are presented in Chapters 7 and 8 respectively. Both these chapters are driven by the same questions and follow roughly the same structure as the two previous chapters on the Northern provinces.

The province of Dong Thap is located in the Mekong River Delta, 165km south-west of Ho Chi Minh City, bordering Cambodia. We chose this province for our research because we wanted to learn from a Southern success story that is not part of the Ho Chi Minh industrial region.

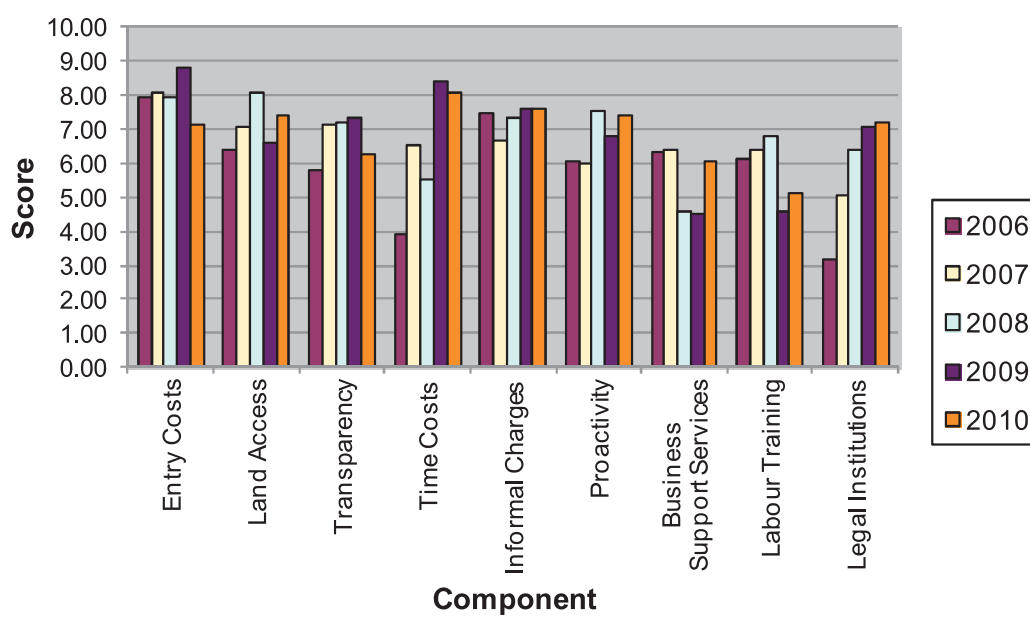
### 7.1 Governance – the PCI scores

This small province, far away from the political and economic centres of the country, has been able to achieve high scores in all five PCIs carried out so far. And its ranking has improved consistently over time such that it occupied third place amongst Vietnam's 63 provinces in 2010 and first place in the Mekong River Delta. Figure 7.1 shows that Dong Thap achieved its highest scores and its greatest improvement over time in the PCI component 'time costs'.

**Table 7.1 Dong Thap PCI: aggregate scores and ranking, 2006–2010**

	2006	2007	2008	2009	2010
PCI score	58.13	64.9	66.64	68.54	67.22
Ranking	11	9	5	4	3

**Figure 7.1 Dong Thap: disaggregated PCI scores, 2006–2010**



## 7.2 Economic development

In analysing the forces which drove this improvement in the PCI, we need to draw attention to a big difference between Bac Ninh – our success story in the North – and Dong Thap – our success story in the South. Their economies are very different. Unlike Bac Ninh, Dong Thap has virtually no big business, neither national nor foreign. The only exceptions are state-owned enterprises such as Petrimex and Domesco. There are only three medium-sized foreign investors. With few exceptions, the economy consists of national enterprises of medium and small scale.

Taking advantage of two branches of the Mekong River, this is an agricultural province, producing in particular rice, tropical fruit, flowers, and fish. Its industry is engaged in agricultural processing: rice processing, cattle feed manufacturing and fish processing. The share of agriculture to GDP remains high at a level of 40.8 per cent in 2010 while industry and construction took 26.5 per cent and the service sector took 32.7 per cent.<sup>25</sup>

While mainly an agricultural province, Dong Thap has been able to average annual growth rates of slightly above 14 per cent during 2006–10, as shown in Table 7.2. The number of *registered* enterprises almost doubled from 1,436 to 2,852 in 2010, with total registered capital amounting to VND 14,387 billion.

**Table 7.2 Economic growth in Dong Thap**

	2000	2001	2005	2006	2007	2008	2009	2010
Growth rates GDP (%)			n/a	14.3	15.8	16.6	11.1	13.0
Ranking GDP growth			n/a	10	4	3	13	12
Number of operating enterprises	853		990	1,005	1,097	1,446	1,583	1,497
Growth rates of taxes paid by enterprises (%)		-4	25	28	21	43	13	22

Source: General Statistical Office.

The Dong Thap government is aware that offering good economic governance is not sufficient to attract new investors. It has therefore planned six industrial parks, three of which have large scale infrastructure for both road and water transport. For these parks, 58 projects have been approved, of which 32 are up and running and a further 17 are in different stages of preparation. While the share of private domestic and foreign investment in total investment has varied between 68.8 per cent in 2006 and 62.7 per cent in 2010, in absolute value the investment of the private sector has increased 1.6 times over this period.

<sup>25</sup> [www.dongthap.gov.vn/wps/wcm/connect/Internet/sitdoanhngghiep/sitakinhtexahoi/sitabaocaokinhte/20110128+tin+hinh+kinh+te+xa+hoi](http://www.dongthap.gov.vn/wps/wcm/connect/Internet/sitdoanhngghiep/sitakinhtexahoi/sitabaocaokinhte/20110128+tin+hinh+kinh+te+xa+hoi) (accessed 15 April 2012).



Dong Thap's excellence in rules and regulations does not extend to infrastructure. Amongst Vietnam's 63 provinces, Dong Thap 'only' occupies rank 16 in the 2010 infrastructure index. While higher than in most other provinces, this rank is much lower than the PCI rank – which was no. 3 in 2010.<sup>26</sup>

### **7.3 The role of the private sector in governance reform**

Dong Thap's PCI performance is impressive: consistently high and consistently improving. In this section we ask whether and how the private sector has contributed to this achievement. In order to answer this question we need to distinguish between big and small business.

#### ***7.3.1 The role of large enterprises***

As indicated earlier, Dong Thap has only a few large enterprises. We investigated the role of those few by talking to their leaders and talking to others about their role. The result is clear: the large enterprises appreciate the reforms which the government has implemented, they have easy access to the leaders and departments in government, but they contribute little to the policy process at provincial level.

This is particularly clear in the case of two quite large enterprises specialising in catfish processing and fish food. They have not joined the local business association, do not seem to participate in debates on the provincial policy and seem to concentrate entirely on their own enterprises. This does not mean that they do not care about what the provincial government does. On the contrary, their decision to invest in Dong Thap was influenced by the efficiently administrated procedures and easy direct access to government when specific issues needed to be resolved.

These enterprises do, however, contribute to the policy process at national level. According to some department heads, large enterprises in Dong Thap are active members of national business associations, such as the Vietnam Food Association, the Vietnam Animal Feed Association and the Vietnam Association of Seafood Exporters and Producers. In contrast, they show less interest in the provincial business association. They have quick and easy individual access to relevant government officials in their province. This seems to be the main reason for them contributing little to the collective organisation of business in Dong Thap. They are not active and do not need to be active in provincial business associations.

#### ***7.3.2 The role of small and medium-sized enterprises***

In contrast to the large enterprises, small and medium-sized enterprises have played an active role in the provincial reform process. They have contributed in many specific ways to the changes in rules and regulations, helping to make them relevant and practical for their realities. The main driver of the reform process, however, was the provincial government.

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<sup>26</sup> The infrastructure index is a separate measure and not a sub-index of the PCI (VCCI 2010).

The period 2005–06 was critical. This was when the reform process received a big push forward. The push came from a provincial government acting upon the directives and signals from the Centre. As set out in Chapter 3, the message from the Centre was that raising competitiveness and fostering economic growth would be rewarded. Even though Dong Thap is far away from Ha Noi, this message was embraced by the provincial leaders, keen to transform their province but building primarily on local entrepreneurship. We explain later (Sections 7.4 and 7.5) how and why the provincial government made use of this political space.

Our informants from both the public and private sector agree that the small and medium enterprises contributed substantially to the details of the reform but had little influence over the direction and timing of the reform. According to the Provincial People's Committee (PPC) and department leaders, SMEs contribute to improvement of rules and regulations through five different channels:

- 1 Submitting letters or documents directly to the PPC. This can be submissions from individual enterprises or the association.
- 2 Submitting criticisms and suggestions to the province's website. Unlike in other provinces, Dong Thap's website is effective and substantial. According to the Information and Gazette Centre of the PPC, the website attracts – on average – 80 submissions per month. These are then passed on to the relevant departments whose responses are also put on the website. According to the Ministry of Information and Communication, Dong Thap was Vietnam's leading province in the use of information technology in 2010.
- 3 Participating in regular business dialogues. Dong Thap has a regulation which states that its districts, cities and towns have to organise dialogues with enterprises at least twice a year. The most significant such meetings are held in Cao Lanh, Sa Dec and Hong Ngu. Representatives from the PPC are expected to attend these meetings and engage with business people. These tend to be big meetings. In addition, individuals or groups of entrepreneurs can request meetings with the (vice-) chairman of the PPC to discuss specific problems. These meetings by appointment are normally held once a month.
- 4 Voicing their concerns at meetings called by the Provincial Entrepreneur Association or the Young Entrepreneurs Café. These are less formal occasions for interacting with the PPC or government officials. The main association and the young business association have not played an important role in driving the reform process in the early stage but more recently they have strengthened their internal organisation and have become more active in bundling their concerns and arranging discussions with the chairman of the PPC or department leaders.
- 5 Apart from the above dialogues, enterprises can and do request individual unofficial meetings with government officials to discuss particular problems they face. The interviews suggest that such individual meetings are not discouraged by the government. Both sides see them as a useful way to get problems resolved. Suspicion that such meetings are used for extracting illegitimate favours is not a prevailing sentiment.

The relative importance of each of these communication channels is difficult to assess. Both government and business people seem to appreciate that they have multiple channels to interact. Of course, some enterprises are more active than others and those who can make comparisons with other provinces regard the ease of access to government as a strength of Dong Thap. All this is confirmed by the high PCI scores shown earlier.

#### **7.4 The role of the provincial government**

There was little doubt amongst our informants from the public and private sector that the provincial authorities were and continue to be the driving force in the reform process. It seems that the provincial secretary of the Communist Party, the chairman of the People's Committee and the heads of department worked well together to drive the process forward. Leadership in the critical year 2005 is credited to the provincial party secretary. It seems that he was key in reading the signals from the Centre, learning from other provinces, articulating a vision for Dong Thap and getting the People's Committee and department heads on board.

In subsequent years, the reform process continued to benefit from strong leadership from the top, in particular the chairmen of the People's Committee. Also the close articulation between leaders and implementers and between public and private sectors continued.

The common vision was self-reliance. It was recognised that the province was poor and could not wait for help from outside. The way forward was seen in providing support for Dong Thap's own enterprises, building on the existing small-scale agriculture and aquaculture, upgrading processes and products, and investing in processing and marketing of local products. Attracting enterprises from other provinces or countries was merely a complement. 2008 was the first year that Dong Thap held an investment promotion event (in Ho Chi Minh City). Some SMEs have come to the province and invested in its new industrial parks.

Compared with other provinces, government policy in Dong Thap is low key. The government concentrates on improving the business environment in close consultation with the private sector. The PCI is used actively in this process. It is not just seen as an external verdict on provincial-level governance; it is used actively for modifying weak aspects of the business environment. For example, the 2008 and 2009 surveys showed that business support services were an area of relative weakness. This led to the Department of Planning and Investment being asked to establish an enterprise assistance centre for SMEs.

The same ethos and thinking has extended from the provincial level to the district level People's Committee and government. This is important because the smaller the enterprise the more likely it is that district level authorities matter to them – and Dong Thap is mainly a small enterprise province.

Districts do not just follow; they are themselves spaces for experimentation and innovation. A good example is the procedure for obtaining building permission in Lap Vo district. An entrepreneur planning to build a workshop needs permission from local government. Putting together the required documentation and paying

the right amount of fees is a time-consuming process, in particular when it involves travel to the capital. In Lap Vo district, public officials at the commune level help the entrepreneurs to complete the procedure, thus reducing the time and cost of compliance. The provincial government has encouraged other districts to adopt this model of providing services closer to where they are needed. The overall point is that the spirit of experimentation and innovation occurs at all levels.

## 7.5 The benefits of neglect

Dong Thap is an unexpected success story. The province is poor, located on the margins of the Vietnamese economy and receiving little attention from central government. These factors are often reasons for continued underdevelopment but there are cases in which these factors contribute to positive development. The international experience shows that being neglected by central government and by big business (national and international) need not be a bad thing. It can contribute to a local process of seeking solutions within rather than outside, a sense of self-reliance at the enterprise, and government level.

This is precisely what has happened in Dong Thap. There is a strong sense of self-reliance. This has propelled the province forward because a number of things seem to have come together:

- Political leadership from the local Communist Party with a vision for fostering the local economy by relying on the Province's own resources;
- People's Committee and government departments willing and able to translate this vision into reality by working closely with the private sector;
- An entrepreneurial culture which seeks advancement not through speculative activity but productive activity extracting and processing what land and water provide;
- Strong social relationships which limit abuse by entrepreneurs of access to government and abuse by government officials of public office.

The last point deserves a special comment. Since this report is concerned in particular with the role of the private sector in governance reform, one needs to address the question of whether close relationships between business and government are abused (by either side) for private gain. This is a big problem in some provinces but probably less so in Dong Thap. There appears to be a relaxed attitude towards close public-private relationships. The engagement of family members of public officials in business activities is not discouraged and is openly discussed. There is a view that this enables the public official in the family to concentrate on his public duty and reduces the temptation to seek 'informal income' from public office. This is not to say that corruption does not exist but there are reasons to believe that social control mechanisms severely limit instances of unearned income.

One could add that opportunities for corruption tend to increase when big public or private money flows in from outside. Such financial flows to Dong Thap have not occurred – a rarely recognised benefit of neglect. Most important, for our concerns, these are favourable conditions for constructive state-business relations. As we

have seen, the good working relationship between government and business has led to substantial accomplishments in governance reform.

## 8 Findings from Ca Mau

Ca Mau is the southernmost province of Vietnam, surrounded by sea on two sides. Its capital, Ca Mau City, is 370km from Ho Chi Minh City and 180km from Can Tho, the main city of the Mekong Delta. We chose Ca Mau to provide a contrast to Dong Thap. The structural characteristics of the two are similar but the PCI performance is very different.

### 8.1 Governance – the PCI scores

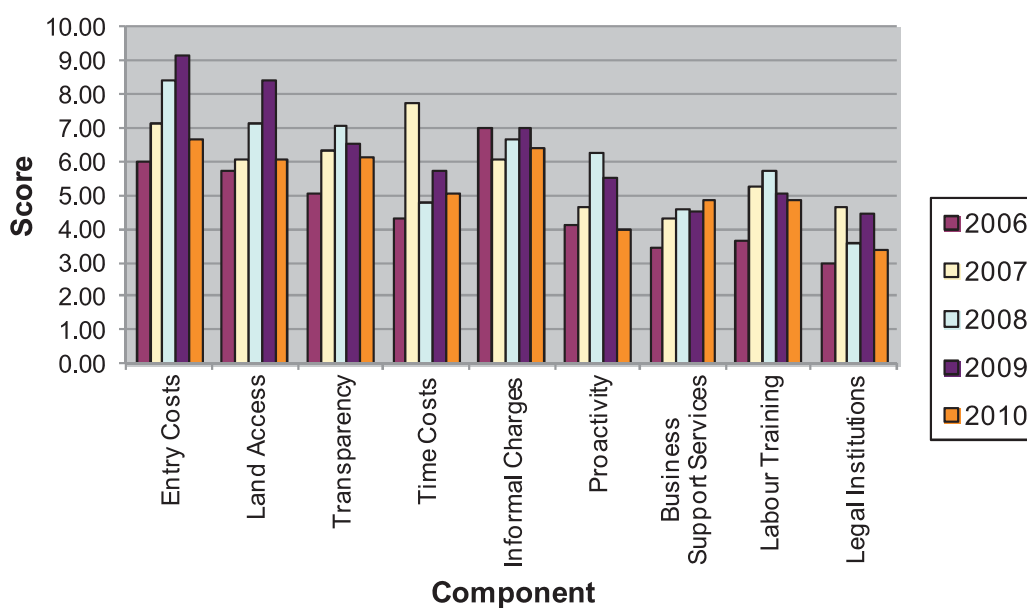
As can be seen from Table 8.1, Ca Mau started with a low rank, then improved substantially but ended up with a low rank. In terms of absolute levels and changes over time, this is very different from the PCI performance of Dong Thap.

**Table 8.1 Ca Mau PCI: aggregate scores and ranking, 2006–2010**

	2006	2007	2008	2009	2010
Score	43.99	56.19	58.64	61.96	53.57
Ranking	57	29	18	22	51

Figure 8.1 presents the poor starting scores of 2006, the subsequent improvements and then the decline in the 2010 PCI. The decline was particularly severe in ‘time costs’ which is surprising given Ca Mau’s deep integration in the world economy – see section 8.2.

**Figure 8.1 Ca Mau: disaggregated PCI scores, 2006–2010**



## 8.2 Economic development

Due to its location, the economy of Ca Mau is dominated by fishing. Conditions are very favourable with a coast of 254km and huge areas for aquaculture, in particular shrimp farming. In 2010 the province sold around 320,000 tons of fish and seafood, with shrimps alone accounting for 120,000 tonnes, most of which were exported ([www.camau.gov.vn](http://www.camau.gov.vn)). In the words of one of our respondents, ‘one third of the province area is used for shrimp farming’. The fishing and seafood industry account for around 80 per cent of the province’s output, other sectors include forestry products and agriculture.

Unlike Dong Thap, Ca Mau has a number of large enterprises, mainly in the fishing industry. Over 20 large enterprises are engaged in seafood processing and many smaller establishments are engaged in aquaculture. Only one of the seafood enterprises is foreign-owned. The largest company, Minh Phu Company, is (mainly) Vietnamese-owned. It had 10,000 workers and exports of 300 million US\$ in 2010.

Ca Mau’s economic performance in recent years is summarised in Table 8.2. Its GDP growth over the period 2006–10 has been relatively stable, averaging around 12 per cent after a peak in 2006. However, investment (not in table) has fluctuated widely due to the establishment of a gas energy fertiliser complex in 2006–07. While the share of private domestic and foreign investment in total investment of Dong Thap was more than 62 per cent, in Ca Mau this share varied between 30 per cent to 37 per cent – due to the big state-owned complex which generates gas and produces fertiliser.

**Table 8.2 Economic growth in Ca Mau**

	2000	2001	2005	2006	2007	2008	2009	2010
Growth rates GDP (%)	10.6	9.3	11.5	19.8	12.3	12.3	11.5	11.5
Ranking GDP growth			n/a	1	33	33	10	24
Number of operating enterprises	672		1157	1240	1502	1876	1992	2125
Growth rates of taxes paid by enterprises (%)		50	33	14	29	37	6	102

Source: General Statistical Office.

## 8.3 The role of the private sector in governance reform

The governance and growth statistics presented above invite two questions: first, how to interpret a case where the governance performance was poor and the economic growth performance was strong? Assuming that the statistics are a good reflection of what actually happened, this is an important question. It will be dealt with in a parallel report on the connection and sequence between governance and growth (McCulloch and Nguyen forthcoming).

Second, how to explain that governance improved for a few years but then fell back to its former low level? This is the question which we concentrate on in the

remainder of this chapter on Ca Mau. Whereas the Dong Thap chapter sought to explain who or what drove the improvements in governance, this chapter needs to add the question of who or what explains the recent decline.

In order to understand the dynamics in Ca Mau it is important to recall that the economy of this province is highly specialised and deeply integrated into the world economy. In the fish and shrimp industry, some 24 large enterprises pull the strings both economically and politically. Seventeen of these enterprises are active members of the Ca Mau Association of Seafood Exporters and Producers (CASEP). This association has close relationships with the government of Ca Mau. This close connection takes three forms. First, some provincial officials, notably from the Centre for Trade Promotion and the Department of Agriculture and Rural Development, are associate members and attend the association meetings. Second, there are regular formal and substantial meetings between the association and provincial leaders, complemented with *ad hoc* meetings when serious problems arise. Third, individual members of the association have easy direct access to the leaders of the People's Committee or relevant government departments.

These three connections between the public and private sector are used actively, but they do not concentrate on governance reform as assessed in the PCI. The latter is aimed at improving the business environment for all enterprises and can therefore be called horizontal policy. In contrast, vertical policy is focused on support for enterprises in a particular sector. It seems that this is what the public-private alliance in Ca Mau is mainly concerned with. It concentrates on the fish and seafood industry. This vertical policy at the provincial level is an extension of the vertical policy at the national level. The central government is working closely with the Vietnam Seafood Exporters and Producers Association (VASEP), the national sectoral association ([www.vasep.com.vn](http://www.vasep.com.vn)).

The interviews with Ca Mau's business and government people make it clear that their interactions are almost entirely concerned with providing information, infrastructure, training, certification and other services for the specific needs of a fish and seafood industry which caters primarily for international markets. Much of this vertical support is in line with what advocates of 'industrial policy' would recommend. Consulting and negotiating with the private sector is also considered good practice.

Complementing the research in the province with interviews in Ha Noi helped to understand what goes on in Ca Mau. The key point is that the public-private interaction that matters most for the Ca Mau enterprises is the one in Ha Noi between VASEP and the Ministry of Agriculture and Rural Development. The big Ca Mau enterprises are members of VASEP, a professionally-run association with a staff of 64 (40 in Ha Noi and 24 in Ho Chi Minh City). It works closely with the above Ministry; in fact it has its offices in the compound of the Ministry. The association provides daily updated information on national and international markets, trade promotion services, short courses tailored to the needs of the industry, and representation of the industry's needs *vis-à-vis* government agencies. Of course, VASEP provides these services not just for Ca Mau enterprises but for 290 members, representing 80 per cent of Vietnam's sea food exports. Annual exports are US\$ 5 billion (in 2010) and rising.

We have to understand the big Ca Mau enterprises in this context of operating in a very competitive global market. This is what they concentrate on. Their local association, CASEP, helps them with this but the key association is VASEP in Ha Noi (CASEP is not a subsidiary of VASEP). Investing in collective business capacity at the provincial level is not important to them. Investing in relationships with the provincial government for the sake of developing the province is not important to them. Conversely, for the provincial government, these big seafood enterprises are the key for the prosperity of the province. At least this is how provincial government sees it.

The provincial government of Ca Mau runs the risk of concentrating too much on the seafood industry. The province has committed 100 billion VND of public money on training and raising productivity in the seafood industry over the period 2010–15 (according to the Department of Agriculture and Rural Development). The fund is big and small enterprises seem to benefit little. Virtually all the efforts are going into one industry and little goes into developing the rest of the economy. In other words, the good relationships between big business and provincial leaders are unlikely to result in inclusive benefits for the local economy in general.

As regards small and medium enterprises, they have been unable to exercise influence on the governance reform in Ca Mau. This comes out clearly from the interviews with both the entrepreneurs and the government officials. There are some SMEs in the seafood industry but most SMEs operate in the other sectors of the economy. These enterprises have no collective voice. There are two yearly meetings between the authorities and SMEs but they are formalities. They are more ceremonial than substantial. Some young entrepreneurs have tried to change this by setting up a youth association and seeking dialogue with the government. The association, however, has few members and little influence. In the three years of its existence it has never been invited to any meeting related to governance reform.

This is in marked contrast to Dong Thap (see previous chapter). In Ca Mau, the authorities have a low opinion of the potential or actual role of the SMEs in the economy of the province. Conversely, the SMEs show little interest in governance reform and little capacity to organise. So there is no impetus for horizontal policies coming from the SMEs. Nor is there impetus for vertical policies to diversify away from seafood.

In summary, the private sector has used its influence to improve the business environment but only for the immediate concerns of the seafood industry and for the large enterprises in this industry.

#### **8.4 The role of the provincial government**

According to the PCI data in Table 8.1, economic governance in Ca Mau improved over the period 2007–09. At no stage did the province attain the PCI scores we have seen in the case of Dong Thap, but there was some improvement. The question we ask in this section is whether the provincial government was a driving force in this process.



Discussing this question with our interviewees turned out to be awkward because they seemed to see above all, things which the provincial government had failed to do. The province's particular weaknesses lie in infrastructure, human resources and administrative reform. The respondents in the private sector and even some of those in the public sector felt that the provincial government was not effective, neither in initiating nor implementing reform. To the extent that improvements occurred, these seemed more due to directives or support from the central government (discussed in section 8.5).

The reasons for the modest contribution of the provincial government in improving the general business environment are not entirely clear. Some of the explanation seems to lie in the provincial government's preference for big projects and quick growth. Four industrial parks were planned and partially built but only one of the industrial parks is working though not working very well. The financial and management capacity of the province is overstretched. Another even bigger venture is the earlier-mentioned 100 billion VND programme to enhance the productivity and quality of shrimp farming. While the financial support for this programme was secured from central government, the implementation is suffering from numerous practical problems especially in the provision of specialised services. Enormous energies from provincial leaders and implementers are then absorbed in trying to solve the problems that come from being trapped in projects that are 'too big and too quick'.

The overall impression one gains from the interviews and the collected data is that Ca Mau manages to attract substantial investment and generate economic growth but this is due to the favourable economic opportunities that arise in the seafood industry. The provincial government has taken care of the needs of this industry and provided exclusive benefits to some big enterprises. But it has not been a driving force for improving the overall business environment of the province.

## **8.5 The role of central government**

As discussed in Chapter 3, the central government retains an influence on what happens in the provinces by providing the overall direction of governance reform and defining the incentives according to which provincial leaders are appointed and promoted. The pace and way in which governance reform is carried out is, however, left to the provincial government. In previous chapters we have seen the different ways in which the provincial governments have used their space.

In the case of Ca Mau, the provincial government has not been proactive and the central government has had a bigger influence. The interviews suggest that the central government has been the main driving force of changes in Ca Mau. For example, in 2007, the three central government Ministries of Planning and Investment, of Finance and of Public Security brought together three procedures into one. They advocated for a 'one stop shop' which would deal with business registration, tax code registration and seal engraving permits – and thus reduce the time and cost business spends on complying with regulations. The provincial government followed this recommendation, seemingly with good effect. As can be seen from Figure 8.1, time costs and entry costs improved substantially in the years 2007 and 2009 respectively.

A similar dynamic can be observed in the training of human resources. Central government expressed concerns and exercised pressure because educational and skill levels were particularly low in Ca Mau. The provincial government then followed the signals and directives that came from the Centre, making human resources training a priority. Some progress was made but it remains an area of major concern.

The biggest influence of central government is felt in a specific big project. A big gas powered fertiliser complex was built to enhance the country's energy security and meet the demand for fertiliser in Southern Vietnam. Today this complex accounts for a third of the province's public revenue.

## 8.6 Recent problems

In spite of improvements in some areas, Ca Mau continues to experience many problems:

- a number of administrative procedures tend to be slow and unpredictable;
- the capabilities of government officials, in particular in medium and lower ranks, are thought to be low;
- infrastructure is seen as poor in relation to that in many other provinces (in the VCCI infrastructure index, Ca Mau ranks 53 out of 63 provinces);
- allocation of land and clearing of sites is fraught with many difficulties for many enterprises.

Some of these issues also arose in other provinces, but the dissatisfaction in Ca Mau seemed greater, certainly in the private sector and to some extent also in the public sector.

It is tempting to regard the conjuncture of these factors as the reason for Ca Mau's recent low PCI score. As shown in Table 8.1, in 2010 Ca Mau's rank dropped to 51st in a total of 63 provinces. In our interviews, we enquired specifically into the reasons for the low recent score. The responses drew attention to unresolved problems but they could not explain the dramatic drop from rank 18 in 2008 and rank 22 in 2009 to rank 51 in 2010. Indeed, some informants suggested that problems in the business environment did not suddenly emerge in 2010. Others, however, felt that two specific problems might have influenced the PCI scores. First, there was a central land decree that stopped conversion of agricultural land to industrial use. Second, there was overcapacity in the industry and entrepreneurs were keen to prevent new entry into industry which might have affected the very low score given to entry cost.

It could also be that respondents in Ca Mau are more aware of shortcomings in the general business environment because the province has pockets of excellence (the gas energy fertiliser complex and the exporting seafood enterprises) which have been able to solve their problems through special arrangements. But this does not explain the big drop from 2009 to 2010.

## 8.7 Comparing Dong Thap and Ca Mau

How can we explain that the dynamics of improving the *general* investment climate in the two provinces are so different? In Dong Thap, the provincial government is proactive whereas in Ca Mau the provincial government merely falls in line with guidance from the Centre.

There seem to be two main reasons:

- In Ca Mau, the provincial government devotes most attention to one internationally competitive sector and has little energy for other sectors. Dong Thap, in contrast, is not blessed with a natural resource which it can exploit readily, leading the government to support the local small and medium enterprises in general.<sup>27</sup> This and the previous chapter show this difference very clearly.
- Relationships in the People's Committee are different in the two provinces. This requires some explanation. According to several informants in Ca Mau, the party secretary and Committee chairman have not always found a common voice. As a result, on some matters the latter may not always have received support from the former. In contrast, the provincial government of Dong Thap enjoyed a mutually supportive relationship with the party leadership in the province. This difference in relationship matters. Being proactive and trying out new solutions to old problems means taking the risk of being reprimanded and criticised. Where the executive has a good relationship with the party secretary, it is more likely to be given the benefit of the doubt; it might even gain recognition for taking new initiatives. To give an example, Dong Thap made progress with its land policy and Ca Mau did not. The comparison between the two provinces suggests that consensus between government and party leader matters for experimentation. Observing this relationship helps to understand the dynamics of the reform process.

## 9 Similarities and differences across four provinces

The main findings from the four provinces are drawn together in Table 9.1. The summary table shows a very interesting result. First, it is clear that in the two cases where there have been substantial and sustained reforms (Bac Ninh and Dong Thap) the private sector was very much involved. However, the nature of private sector involvement was different in the two cases, with large firms playing an important role in Bac Ninh, whilst SMEs played the key role in Dong Thap. In part this reflects the different natures of the two economies, with Bac Ninh

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<sup>27</sup> This is in line with one of the main arguments of the resource curse literature. See for example, Rosser (2006).

dominated by large export-driven firms, whilst Dong Thap, being remote and rural, is dominated by much smaller and more local firms. In the other two provinces, large firms did not play a leading role in reform, but did lobby for their own interests, particularly in Ca Mau, whilst small firms were ignored and generally irrelevant in the reform process. Thus on the private sector we tentatively conclude three things: large firms will always lobby for their own interests; small firms are often (although not always) excluded from influence on the reform process; and, critically, organisational capacity and leadership in the private sector is necessary (but not sufficient) for successful reform.

The second conclusion we draw relates to the role of government. Again, it is clear that both cases of success were heavily influenced by proactive, competent and stable leadership from the provincial government. Without this, private sector lobbying merely serves particular interests but does not translate into broader-based reform. Thus it is the combination of an organised and capable private sector and proactive local leadership that seems to give rise to success, rather than one or the other. In the absence of such leadership, or in situations where there is political conflict or constant change, the existence of a central government mandate for reform can hold back deterioration in governance and promote some constructive administrative reforms. But the central government's inability to engage directly with the local private sector means that it cannot create the embedded dynamic relationships that seem critical for serious reform. Nor can it encourage the coordination and common ground within the private sector that is essential for a coherent dialogue about reform.

Small enterprises found it difficult to engage in the reform process. There were exceptions, notably Bac Ninh in the early stage and Dong Thap in the later stage. Our discussion with experts suggests that in most parts of Vietnam small enterprises are marginalised from the reform process. The reasons are several. First, in a small enterprise, the owner-manager has multiple roles. This makes it difficult to add a further role of engaging in policy advocacy. Business associations can help to give them more voice but often government hinders rather than helps the effectiveness of associations.<sup>28</sup> Small-scale entrepreneurs also feel that government officials prioritise large enterprises, because this provides opportunities for complementing their formal income with informal charges.

This raises the question of whether personal enrichment by public officials is a hidden driver of economic reform. There is a literature which suggests that it played a role in Chinese provinces (Francis 2001), but the evidence from our Vietnamese provinces is not clear. Most respondents in the public and private sector were reluctant to engage in discussions of this topic but those who opened up admitted that the families of public officials often gained financially from a prospering private sector. It is not possible for us to ascertain to what extent this is the case. We can, however, reflect on the relevance for the reform process which is our main concern. Does the financial gain by the families of public officials have

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28 For example, insisting that a retired government official run the association makes it more difficult for a small business to have a vigorous and authentic voice.

an impact on the reform process? Here it seems essential to distinguish between corrupt and legitimate ties between public officials and private business. Where the financial gain is based on abusing a public position, the official concerned will want to maintain the old way of doing things rather than make the procedures easier and more transparent for business. In other words, gains based on corrupt ties are likely to lead to blocking reform. Where the financial gain is based on a family member prospering in business and this business benefiting from reform of regulations, the official is likely to support reforms enthusiastically. This distinction should help further discussion of the incentives of public officials for economic reform. Let us also recall a finding from across the provinces and confirmed by outside experts. A good track record in accelerating and improving economic reform enhances the career prospects within government and the Party.

Table 9.1 provides an overview of the different constellations of forces which help explain the (lack of) progress in the four provinces. There is, however, a dimension which the Table does not capture and which seems to have played a role in the reform process: unified support versus divisions amongst the provincial leaders. A mutually supportive relationship between the provincial executive (chairman and vice-chairmen of the People's Committee) and the provincial party secretary is particularly important. Government leaders and Party leaders tend to be the key people in the Provincial People's Committee (PPC) and forging an alliance within the PPC seems critical for undertaking daring reform. The final chapter elaborates on these political dimensions of the reform process, in particular the role of the Party.

**Table 9.1 Drivers summary table**

Drivers	Bac Ninh	Hung Yen	Dong Thap	Ca Mau
<b>Central government</b>	Connections with central government and proximity to Ha Noi probably useful but not the dominant driver	Central government has been the only mainstay of reform, but without a local champion, reform has flagged	Central government has been an important driver	Central government is a key driver, particularly of administrative reform
<b>Provincial government</b> – Leaders – Bureaucracy	Provincial leadership played a critical role in the later stages of reform	Provincial leadership has constantly changed leaving policy uncertainty and a lack of direction	Provincial leadership has been the critical driver	Provincial leadership has been mediocre and is not the key driver of change
<b>Large business</b>	Big firms play an important role throughout, working closely with provincial government	Large businesses have not played a key role in driving reform. Indeed, the lack of a leadership role from business may be one reason for the lack of governance reform	Big firms have focused on their own needs rather than on generalised reform	Big firms have been influential in driving reforms, but only for issues of concern to them
<b>Small business</b>	SME association was the main driver in the early stage but had less influence later on	SMEs have had very little influence over reform	Good SME/ government relationships (and political links) have helped reform to be more broad-based	SMEs have had virtually no influence on reform

The focus in this chapter and in previous chapters on reform in the provinces does not imply that central government is superfluous. Far from it. Our interviews in the provinces and with key actors in Ha Noi have confirmed the urgent need for a stronger central framework to avoid a ‘race to the bottom’ in investment incentives. It is entirely rational for each provincial government to attempt to provide better incentives than their neighbours to attract investment to their provinces. However, at a national level this does not make sense – it simply results in a substantial loss of tax revenue to the state. Stricter regulation of the nature of incentives which can and cannot be offered could mitigate this tendency. Moreover, better central coordination of strategic investments (such as seaports and airports) is needed to avoid wasteful investments with low utilisation rates. This is not a new insight, central government is aware of it and is seeking solutions which do not block provincial energies but improve overall efficiency.

## 10 Quantitative analysis

The qualitative analysis presented in the above chapters suggests that the combination of engaged private sector and proactive public sector have been the drivers of governance reform in the provinces. However, inevitably, our case studies are only able to explore the detailed interactions in a small number of locations. To examine whether our hypotheses are true more generally necessitates the use of quantitative analysis covering all 63 provinces of Vietnam.<sup>29</sup>

Here we are very fortunate, because Vietnam (uniquely to our knowledge) has an indicator of the quality of local economic governance at the provincial level for several years.<sup>30</sup> The Provincial Competitiveness Index (PCI) measures different aspects of economic governance at the provincial level based on the responses from a random sample of firms in each province. This data, when combined with data on other provincial characteristics, allow us to test a range of hypotheses about the determinants of provincial governance reform. This chapter explains the quantitative data available to us; sets out a range of factors which can be measured and whose influence can be tested using quantitative methods; and then presents the results of testing our hypotheses.

### 10.1 Data

We employ data from several different sources in our analysis. To measure the quality of local economic governance we draw on the Provincial Competitiveness Index (PCI). The PCI is a composite index of provincial economic governance

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29 There were five centrally run cities and 59 provinces in Vietnam before 2008. After 2008, there are five centrally run cities and 58 provinces only as Ha Tay province merged with Ha Noi.

30 Several countries have undertaken similar exercises, but almost always for only one or two years – see Asia Foundation (2011) for an overview of similar work in Indonesia, Bangladesh, Sri Lanka and Cambodia.

which has been calculated each year since 2006 by the VCCI.<sup>31</sup> It is based upon a mail-out survey to a random sample of firms in each province.<sup>32</sup> The survey asks a range of questions about firms' perceptions of local economic governance, as well as concrete measures of their experience of local governance. A particular strength of the PCI is that it focuses on aspects of local governance which are under the control of the provincial administration. It therefore excludes factors such as the quality or availability of national roads, airports and ports which would bias the index in favour of larger cities or provinces. Firm responses to the questions are combined into a set of nine sub-indices reflecting provincial performance on:

- Entry costs;
- Land access and tenure security;
- Transparency;
- Time costs of regulatory compliance;
- Informal charges;
- Proactivity of the provincial government;
- Business support services;
- Labour training;
- Legal institutions.

Provincial scores on each sub-index represent the province's performance on that topic relative to the performance of other provinces in Vietnam. The overall PCI index is a combination of the sub-indices, yielding an overall score for the quality of economic governance in each province.<sup>33</sup> In our analysis, we measure the speed of economic reform as the average annual growth rate of the PCI in each province between 2006–10.

In addition to the PCI data, we draw data from several other sources. In particular, we use data on the value of domestic investment from the Enterprise Censuses<sup>34</sup> conducted by the GSO. This annual census attempts to cover all non-state enterprises with ten or more employees (as well as a sample of smaller firms). We also draw on the GSO's national accounts data on GDP at the provincial level, as well as a range of provincial statistics from the GSO Statistical Yearbook. We also employed the Ministry of Finance's archive to include data on budget transfers between central and provincial governments.

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31 A pilot PCI was conducted in 2005 but this did not cover all provinces in the country.

32 The sampling frame for the survey is the list of firms provided by the provincial tax authority. For example, in 2007, 6,700 firms were chosen randomly from the list of 177,815 firms provided by the tax office. To ensure representativeness, the sample is stratified by legal type of enterprises, sector of business and age of firm.

33 For full details of the construction of the PCI, see VCCI (2008). The published PCI scores use a weighted sum of the sub-indices, with weights determined by the influence of each sub-index in predicting different aspects of firm performance. Because our analysis requires a consistent index across time, we constructed a mini-PCI using only those variables used in all years from 2006–10 and combined the sub-indices using equal weights.

34 Technically these are surveys since firms with fewer than ten employees are only sampled rather than enumerated in full.

Finally, to explore the influence of provincial leadership on governance reform, we constructed a database of the chairs of the Provincial People's Committee in each province from 2006–10. From this we can see when the chair changed (often, but not always, after Party Congresses) and the reason for the change (i.e. whether they retired/fell ill/died, were disciplined, were transferred to another position at the same level elsewhere, or were promoted to a more senior position, e.g. secretary of the province Party, or chairman of a larger province or a move to a ministerial position).

## 10.2 Factors influencing governance reform

There are a range of factors which might determine whether a provincial government pushes forward with economic reform.

*Private sector investment:* one possibility is that private sector growth stimulates engagement with the government which then leads to reform. If this was the case we would expect to see prior investment positively correlated with subsequent improvements in the PCI.

*Leadership changes:* another possibility is that reform is affected by changes in the local leadership. Leaders of the province change, typically around every five years. As noted above, our dataset includes information on the year in which the provincial leaders (chairs of the PPC) changed and the reason for the change. Unfortunately we have no information on the quality of leaders. However, the different reasons for change of leader lead to different predictions about the impact on governance. Specifically, if a leader retires, or has to step down due to illness or death, then we cannot know whether they were more or less reform-minded. We therefore expect that, on average, their governance performance will have been average. On the other hand, if a leader changes because they were promoted, this may be an indication of good performance<sup>35</sup> – hence we would expect that, on average, their governance performance was good. Finally, if the leader changes because of being disciplined, this suggests that their governance performance may have been poor.<sup>36</sup>

*PCI team visits (diagnostic workshops):* a third possibility is that performance on the PCI is driven by the Centre. VCCI is responsible for administering the PCI tool and provides substantial additional support and help to provinces each year in understanding the results and in helping provinces understand how they can improve their performance. It is therefore possible that economic reforms proceed fastest in the places that the PCI team visited the most.<sup>37</sup> Of course, visits by the PCI team are not random – they occur at the invitation of the province. There are

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35 As a matter of fact, in Vietnam, official rotation between central and provincial positions are planned in advance (from three to five years). The governance performance is among key factors that test the high ranking official candidates' capability for planned promotion.

36 Leaders might also be disciplined for being too reform-minded – later we test which effect predominates.

37 We are focusing on visits by the PCI team for the purpose of diagnostic workshops; VCCI staff visit provinces for a wide variety of reasons.



two possible reasons why Provincial leaders may have invited the PCI team to visit: first, because they were reform-minded and keen to improve; and second because they had scored badly on the PCI and that this was a source of embarrassment for them. Since we know the PCI scores, we can try to distinguish between these two reasons. We also estimate a model which attempts to assess the impact of PCI team visits on the PCI, taking into account the likely relationship between reform-mindedness and PCI team visits.

*Structural characteristics of the province:* a further possibility is that there are structural characteristics of the province that make it more or less likely that economic reform will be pursued. In particular, provinces that are close to Ha Noi or Ho Chi Minh City may be more likely to be part of the discussion of economic reform nationally than those that are more remote. Similarly major cities may be under more political pressure to pursue reforms because of their higher visibility on the national stage. Against this, larger cities tend to generate much more revenue than other provinces. This makes them politically more powerful since they are funders of central government rather than supplicants. Malesky (2008) has shown that this provided such provinces with considerable autonomy for policy reform. This autonomy may enable such provinces to push forward faster with reforms than other, more dependent, provinces.

### 10.3 Results

The descriptive statistics for the variables used in our analysis are shown in Table 10.1.

**Table 10.1 Descriptive statistics of the determinants of governance improvements**

Variable	mean	sd	min	max
Avg annual growth in PCI (2006–10)	0.0025	0.0218	-0.049	0.041
PCI	48.4	4.10	38.17	58.50
Log real investment per capita	6.22	1.02	4.15	8.82
Private investment share of total investment	0.84	0.04	0.74	0.97
Log real GDP per capita	8.49	0.58	6.23	10.70
Leader changed	0.70	0.46	0	1
Distance to Ha Noi/Ho Chi Minh City	253.7	221.4	0	835
City dummy	0.08	0.27	0	1
Share of population with secondary schooling	87.2	9.85	65.7	99.79
Revenue ratio under 100%	0.23	0.43	0	1

Note: figures are for 2006 unless otherwise stated. As noted in the above section, PCI in all the results in this chapter refers to the mini-PCI constructed to be comparable across all years of the panel.

It is interesting to note that when using a PCI measure, average annual PCI growth over the period 2006–10 is almost zero (0.25 per cent per annum). However, there is a very wide range of performance; the province with the fastest growing PCI

saw an increase of 4.1 per cent per year, whilst the PCI of the worst performing province shrank by almost 5 per cent per year. The average PCI score in 2006 was 48.4, but again there was significant variation with the worst province scoring only 38.2, while the best had a score of 58.5.

The data also show very large variations in the size of investment per capita and GDP per capita between provinces with Ha Noi getting more than 100 times as much investment as the lowest ranking province (Ha Giang). Provinces also vary in the dominance of the private sector in investment; in some provinces almost all investment is from the private sector, whilst in others as much as a quarter of investment is from the state. Other structural characteristics also reflect great diversity. For example, the average distance from either Ha Noi or Ho Chi Minh City was 253km – but Quang Ngai is 835km from the nearest of these two cities. Similarly, whilst 87 per cent of the population has at least secondary school education in the average province, this varied from 66 per cent in Can Tho to over 95 per cent in 20 provinces.

Finally, looking at political leadership, we see that almost three-quarters of provinces had some kind of change in leadership during the period, with many experiencing more than one change. However, less than a quarter of provinces run financial surpluses.

Using the variables in Table 10.1, we used regression analysis to estimate the impact of each of these factors on the growth in the PCI between 2006 and 2010 (see Appendix 4 for details). These results tell an interesting story about the political determinants of governance change.

First, provinces that started with a low PCI score in 2006 were significantly more likely than provinces with high scores to have higher growth in their PCI score over the period. This is consistent with qualitative evidence suggesting that a key motivation for focusing on improving governance is avoiding embarrassment by being publically ranked near the bottom. Figure 10.1 illustrates this point. A province with the average value of PCI in 2006 of 48.8 (and average values of all the other variables above), typically experienced a growth in its PCI of 0.25 per cent per year from 2006–10. But, as the downward slope in Figure 10.1 shows, a province with the same characteristics but with a PCI score five points lower, typically experienced a much higher PCI growth of 1.4 per cent per year. This suggests that the embarrassment of a low PCI score provides an incentive for provincial governments to improve their performance.

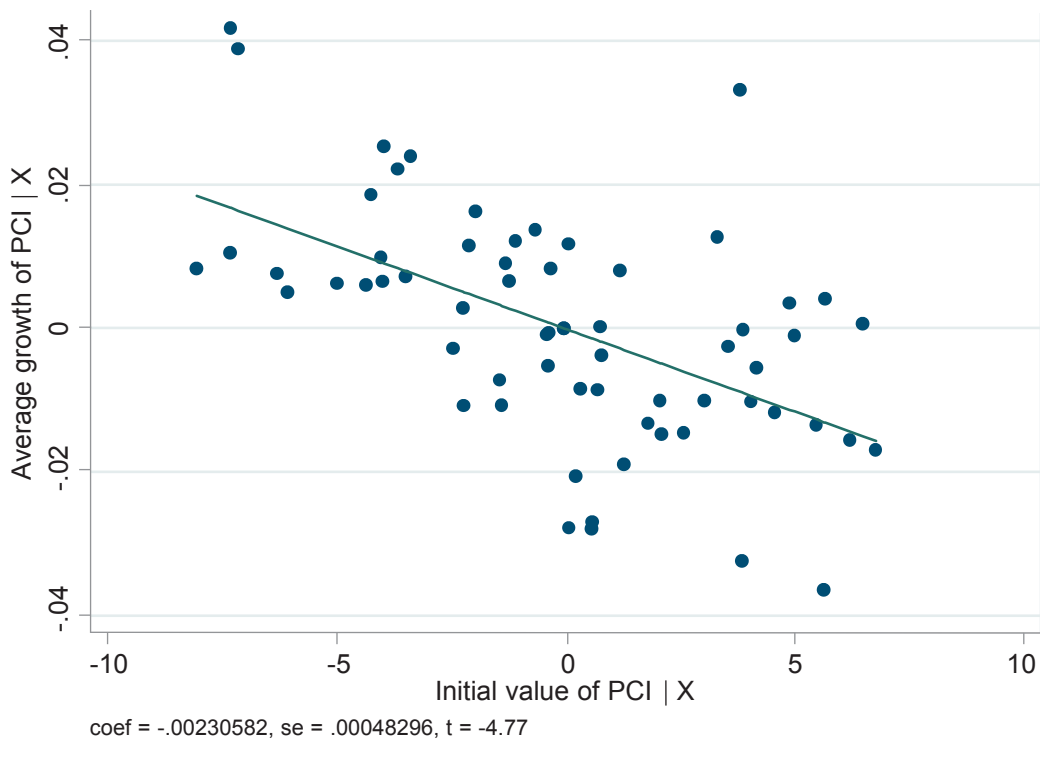
Second, we find no statistically significant effect of investment on subsequent PCI improvements.<sup>38</sup> Similarly, it does not appear to be the case that the speed of reform is related to the size of the province's economy, nor to the share of the private sector in local investment. This runs counter to the evidence from our qualitative interviews which suggested an important role for the private sector. Note that this result does not mean that the private sector did not have a role in

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38 Appendix 4 only shows the result for the share of the private sector in investment; results using the absolute quantity of investment are available on request.

reform; it merely shows that the amount of investment and the size of the economy are not significant factors in determining the speed of reform. Thus it is as possible for provinces with low levels of investment, or with low shares of private investment, to achieve significant reform as it is for others with higher levels of investment.

**Figure 10.1 Growth in PCI 2006–2010 against initial PCI score in 2006**



Interestingly, having had some kind of leadership change seems to spur improvement in governance rather than limit it. Whilst our qualitative interviews pointed to frequent changes in leadership being disruptive to reform, it would appear that, on average, replacing leaders promotes reform. One possibility is that replacements are merit based and so are more effective at implementing reform than their predecessors. Further below in this section we analyse how improvements in governance influence the prospects of promotion.

Distance from Ha Noi or Ho Chi Minh City makes no difference to performance in reforming governance, suggesting that information flows and monitoring is strong between the Centre and the provinces, regardless of location. Certainly our qualitative interviews in the provinces suggested that the PCI was very well known regardless of location. However, the reform is significantly slower in the five major cities (Ha Noi, Ho Chi Minh City, Can Tho, Danang, Hai Phong). This may point to the difficulties of reform in the major cities, perhaps due to the higher political visibility of measures that contravene national regulations, even if they improve the investment climate. Rather surprisingly, better educated provinces tended to have slower PCI growth, although this is consistent with other work showing that education does not necessarily translate into better governance (McCulloch and Malesky 2011).

As expected, we find a large and statistically significant effect on PCI growth of being a surplus province. This is consistent with the literature suggesting that provinces with large fiscal resources have greater policy autonomy to pursue reforms (Malesky 2008).

Another potential explanation for improved governance performance is the technical support and advice provided by the PCI teams themselves. As noted above, there are two possible reasons why a provincial leader might invite the VCCI to a province: the local leader may be embarrassed by poor performance; or they may be reform-minded. These two explanations have different predictions about the relationship between such visits and the PCI. If leaders invite the PCI team to visit when their PCI scores are low, then we would expect a negative correlation between such visits and PCI scores. Conversely, if the VCCI are invited by reform-minded leaders, then we might expect a positive correlation between PCI team visits and the PCI scores (assuming that the PCI is likely to be higher in places with reform-minded leaders).

Table A4.2 (in Appendix 4) shows the correlation matrix between the PCI and PCI team visits. The table shows three things: first, that PCI scores are correlated with PCI scores in previous years – good performance in the past makes it more likely that performance in the future will be good too (although this is not inevitable); second, visits by the PCI team are also persistent, that is, having had a visit in the past makes it more likely to receive one in the future; and third, there is a strong positive correlation between PCI scores and PCI team visits. Of course, correlation is not causation – we do not know whether PCI scores are high because of the support provided by the PCI team, or whether provinces with high scores for other reasons were more likely to invite the VCCI to visit. However, we find no evidence that provinces with poor scores are systematically more likely to invite the PCI team to visit (even though, as noted above, they are more likely to improve their performance subsequently).

This leaves the question of whether PCI team visits have an impact on the PCI scores. So far our analysis has focused on the impact of various initial conditions in 2006 on PCI growth over the period (2006–10). However, to assess the impact of PCI team visits on the PCI, we need to exploit the annual data, to be able to see the pattern of visits and PCI changes. Appendix 4 outlines a simple model for doing this and shows the results in Table A4.3. Our analysis suggests that there is a strong, although not always statistically significant, impact of a PCI team visit on a province's PCI performance.

Overall, our model provides support for the evidence from our qualitative interviews that reform is pursued proactively by provinces that have a degree of autonomy (outside the high profile national cities), as well as those that are embarrassed by their initially poor scores. It also supports the idea that visits from the PCI team help provinces to improve. However, these results also challenge the idea that it is prior investment, or the share of the private sector in investment, that drives the reform process.

Finally, to explore the idea that an important motive for reform is the desire for promotion, we exploit the fact that we know the reason for the change in leadership. We therefore examined the growth in PCI immediately prior to the change in leadership. Table 10.2 shows the PCI growth rate preceding the change of leadership by reason for the change.

**Table 10.2 PCI improvement prior to change of leadership**

Reason for change	Avg PCI growth	Avg GDP growth	N
No change	0.001 (0.006)	0.102 (0.016)	148
Retirement/illness/death	-0.013 (0.012)	0.099 (0.004)	14
Disciplined	0.012 (0.045)	0.209 (0.110)	5
Transferred/promoted to deputy	0.067 (0.046)	0.095 (0.013)	5
Promotion/minister/secretary of the province	0.032 (0.019)	0.076 (0.036)	18

Note: Standard errors in parentheses.

The results are consistent with the hypotheses regarding the motivation for reform. Provincial leaders who were promoted tended to be in provinces that had performed well in improving the PCI; those that were disciplined were in provinces where the PCI had not performed well (although the standard error is large); those that retired tended to have relatively poor performance as well.<sup>39</sup> A multinomial logit regression produces the same result, with prior PCI growth associated with a significant increase in the probability of promotion. Note that prior GDP growth is not associated with promotion.<sup>40</sup> Thus the potential impact on the promotion prospects of the leader may be one factor that drives provinces to reform.

#### 10.4 Conclusions of the quantitative analysis

This chapter has attempted to test quantitatively some of the hypotheses about the determinants of governance reform arising from our qualitative interviews. The results confirm some of these hypotheses, but challenge others. For example, our qualitative research suggests that the PCI is an effective tool for promoting governance reform, precisely because it provides an independent and transparent measure of performance. Provinces scoring poorly frequently feel embarrassed by their score and take steps to improve it. We see confirmation of this effect in the quantitative data.

Similarly, our qualitative interviews raised a range of hypotheses about the political determinants of reform. The quantitative evidence finds support for some of these. For example, provinces with greater revenue autonomy are more likely to be able to pursue reforms; but achieving rapid reform in large cities is more difficult,

39 The results in Table 10.2 only refer to PCI growth performance in the year preceding the change of leadership. To provide a longer time frame, we also selected the 28 provinces where only one change happened during 2006–2010 and calculated the average PCI growth prior to the change. The results are very similar to those shown above.

40 In fact, high prior GDP growth is associated with being disciplined, but with a sample size of five we do not put any weight on this result.

perhaps because the economies of such cities are more complex, or because reforms which challenge central authority are more visible. We also find some evidence that promotions are merit-based, with changes in leadership bringing in new ideas and new impetus for reform.

At the same time, our results challenge the idea that the size or share of the private sector is a key driver for reform. This could be because, in some provinces, reforms are genuinely driven by government, either provincial or central, with the private sector playing a more limited role. Alternatively, it may be the nature and quality of the interaction between the private sector and the state that determines reform, rather than the absolute amount of investment or its origin. Investment arises for many reasons (accessibility of land, access to markets, low transaction costs, high quality labour, etc), many of which have little to do with the quality of provincial governance. Thus it is perfectly possible to have high levels of investment in provinces with poor governance (and vice versa). What would appear to matter for reform is the willingness of the provincial authorities to engage with the private sector and the capacity of the private sector to do so. This is consistent with the strong relationship that we found between PCI team visits and provincial reform. Where both the desire and capacity of the public and private sector to interact existed, reform took place, regardless of the absolute value of investment or the extent to which investment originated from the private sector.

## 11 Conclusions: the roles of business, government and Party

Governments and aid agencies around the world are investing efforts and money in improving the investment climate. They assume that there is evidence-based knowledge on how best to bring about the corresponding reforms. This assumption is questionable. Answers to the question of who drives the reform of the investment climate are far from clear. This is why we undertook this research on the drivers of economic reform in Vietnam's provinces, concentrating mainly on the process since 2005. This final chapter pulls together the main findings from the qualitative and quantitative analysis.

### 11.1 Recognising the role of the private sector in enhancing reform

Provincial government is by necessity involved in the economic reform process but who is actually driving it? In our research we found that in those provinces which are making most progress in economic reform (Bac Ninh and Dong Thap), the private sector played an important role. Not against government but with government. There was no formal public-private coalition but the dynamic was one of proactive government seeking the input from the private sector and the latter lobbying for and contributing to responsive and effective government. In Bac Ninh, the initial push came from the private sector; in Dong Thap the initial push came from the public sector. In both cases, there was a clear and open recognition that the two sides needed each other in order to bring about effective reform.

Malesky's earlier research showed that foreign enterprises had a considerable influence in helping provinces to increase their autonomy and engage in experiments in the 1990s and early 2000s. We have tried to ascertain whether – in the period since 2005 – national enterprises have been able to exert influence. The answer is threefold: first, national enterprises have indeed exerted considerable influence. We noticed this in Bac Ninh and Dong Thap (see Chapters 5 and 6).

Second, the potential for influencing policy is much greater than actual influence. The reason is the lack of organisational capacity in the form of business associations. The experience of Bac Ninh in the 2005–08 period showed what can be achieved. At that time, the local SME association forced the pace of reform and organised regular meetings with reform-minded government leaders. In Dong Thap, local enterprises have only participated by invitation, relying on the initiative of the provincial government to consult with them. Their organisational capacity remains weak. In Hung Yen and Ca Mau, there are associations but without strong leadership and influence. Local enterprises complain about government but do little to improve things. Of course individually there is little they can do. What is required is bundling their concerns and giving them organisational force. This is required not just in the provinces which we investigated but in many other provinces.

We recognise the main reason for the current weakness of associations.<sup>41</sup> Large enterprises find it easier to exert influence by contacting government leaders directly and individually.<sup>42</sup> We established in our interviews that this is the preferred route for leaders of big business. Participating in collective efforts is more time consuming. Leading collective efforts is more time-consuming still. Small enterprises need business associations to exert influence but their owners rarely have the clout – or time – to organise collective efforts. They also have the problem of being taken less seriously because of the large firm bias amongst many public officials.

Third, there is a way in which national enterprises have had a big influence on the reform but it is rarely acknowledged as such. The PCI which has been conducted since 2005 is based on the perceptions of domestic enterprises. The publication of the PCI scores and the ranking of provinces have attracted a lot of attention and triggered a range of responses:

- Business and central government have used the PCI as a source of information on the performance of provincial governments.
- Changes in PCI ranking have had an influence on whether provincial government officials were promoted or demoted – according to some observers.

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41 The problem of weak business associations has been recognised for some time (see, for example, Nguyen Dinh Cung *et al.* 2004: 12–16). The weakness continues but the reason seems to have changed over time.

42 In earlier years, policymaking tended to be a closed process (Tran Huu Huynh and Dau Anh Tuan 2007: 28–9). Government doors are now more open to allow business participation in this process.

- Provincial governments have sought assistance from VCCI to improve their ranking – as evidenced in the quantitative analysis.
- Poor performers have tried to learn from strong performers – confirmed in our interviews.

In short, the PCI scores which domestic enterprises have given to their provincial government seem to have had a considerable influence on the reform process. We will come back to this later as it is a vital piece in our assessment of the drivers of the reform process.

## 11.2 Learning in 63 laboratories

Neither the general policymaking literature nor the investment climate literature is able to give clear advice on how to bring about economic reform and tailor it to local conditions. Taking into account local conditions was a particular challenge in Vietnam. The geographical, economic and cultural conditions within the country vary a great deal. Add to this that the country was embarking on the transition from central planning to market economy and that North and South had different political legacies. The challenge was enormous and the chosen way forward was decentralisation of some government functions, notably those relevant for improving the investment climate. As shown in Chapter 3, decentralisation occurred through a process of political negotiation in which provincial leaders played the key role and were supported by some leaders in the central Party. Formal decentralisation was the result of a process of experimentation characterised by breaking fences and learning step-by-step. We have concentrated our research on the process since then.

Our qualitative and quantitative research leads us to suggest that the reform process since 2005 is a continuation of the previous practice of learning by experimenting. Each province is given the space to try out new things. Vietnam is learning by experimenting in 63 laboratories. Some provinces have used this space to the full, learnt a lot and built up their governance capacities in impressive ways. Others have been reluctant learners and reformed because they felt they had to. The differences in provincial state capacity which we have experienced – in the course of this research and in the course of visits to other provinces – are huge. Certainly the view of some critics that provinces are not capable of conducting effective economic policy is no longer valid as a generalisation.

Many factors have contributed to this learning and capacity building. The relative importance of these factors varies between provinces but it is important to see them working in conjunction. First, provincial leaders and officials have the ambition to make a difference to their career and to their province's growth. This came out clearly from the interviews. Second, provincial leaders who made the greatest progress learnt from working with the private sector. The comparison between our provinces makes this clear. Third, provinces learn from each other. A number of respondents confirmed that they sought to find out what has worked in other provinces but we cannot say how systematically such learning from each other is pursued. Third, central government contributes through its promotion



decisions. This takes us back to Chapter 3 where we asked how the Centre influences reform in the provinces. The research confirms that central government has retained substantial influence through its promotion decisions. Our interviews in the provinces confirm that promotion – decided by the Centre – plays a role. (Vice-) chairmen of the People's Committee and the heads of department seek promotion by implementing reforms which enhance economic growth and thus raise tax income of their province. Further confirmation comes from our quantitative analysis: provincial leaders who were promoted tended to be in provinces that had performed well in improving the PCI; those that were disciplined were in provinces where the PCI had gone backwards.

The Party also plays a role. Reforming requires changing the *status quo*, often in controversial ways. Precisely because Vietnam changed so fast, issues keep coming up for which there is no officially recognised way forward. Experimenting is needed but means taking risks. Where government executives have good connections with Party leaders, they are more likely to take such risks. The comparison between Dong Thap and Ca Mau shows that consensus between government and party is conducive to government reform. The greater the experimentation, the greater the need to engage the Party in discussion. Comparison of our research, which deals with the second wave of reform, with accounts of the first wave of reform (which is well portrayed in Rama 2008) shows that in this respect little has changed.

In summary, in the course of examining the drivers of economic reform, a learning dynamic became apparent. It is uneven between provinces but it is strong. This finding deserves further analysis. There is a literature which suggests that political decentralisation contributes to policy experimentation, but Hongbin Cai and Daniel Treisman (2006, 2009) present counterarguments based on empirical and modelling work. It would be useful to specify in further research under what conditions decentralisation leads to the observed learning and experimentation.

### 11.3 Decentralisation out of control?

We discussed our findings from the provinces with people from business, government, research and media in Ha Noi. Most acknowledged that decentralisation has been a success but then emphasised the problems which the empowerment of provincial government has brought about. The favourite topic was wasteful investment, in particular the excessive number of airports, seaports, and industrial zones built in the country. Provinces built expensive infrastructure seeking high prestige but ending up with low utilisation. Many of our informants referred to such problems. Some went further in proclaiming that decentralisation was out of control, giving entertaining examples. One of our informants lamented: 'thanks to decentralisation this agricultural province now has 14 golf courses! They destroyed the rice fields to convert them to golf courses!'

Addressing this question of whether decentralisation has gone too far means going beyond our initial research agenda. We will, however, address it here because our research on the dynamics of decentralised reform gives us some insights which might be of wider interest.

It is clear that there are problems of inefficiency and waste. The most visible sign are the cement, steel, electricity, golf and real estate projects which have been started but not completed. The reasons for this failure need to be laid bare and discussed openly. Our informants emphasised that there was too much emphasis on speed and not enough consideration of scale economies. In search of fame and money, private and public leaders fast-track their projects, often forgetting that some of these projects are too big for their province. Or they fail to liaise with neighbouring provinces where similar projects are planned. The resulting lack of efficiency and scale economies is increasingly recognised in the decentralisation debate. This is good.

The decentralisation debate, however, needs to recognise also the enormity of what Vietnam has achieved and acknowledge that the empowering of provincial governments was key to the country's success. The improvements in Vietnam's economic governance have been fast and substantial. It would have been impossible to orchestrate this centrally. Allowing all provinces to find their own way forward was central to Vietnam's progress in institutional and economic development. This is impossible to prove because we cannot examine the counterfactual.<sup>43</sup> We can, however, observe what happens in other countries where inappropriate recipes for governance reform are disseminated by central governments or foreign aid agencies. The history of governance reforms from outside includes many failures.<sup>44</sup> The conclusion drawn by critical analysts is to move away from ideas of global best practice and concentrate more on homegrown experiences (CFS 2010). 'Working with the grain' of local society is a perspective which is gaining increasing respect amongst researchers and policymakers (Crook and Booth 2011).

This perspective is needed but lacking in current assessments of Vietnam's recent reforms. Take, for example, the *2012 Vietnam Development Report*. It explicitly recognises that reform was gradual and based on experimentation in the early stage (p13) but then loses sight of this perspective in its assessment of the recent decentralisation experience. Where we see 'Learning in 63 laboratories' (heading of Section 11.2), the *Vietnam Development Report* (p18) sees 'fragmented development and institutional inertia'. This does not seem a helpful perspective for understanding what goes on in the provinces. And it is not helpful for finding ways of dealing with the wasteful investment that has undoubtedly occurred. The next section elaborates on our learning perspective and sets out how monitoring and setting boundaries helps to make the required improvements.

#### 11.4 Monitoring and setting boundaries

The extent and way in which provincial governments have used the space created by formal decentralisation varies. Some have learnt a great deal, built up considerable capacity and improved the local investment climate. That such

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43 The Abadie Synthetic Control Method for Comparative Research tries to deal with such problems but applying it to our case would be difficult (Abadie *et al.* 2011).

44 For example, the structural adjustment programmes imposed by donor agencies on African countries in the 1980s destroyed many of their state capacities (van de Walle 2001).

differences emerge was to be expected. What is unusual, however, is that Vietnam has a capacity to monitor the differences in the quality of local economic governance. In this section we explain why and how this monitoring capacity has influenced the dynamics of reform, why this capacity needs to be further extended and why it needs to be complemented with a capacity to set limits to what provincial governments can do in certain critical areas. We organise this discussion around the actors that are key for the boundary setting and monitoring: the Party and VCCI.

#### **11.4.1 The role of the Communist Party**

Governance reform is difficult to do. There was no tested and successful role model, certainly not in the early years of this century when Vietnam decided to empower provincial governments to reform economic governance and improve the investment climate. This decentralisation has been a success and it is important to understand why. In this concluding chapter we have argued that the key reasons were that Vietnam relied on its tradition of experimentation and allowed all provinces to find their own way of reforming in line with their endowments and preferences. From the national point of view, 63 (initially 64) provinces were unleashed to explore, to compete with each other and to learn from each other. The learning dynamics were enormous and the advances in reform were considerable. We know, however, from the PCI monitoring and from the research presented in this report that some provinces have been much more successful than others in using the space given to them. In spite of the tensions this has brought about, Vietnam has not fallen apart. Our discussions with a wide range of stakeholders indicate that the Communist Party has been the key force in holding the country together and providing the necessary glue for an increasingly complex political system.<sup>45</sup>

The Party has, however, failed to deal with two problems which endanger the entire edifice. Our research in the provinces highlights two corrosive issues: tax exemptions and land hoarding. There is evidence that granting excessive tax incentives continues in many provinces, that it undermines the financial capacity of their governments and leads to a race to the bottom.<sup>46</sup> And our interviews suggest that it undermines the legitimacy of provincial governments in the eyes of SMEs who rarely benefit. It even makes relationships between enterprises of different size difficult and thus makes it more difficult for the private sector to organise and develop a collective organisational capacity.

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45 It is worth pointing out that the Vietnamese system has generated lower inequality than the Chinese system. Over the past two decades, no two economies have averaged more rapid economic growth than China and Vietnam. But China's inequality has risen more rapidly than that of Vietnam. Abrami, Malesky and Zheng (2008) suggest that this is because of the difference in Party organisation. Compared with China, Vietnam's institutions empower a larger group of insiders and place more constraints on the party leadership, both through vertical checks and semi-competitive elections. As a result, Vietnam spends a larger proportion of its revenue on transfers and has been able to achieve more equalisation between provinces and individuals.

46 Granting tax incentives in the first wave of reform can be seen as a way of augmenting autonomy for provinces (Malesky 2008) but this political case for tax incentives no longer applies in the current phase.

Land speculation also has a poisonous effect, in particular when land is sold at preferential prices to enterprises which then do not use it in the promised way. We have seen in the course of our interviews that this practice does much harm and we have also seen that provincial governments are struggling to deal with it effectively.<sup>47</sup>

Both practices have been known for some time but progress in dealing with them has been slow. Provincial governments on their own cannot resolve this, partly because there is a conflict of interest between what is good for Vietnam, for the province, for the enterprise and for the individual officials concerned. Addressing these conflicts of interest requires guidance and intervention from above. It is difficult to see how these corrosive practices can be stopped without substantial involvement of the Party. Recent Politbureau Resolution No. 9 (December 2011) provides a basis for doing this. The resolution is a political affirmation of the transformative role of enterprises and their social responsibilities. Paying taxes is the prime social responsibility of an enterprise. Equally, acquiring land on false pretences is not compatible with Party Resolution No. 9.

Resolutions are important but not sufficient. Continuous monitoring on these two issues is important. The recent report of Vũ Xuân Thuyên (2010) shows that provinces continue to engage in negative competition. Enlisting the press in such monitoring seems appropriate. Vietnam has a cadre of competent and responsible journalists, in particular in the field of state-business relations. The press is, however, often held back from reporting illicit tax and land deals. Giving the press more freedom to report on issues where business and/or government act against the national interest and against the interest of society seems essential.

By concentrating its moral and political power on these two issues, the Party can make a major difference to shifting competition between provinces and competition between enterprises from the low road to the high road. By setting boundaries to what is acceptable, the Party can make a leap towards its ultimate objective: making Vietnam both competitive and inclusive.

#### **11.4.2 VCCI**

VCCI is a very Vietnamese organisation. It represents the private sector but it works closely with government and has strong links with the Party. The VCCI Board consists of business leaders representing individual enterprises and associations. The VCCI chairman is elected by the General Convention of Businesses but the appointment needs to be approved by the Party. The ambiguity in its constitution is reflected in the many tasks it carries out, many of which would be carried out by governmental organisations in other countries. It can cope with the multitude of tasks because it has a large professional staff and because it regards its wide mandate as an opportunity for reaching out rather than a burden.

Conducting the annual survey of the quality of economic governance in 63 provinces has become one of the most important and influential activities of VCCI. We have explained, in Section 11.1, how this annual survey, the PCI, gives national

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47 See also the recent Tien Lang case in Hai Phong – [www.vnnnews.net/tag/tien-lang](http://www.vnnnews.net/tag/tien-lang) (accessed 15 March 2012).

enterprises an important voice even in provinces where their organisational capacity remains weak. In this section, we suggest that the PCI has become a driver of quality improvements in its own right. The survey is conducted in a professional and impartial way; the indicators it generates have legitimacy. They can be compared across provinces and over time, enabling entrepreneurs, researchers, media, central government and provincial governments themselves to make broad judgements on both improvements and deterioration. It gives rise to numerous learning effects. It leads provincial governments to engage in positive competition with other provinces and emulate successful provinces. Provincial leaders are aware that high scores can enhance their promotion prospects and *vice versa*. It is a low cost way of enhancing an upward dynamic in governance reform. Continuing this annual survey seems essential but not sufficient.

Further improvement is needed. In order to achieve this it is not helpful to put the problems of decentralisation in terms of 'fragmentation' (as done in the 2012 *Vietnam Development Report*). 'Uneven learning' offers a better point of departure. Learning has been uneven between provinces – as evidenced in uneven PCI scores – indicating that the poor performers need help. VCCI already plays a role in helping poorly performing provinces to understand their own problems and indicating how other provinces have dealt with such problems. This can be stepped up. Distilling the key lessons from the last five years of reform, along with facilitating greater interaction on these issues between provincial governments could help boost reform and raise the quality of governance.

It is not enough, however, to work only on ways of strengthening the upward spiral in governance reform. It is equally important to take on those issues which feed into the downward spiral, namely tax avoidance and land corruption. No single organisation and no single measure can stop this downward dynamic. VCCI can, however, play an advocacy role and support Party and government in dealing with these problems. VCCI can play a key role because:

- It has direct knowledge of how these problems harm in particular the small and medium-sized enterprises. VCCI has a mandate to strengthen in particular the competitive prospects of small and medium-sized enterprises.
- It has direct access to big business, including foreign business, through a number of formal and informal channels. For example, VCCI is co-organiser of the Vietnam Business Forum, jointly with the American and European Business Chambers.
- It is well respected by the provincial governments and it has direct knowledge of the very uneven capacities of provincial governments for undertaking reforms. The success of the PCI lies in unpacking problems and tailoring support to local conditions.
- It has a history of working with policy researchers and making productive use of their expertise. Both local and international organisations have been involved in conducting analyses of the taxation and land issues.<sup>48</sup>

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48 See, for example, recent land transparency and land corruption studies by DEPOCEN (2010) and World Bank (2011) and the study of illegal policies for investment attraction by Vũ Xuân Thuỳên (2010).

- Most importantly, it can obtain political backing from the Party for taking on such sensitive issues. Recent Party Resolution No. 9 (December 2011), which recognises the transformative role of enterprises and underlines the social responsibilities of enterprises, provides a good basis for new initiatives.

In summary, a central recommendation emerging from this report is that land acquisition and tax avoidance issues be prioritised by Party, government and VCCI. These were not issues which we set out to study when we started the research but they kept coming up in the interviews and therefore kept coming up in the course of this report. Many other countries struggle with the same issues but perhaps Vietnam can surprise the world again by finding – through experimentation – solutions which suit the country's economic and political circumstances yet enable it to compete effectively in the global economy.

### 11.5 Lessons for other countries

The overriding lesson for other countries is that Vietnam was successful by finding its own way forward rather than relying on models advocated by international development agencies. This comes out clearly from Rama's (2008) account of the first wave of reform and from our account of the second wave of reform. This is not an argument against learning from each other's successes and mistakes. It is, however, an argument for starting with one's own internal and external circumstances.

The same point was made a long time ago by the historian Alexander Gerschenkron. In his book *Economic Backwardness in Historical Perspective* (1962) he argued that latecomers have to plot their own distinctive path of development. Repeating what others have tried before is rarely possible because each country has its own specific internal conditions and because the rise of the early developer changes the external conditions for the latecomer. Analysis of early industrialisation in continental Europe led Gerschenkron to this conclusion. Analysis of the successful industrialisers in East Asia leads to the same conclusion. Japan, Korea, Malaysia, Taiwan and China did not follow models from elsewhere. In 'Institutions and Growth in East Asia', Stephan Haggard (2004) emphasised how East Asia succeeded through a long process of 'transition' that was highly experimental in nature. Similarly, Michael Hobday (2003), in a review of Asian industrial development, concludes that it is diversity rather than uniformity in the institutional arrangements and development policy that characterises the innovation experience of the Asian Tigers.

We can add the case of Vietnam to this formidable list. Starting from desperate conditions less than 30 years ago, it has found its own way forward and transformed itself. While our research was not concerned with Vietnam's industrial development in general, the focus on reform in the provinces helped to understand three key features of the transformation: first, there was an alignment of interests of the newly-enabled decentralised actors with the reformers in central government; second, provinces had the space to experiment (what we called 'learning in 63 laboratories'); and third, the private sector engaged actively in these experiments.

The implication is not that international assistance agencies were superfluous. They could make useful contributions because they were feeding into a process of decentralised reform which was being driven forward from within Vietnam. They were active in 27 or so provinces. GTZ, DANIDA, IFC, ILO, UNIDO, SIDA, CIDA and others provided useful technical inputs for administrative reform and provided complementary tools for understanding and promoting local economic development. One of the most influential contributions was the financial and technical support by USAID, DAI and the Asia Foundation for the Provincial Competitiveness Index. As stressed earlier, the PCI provided critical capacity to monitor reform efforts and contributed to multiple learning effects within and across provinces.

This PCI experience entails a clear and specific lesson for other countries. It highlights the power of having an explicit quantitative tool which measures reform performance. The PCI has been a useful tool through which the central government can both encourage and reward good performance and, where necessary, sanction poor performance. In Vietnam this has spurred stronger efforts for reform. Similar indices have been constructed for other countries,<sup>49</sup> but these have often been one-off exercises with limited impact. Donors can support the institutionalisation and adoption of such measures, thereby providing a tool for governments which, if successful, can become part of the government's own mechanism for monitoring sub-national performance.

The limitation of the Vietnamese index needs, however, to be recognised. It is deliberately limited to a relatively narrow range of administrative measures and regulations. The long-run development of provinces (or other sub-national units) also depends upon the production and effective management of other key public goods and services, including infrastructure, better educational standards, and environmental controls. It would be appropriate to consider the development of systematic, independent measures of these factors to encourage progress in these dimensions too.

While this research supports the case for decentralising authority for reforming the investment climate, it also recognises the pitfalls of decentralising investment control, with large sums wasted on inefficient tax competition and wasteful infrastructure projects. This suggests that investment decentralisation needs to be accompanied by strong central regulation specifying what provincial governments are permitted to offer investors and what they are not. These rules should apply equally to all provinces. The aim should be to encourage provinces to compete on their helpfulness to investors and the quality and timeliness of the services they offer, not on tax incentives or holidays. Similarly, large infrastructure investments, such as seaports and airports, must be subject to central control or, at least, consistent with central master plans to avoid inefficient oversupply of such public goods.

A further problem caused by decentralising investment controls in Vietnam has been a tendency for local elites to push farmers off land to make way for development with very little compensation. This is a common problem in rapidly

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49 See [www.asiafoundation.org](http://www.asiafoundation.org) for details of such indices in Indonesia, Bangladesh, Sri Lanka, Cambodia and the Philippines.

industrialising countries across the world. Here it is essential that the Centre acts as a counterweight to local development interests, providing a clear framework for the process which must be followed and ensuring that compensation is appropriate. In both this area, and in framing the tax regime, donors can play a useful role, bringing experience from other countries to the attention of policymakers and supporting their access to expertise in constructing regulatory frameworks which are suitable to the country's specific context.

Finally, there is a lesson for the private sector in Vietnam and in other countries. The research highlights the importance of both formal and informal spaces for communication and dialogue between the private sector and government. Reform has happened fastest in places where government has had a good understanding of the problems faced by the private sector and has been responsive to their needs. The capacity of government to do the right things depends to a considerable extent on the capacity of the private sector to engage. Governments and donors can support and challenge the private sector to develop such collective capacity but to do so is above all the responsibility of the private sector itself. Business people throughout the world excel in pointing out public sector failures. Few recognise that public sector failure often arises because the private sector is not sufficiently well organised to work with government in a constructive way. The comparison between provinces in Vietnam underlines the importance of developing the organisational capacity of the private sector. This is not a new point. The importance of well-organised business associations has been recognised for a long time in Vietnam and elsewhere.<sup>50</sup> This point, however, needs to be made more forcefully. For government to be effective in improving the investment climate and conducting industrial policy, it requires an effective business sector. Conversely, behind public sector failure is often private sector failure.

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50 See, for example, Tran Huu Huynh and Dau Anh Tuan (2007), Abdel-Latif and Schmitz (2010), Schneider and Maxfield (1997).



# Appendix 1: Interview questions for business

Enterprise:

Respondent:

Date:

1. What is your main line of business?
2. What was the best experience for your business last year and what was the worst?
3. Why is your business in the province of .....?
4. Does the provincial government matter for the success of your business? If yes, in which way?
5. Have you heard of the PCI? Do you know what it is about?
6. According to the PCI, the greatest progress over the last five years was made in the area of .....? Do you agree there was real improvement? Can you give us two examples of progress (or lack of progress), comparing 2005 with 2011?
7. Have the changes in policies and regulations influenced your investment decisions?
8. What prompted the reform?
  - Pressure from within the government?
  - Pressure from outside: the private sector?
  - Other factors?
9. Who initiated the reform discussion? Who was pushing for it? What did they do?
10. Who slowed it down? What did they do?
11. In your experience, were the promises (declarations/announcements) of department leaders followed through by officials in lower ranks? What did they do – or fail to do?
12. Was there a critical year (moment/event) in the reform process? What happened?
13. Were you personally involved in the discussion of the reform? How?
  - Discussing with other business people?
  - Discussing directly with government people?
14. Did you have any influence? If yes, how do you know?
15. Did other business people – or a group of business people – play a major role? Who? How?

16. Which kind of contacts/meetings with government people were more effective for moving the reform forward? Formal or informal?
17. In what forum did you or other business people get involved in the reform debate?
  - Annual Meeting of government and investors?
  - People’s Committee?
  - Party meetings?
  - Business association meetings?
  - Personal meetings with government people?
 Which of these were most important?
18. Where did the personal meetings with government take place?
  - In the government office?
  - In the enterprise?
  - Over dinner/lunch?
  - Family gatherings?
  - Other?
 Which of these happened most frequently? How frequently?
19. Are you a member of the SME association? Any other association?
20. Was your association active in the reform process? Did it have any influence? Major or minor? What did it do? Were you personally involved?
21. Does it matter to you personally whether the reform succeeds? Why? Why not?
22. Is there discussion amongst business people about the ranking of your province in the PCI? Once/occasionally/frequently? Has this led to pressure on the provincial government to change rules and regulations further?
23. Please give us your view on the influence which the main stakeholders had on the reform. And indicate whether the influence was high/medium/low/non-existent.

Stakeholder	High	Medium	Low	None
Provincial leader				
Dept of Planning & Investment				
Dept of Industry & Commerce				
Dept of Natural Resources & Environment				
Industrial Zone Authority				
Other departments				
Central government				
People’s Committee at District Level				
Foreign Donor Agencies (indicate which)				
Press/TV/Radio				
National business leaders				
Foreign business people				
SME association				
Other association (indicate which)				
Chamber of Commerce and Industry				
Other stakeholders (indicate which)				

24. Which stakeholders had the biggest influence? Rank. 1....., 2....., 3.....
25. Are there **other** areas in which business played an important role in driving the reform forward? Which areas? How did entrepreneurs get involved?
26. With regard to the future, does your province need further improvements in policies and regulations? In which area?
27. What are you doing to make this happen?
28. Are you planning to make substantial investment over the next three years?
29. In this province or elsewhere? If elsewhere, why?
30. Do provincial policies and regulations have a major influence on whether or where you will invest?

## Appendix 2: Interview questions for government

Department/Organisation:

Respondent:

Date:

1. What is your role in this department/organisation? What do you do?
2. In which way does your department matter for business?
3. Have you heard of the PCI? Do you know what it is about?
4. According to the PCI, the greatest progress over the last 5 years was made in the area of .....? Do you agree there was real improvement? Has it influenced the work of your department?
5. What prompted the reform?
  - Pressure from within the government?
  - Pressure from outside: the private sector?
  - Other factors?
6. Who initiated the reform discussion? Who was pushing for it? What did they do?
7. Who slowed it down? What did they do?
8. In your experience, are the promises (declarations/announcements) which you make as department leader understood/followed through by officials in lower ranks? What do they do – or fail to do?
9. Was there a critical year (moment/event) in the reform process? What happened?
10. Were you personally involved in the discussion of the reform? How?
  - Discussions in your own department?
  - Discussions with other departments?
  - Discussions with business people?
11. Did you have any influence? If yes, how do you know?
12. Did other government people – or a group of government people – play a major role? Who? How?
13. Which kind of contacts/meetings with business people were more effective for moving the reform forward? Formal or informal?
14. In what forum did you or other business people get involved in the reform debate?
  - Annual Meeting of government and investors?
  - People's Committee?

- Party meetings?
  - Business association meetings?
  - Personal meetings with business people?
- Which of these were most important?

15. Where did the personal meetings with business people take place?

- In your office?
- In the enterprise?
- Over dinner/lunch?
- Family gatherings?
- Other?

Which of these happened most frequently? How frequently?

16. What has been the role of the business association in the reform process? What did it do in 2005/6? And in 2010/11? With regard to which questions has it been effective? Why? With regard to which questions has it been ineffective? Why?

17. Does it matter to you personally whether the reform succeeds? Why? Why not?

18. Did your department have any influence? Major or minor? What did it do?

19. Is there discussion amongst government people about the ranking of your province in the PCI? Once/occasionally/frequently? Has this led to pressure on your department to change policies and regulations further?

20. Please give us your view on the influence which the main stake holders have had on the reform. And indicate whether the influence was high/medium/low/non-existent.

Stakeholder	High	Medium	Low	None
Provincial leader				
Dept of Planning & Investment				
Dept of Industry & Commerce				
Dept of Natural Resources & Environment				
Industrial Zone Authority				
Other departments				
Central government				
People's Committee				
Foreign Donor Agencies (indicate which)				
Press/TV/Radio				
National business leaders				
Foreign business people				
SME association				
Other association (indicate which)				
Chamber of Commerce and Industry				
Other stakeholders (indicate which)				

21. Which stakeholders had the biggest influence? Rank. 1....., 2....., 3.....
22. Are there **other** areas in which business played an important role in driving the reform forward? Which areas? How did entrepreneurs get involved?
23. With regard to the future, does your province need further improvements in policies and regulations? In which area?
24. What are the priorities of your department for the next two years?
25. What are you doing to put them into practice?

## Appendix 3: List of respondents

Number	Name	Organisation	Position	Category	Province
1	Nguyen Nhan Chien	Bac Ninh Provincial Committee	Vice Chairman	Government	Bac Ninh
2	Bui Hoang Mai	Industrial Zone Authority	Vice Director	Government	Bac Ninh
3	Nguyen Van Hai	Department of Industry and Commerce	Director	Government	Bac Ninh
4	Nguyen Phuong Bac	Department of Planning and Investment	Vice Director	Government	Bac Ninh
5	Tran Quang Huy	Department of Natural Resources and Environment	Director	Government	Bac Ninh
6	Nguyen Duc Truc	Department of Justice	Director	Government	Bac Ninh
7	Le Tien Nam	Department of Construction	Vice Director	Government	Bac Ninh
8	Dang Minh Ngoc	Hung Yen Provincial Committee	Vice Chairman	Government	Hung Yen
9	Dang Ngoc Quynh	Department of Planning and Investment	Director	Government	Hung Yen
10	Nguyen Hai Trieu	Department of Industry and Commerce	Director	Government	Hung Yen
11	Le Ngoc Soi	Department of Natural Resources and Environment	Vice Director	Government	Hung Yen
12	Bui Quang Kiem	Department of Construction	Vice Director	Government	Hung Yen
13	Doan Anh Quan	Board Management of Pho Hien University Park	Manager	Government	Hung Yen
14	Chu Tuong Anh	Department of Taxation	Vice Director	Government	Hung Yen
15	Le Huu Thuan	Department of Labor, War Invalids, and Social Affairs	Vice Director	Government	Hung Yen
16	Pham Thi Ly	Department of Science and Technology	Vice Director	Government	Hung Yen
17	Nguyen Trong Tam	Department of Agriculture and Rural development	Chief of Secretariat	Government	Hung Yen
18	Mr. Tuan	Department of Home Affairs	Manager of Administration Innovation	Government	Hung Yen

Number	Name	Organisation	Position	Category	Province
19	Bui The Cu	Industrial Zone Authority	Vice Director	Government	Hung Yen
20	Vo Minh Tam	Department of Natural Resources and Environment	Vice Director	Government	Dong Thap
21	Luong Van Dang	Industrial Zone Authority	Vice Manager	Government	Dong Thap
22	Vo Thanh Luong	Department of Construction	Vice Manager of General Office	Government	Dong Thap
23	Nhi Van Khai	Department of Industry and Commerce	Vice Director	Government	Dong Thap
24	Ngo Hong Trieu	Department of Planning and Investment	Vice Director	Government	Dong Thap
25	Tran Phuoc Hung	Department of Home Affairs	Manger of PAR	Government	Dong Thap
26	Le Minh Hoan	People Committee	Chairman	Government	Dong Thap
27	Pham Thanh Phong	Department of Justice	Director	Government	Dong Thap
28	Nguyen Thien Nghia	Project 30 Unit	Vice Chief	Government	Dong Thap
29	Nguyen Phuoc Son	Department of Science and Technology	Director	Government	Dong Thap
30	Tran Minh Hong	Department of Labor, War Invalids, and Social Affairs	Director	Government	Dong Thap
31	Mai Hong Thanh	Investment Promotion Center	Director	Government	Dong Thap
32	Nguyen Huu Dung	Cao Lanh City of People Committee	Chairman	Government	Dong Thap
33	Nguyen Phung Hai	Tan Hong's District People Committee	Chairman	Government	Dong Thap
34	Duong Tien Dung	Provincial Committee	Vice Chairman	Government	Ca Mau
35	Pham Tuan Kiet	Provincial Promotion Centre of Commerce, Investment, Tourist	Vice Director	Government	Ca Mau
36	Nguyen Viet Lap	Industrial Zone Authority	Vice Director	Government	Ca Mau
37	Ngo Thanh Nhon	Department of Planning and Investment	Vice Director	Government	Ca Mau
38	Quach Minh Luan	Department of Commerce and Industry	Vice Director	Government	Ca Mau



Number	Name	Organisation	Position	Category	Province
39	Dang Huu Lac	Department of Natural Resources and Environment	Vice Director	Government	Ca Mau
40	Dang Thai Nguyen	Department of Construction	Vice Director	Government	Ca Mau
41	Chau Cong Bang	Department of Agriculture and Rural Development	Vice Director	Government	Ca Mau
42	Le Thanh Tong	Department of Labor, War Invalids, and Social Affairs	Vice Director	Government	Ca Mau
43	Tran Thanh Hoa	Department of Home Affairs	Vice Director	Government	Ca Mau
44	Nguyen Thanh Xua	Department of Taxation	Vice Director	Government	Ca Mau
45	Thanh Ngon	Dam Doi District People Committee	Vice Chairman	Government	Ca Mau
46	Vu Xuan Thuyen	Agency of Enterprise Development, MPI	Senior official	Government	Ha Noi
47	Le Viet Thai	Research Department on Economic Institutions, CIEM	Head of the Department	Government	Ha Noi
48	Nguyen Van Vu	Viglacera, Yen Phong Industrial Zone	Director	Business	Bac Ninh
49	Kim Yong Seok	SamSung Electronics Vietnam	Complex Planning Director	Business	Bac Ninh
50	Chan Gyun Young	Seoul Metal Vietnam JSC	General Director	Business	Bac Ninh
51	Vu Quang Anh	ALS Bac Ninh Company Co. Ltd	Director	Business	Bac Ninh
52	Nguyen Hong Hanh	Kinh Bac City Development Holding Corp	Sale Executive	Business	Bac Ninh
53	Sachio Kageyama	Canon Vietnam	General Director	Business	Bac Ninh
54	Tran Vong	Bac Viet Structure Steel Building Company	Human Resource Manager	Business	Bac Ninh
55	Jack Lin	Mitac Precision Technology Vietnam Co. Ltd	Senior Manager	Business	Bac Ninh
56	Peter Pan	Hon Hai Technology Group	Manager Land Division	Business	Bac Ninh
57	Dong Ngoc Cam Nhung	Vissan Limited Company in TienSon Industrial Zone	Production Manager	Business	Bac Ninh

Number	Name	Organisation	Position	Category	Province
58	Tran Ngoc Linh	Duc Viet Manufacturing & Trade Joint Stock Company	Director	Business	Bac Ninh
59	Phung Thi Thu Ha	Ace Cook Vietnam	Administration Manager	Business	Bac Ninh
60	Nguyen Dinh Vinh	Ariston Thermo Vietnam Co. Ltd	Production Manager	Business	Bac Ninh
61	Vu Mai Anh	Vinamilk	Chief Accountant	Business	Bac Ninh
62	Nguyen Thi Hoa	Truong Giang Company	Director	Business	Bac Ninh
63	Vu Quy	Hung Long Company	Director	Business	Bac Ninh
64	Nguyen Van Son	Hoang Anh Company	Director	Business	Bac Ninh
65	Nguyen Van Trung	Trung Nguyet Company	Executive Director	Business	Bac Ninh
66	Pham Van Tiep	Hung Phat Co. Ltd	Director	Business	Hung Yen
67	Nguyen Thi Muon	Phuc Hung Co. Ltd	Director	Business	Hung Yen
68	Nguyen Thi Thanh	Thanh Vinh Private Company	Director	Business	Hung Yen
69	Ha Van Lai	Lai Hoai Co. Ltd	Director	Business	Hung Yen
70	Bang Cheol Sik	KPI Special Vehicles Body Co. Ltd	General Director	Business	Hung Yen
71	Chang Hong Kim	DongYang E&P Vietnam Co. Ltd	General Director	Business	Hung Yen
72	Tran Quang Duong	Vietnam-Italy Steel	Project Manager	Business	Hung Yen
73	Tran Thanh Long	Ngoc Diep Joint Stock Company	Factory Director	Business	Hung Yen
74	Tsuneto Yasuji	Canon Electronics Vietnam Co. Ltd	General Director	Business	Hung Yen
75	Hiroshi Kurosaki	JP Corelex (Vietnam) Co. Ltd	General Director	Business	Hung Yen
76	Le Thi Mai May	Fancy Creation Vietnam Co. Ltd	Chief Accountant	Business	Hung Yen
77	Chiba Tokiteru	Akiyama – SC (Vietnam) Co. Ltd	General Director	Business	Hung Yen
78	Le Minh Thuan	Sao Mai Co.	Vice Director	Business	Dong Thap
79	Nguyen Ba Dien	Golden Lotus Co.	CEO	Business	Dong Thap
80	Phan Thanh Nhan	Minh Thanh Co.	Director	Business	Dong Thap
81	Ha Xuan Long	DASCO. Co.	Director	Business	Dong Thap
82	Nguyen Anh Dung	Water Supply Co. Director	Vice General	Business	Dong Thap

Number	Name	Organisation	Position	Category	Province
83	Trieu Duong	New Hope Co.	General Director	Business	Dong Thap
84	Nguyen Hoang Trieu	Docifish Co.	Director	Business	Dong Thap
85	Le Ba Ty	Truong Giang Seafood Co.	Director	Business	Dong Thap
86	Nguyen Van Hung	Dong Thap Packaging Co.	Director	Business	Dong Thap
87	Tran Thi Dao	IMEXPHARM Co.	Director	Business	Dong Thap
88	Dam Thi Van	Hoa Hung Co.	Director	Business	Dong Thap
89	Tran Thi Le Khanh	Vinh Hoan Co.	Director	Business	Dong Thap
90	Nguyen Quang Thinh	PG Bank	Director	Business	Dong Thap
91	Tran Quang Si	Petroleum Trading Co.	Vice Director	Business	Dong Thap
92	Le Ngoc Hang	Hidico	Director	Business	Dong Thap
93	Nguyen Chi Linh	Chi Linh Co. Ltd	Director	Business	Ca Mau
94	Pham Hung Trang	Constructing and post service Joint Stock Co.	Director	Business	Ca Mau
95	Mr. Thong	Camau Trading Joint Stock Co.	Manager of Human Resource Department	Business	Ca Mau
96	Nguyen Minh Phu	Minh Phu Seafood Co.	Chairman	Business	Ca Mau
97	Do Cong Thanh	Ca Mau Processing Seafood Co.	Vice General Director	Business	Ca Mau
98	Chu chea hok	Sinh Viet Company	Director	Business	Ca Mau
99	Ta Hoang Nam	Hue Nam Co.	Director	Business	Ca Mau
100	Mr. Chung	Quoc Viet Processing Seafood and Ex-Im Co.	Vice Director	Business	Ca Mau
101	Vo Anh Hoang	Minh Hai Hospital	Director	Business	Ca Mau
102	Nguyen Viet Khai	Quang Dien Co.	Vice Director	Business	Ca Mau
103	Manager	NH & KS BEST CM Co.	Manager	Business	Ca Mau
104	Nguyen Tran Bat	InvestConsult Group	Chairman of Board	Business	Ha Noi
105	Nguyen Phuong Thao	Vietnam Investment Development Group	Business Director	Business	Ha Noi
106	Nguyen Nhan Phuong	SME Association	Chairman	Association	Bac Ninh
107	Dang Dinh Quan	Hung Yen Enterprises Association	Chairman	Association	Hung Yen

Number	Name	Organisation	Position	Category	Province
108	Nguyen Duc Thien	Young Entrepreneur Association	Chairman	Association	Hung Yen
109	Nguyen Hai Quan	Young Entrepreneur Association	Chairman	Association	Dong Thap
110	Dang Xuan Huy	Dong Thap Enterprises Association	Chairman	Association	Dong Thap
111	Minh Khoi	Young Businessman Association	Chairman	Association	Ca Mau
112	Vu Quoc Tuan	Vietnam Association of Craft	Chairman	Association	Ha Noi
113	Nguyen Hoai Nam	Vietnam Association for Seafood Exporters and Producers	Deputy General Secretary	Association	Ha Noi
114	Nguyen Van Lan	MPDF – IFC	Senior expert	Donor	Ha Noi
115	Mimi Groenbech	International Labour Organization	Chief Technical Adviser	Donor	Ha Noi
116	Nguyen Cao Cuong	Foreign Investment Review	Editor in Chief	Media	Ha Noi
117	Manh Quan	Saigon Tiep thi Review	Journalist	Media	Ha Noi
118	Le Duy Binh	Economica Vietnam	Director	Expert	Ha Noi
119	Phan Huu Thang	Center for Foreign Investment Studies	Director	Expert	Ha Noi
120	Nguyen Minh Phuong	Institute of Scientific of State Organization, Ministry of Home Affairs	Manager	Expert	Ha Noi
121	Nguyen Cuc	Institute of Politics – Administration Region I	Senior official	Expert	Ha Noi

## Appendix 4: Modelling the determinants of governance reform

We estimate the following model:

$$PCIGrowth0610_i = \beta_0 + \beta_1.PCI06_i + \beta_2.InInvprivateshare_i + \beta_3.InGDPpercap_i + \beta_4.Leaderchange_i + \beta_5.Distance_i + \beta_6.City_i + \beta_7.Secondary_i + \beta_8.revenueratio_i + \varepsilon_i$$

Where  $PCIGrowth0610_i$  is the growth of the PCI from 2006 to 2010 of province  $i$ ;<sup>51</sup>  $PCI06_i$  is the initial value of the PCI in 2006;  $Invprivateshare$  is the average share of private investment in total investment between 2000–2010;  $lnGDPpercap_i$  is the log of provincial GDP per capita in 2006;<sup>52</sup>  $Leaderchange_i$  is a dummy variable indicating that there was at least one change of chairman of the Provincial People's Committee during the period;  $Distance_i$  is the distance from Ha Noi or Ho Chi Minh City;  $City_i$  is a dummy variable indicating that the province is one of the five national cities (Ha Noi, Ho Chi Minh City, Can Tho, Danang, Hai Phong);  $Secondary_i$  is the share of the provincial workforce that have at least secondary schooling in 2006;  $revenueratio_i$  is a dummy variable indicating that the province receives less than 100 per cent of its locally collected revenues from the Centre (an indication that it is a surplus province); and  $\varepsilon_i$  is an i.i.d. error term.<sup>53</sup>

The results of estimating four different versions of this model, starting from the most parsimonious to the complete model, are shown in Table A4.1.

The results show several interesting features. First, strong convergence of the PCI appears in every model. Second, neither the share of private sector in investment, nor per capita GDP are statistically significant in any model. In fact, per capita GDP becomes statistically significant if the model is run without control variables – but this disappears when other variables are added, and the size of the coefficient falls when RevenueRatio is added. This suggests that GDP was picking up the effect of a low revenue ratio, since these variables are strongly (negatively) correlated.

The remaining variables have consistent effects throughout: leadership change increases reform; distance has no effect; but being a city makes reform more difficult. Having more secondary education has a consistent negative effect, as do the two outliers provinces of Lang Son and Bac Kan.

51 The mean of the annual arithmetic growth rate is used to avoid excess dependence on the end period values.

52 Both investment and GDP are measured in constant 1994 prices.

53 In addition we add dummies for two provinces (Lang Son and Bac Kan) which are significant outliers and which strongly bias all the other results.

**Table A4.1 Determinants of PCI growth**

	Average PCI Growth			
	Model 1	Model 2	Model 3	Model 4
PCI06	-0.002 (-3.35)	-0.00208 (-3.33)	-0.00238 (-4.77)	-0.00238 (-4.92)
Invprivateshare		-0.01356 (-0.23)	0.016352 (0.34)	-0.00096 (-0.02)
lnGDPpercap		0.003037 (0.6)	0.004642 (0.96)	-0.00012 (-0.02)
Leaderchange			0.007419 (1.56)	0.009342 (1.98)
Distance			-3.99E-06 (-0.4)	-2.92E-06 (-0.3)
City			-0.01558 (-1.94)	-0.02266 (-2.64)
Secondary			-0.0013 (-6.22)	-0.00129 (-6.36)
RevenueRatio				0.012568 (2.02)
province20_LangSon	-0.05669 (-2.91)	-0.05578 (-2.8)	-0.06317 (-4.08)	-0.06119 (-4.06)
province24_BackKan	-0.03683 (-1.89)	-0.0301 (-1.32)	-0.04336 (-2.27)	-0.05224 (-2.73)
Constant	0.100657 (3.47)	0.090222 (1.38)	0.176263 (2.79)	0.226934 (3.42)
Adjusted R2	0.2214	0.2001	0.5218	0.5476
Number of observations	64	64	64	64

Note: t-statistics in parentheses.

**Table A4.2 Correlations of PCI scores and VCCI PCI team**

	PCI (t)	PCI (t-1)	PCI (t-2)	VCCI (t)	VCCI (t-1)	VCCI (t-2)
PCI (t)	1					
PCI (t-1)	0.7593*	1				
PCI (t-2)	0.7182*	0.7569*	1			
VCCI (t)	0.1838*	0.1286*	0.1798*	1		
VCCI (t-1)	0.2409*	0.1673*	0.1525*	0.2931*	1	
VCCI (t-2)	0.3119*	0.2082*	0.1582*	0.2970*	0.3399*	1

Note: An asterisk indicates statistically different from zero at a 5 per cent confidence level.

## A model of the impact of PCI team visits on PCI performance

Consider a simple dynamic model of the PCI score in province  $i$  in year  $t$ .

$$PCI_{it} = \alpha.PCI_{it-1} + \beta.VCCI_{it} + \gamma_t + RM_i + v_{it}$$

Where  $VCCI_{it}$  is a dummy variable indicating whether there was a visit from the PCI team of VCCI<sup>54</sup> to the province in year  $t$ ;  $\gamma_t$  is a set of dummy variables indicating factors that affect all provinces in a given year;  $RM_i$  is an unobserved variable indicating how 'reform-minded' the province is; and  $v_{it}$  is a i.i.d. error term. This model suggests that PCI scores are persistent, as indicated by their strong correlation over time, but that a PCI team visit may boost the PCI score in the year in which it takes place.

Estimating this model is complicated by two factors. First, it is a dynamic model, with an endogenous dependent variable on the right-hand side of the equation. Second, we assume that there is an unobserved characteristic of 'reform-mindedness' which can also influence the score for a province. Moreover, reform-mindedness is almost certainly positively correlated with both PCI performance and with whether the province invites the PCI team to visit. As a result, OLS estimates of  $\alpha$  and  $\beta$  will be biased upwards. Moreover, this problem cannot be solved by estimating using a fixed-effects panel estimator, because this induces correlation between  $PCI_{it-1}$  and the averaged error term, giving a downward bias to the estimated parameters. Similarly, a first-difference estimator has a strong downward bias due to correlation between  $PCI_{it-1}$  and  $v_{it-1}$ . The solution is to use a one-step difference Generalised Method of Moments (GMM) estimator (Arellano and Bond 1991). In principle, this can eliminate the bias caused by the unobserved reform-mindedness as well as address the endogeneity of the lagged dependent variable. The results are shown in Table A4.3.

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54 Note that we are referring here only to visits of the PCI Team of the VCCI for diagnostic workshops, not the visits by VCCI staff to the province for other reasons.

**Table A4.3 One-step difference GMM estimation of impact of PCI team visits on PCI score**

Dynamic panel-data estimation, one-step difference GMM							
Group variable: pci_id		Number of obs	=				190
Time variable: year		Number of groups	=				64
Number of instruments = 10		Obs per group:	min	=			1
Wald chi2 (3) = 29.12			avg	=			2.97
Prob > chi2 = 0.000			max	=			3
pci	Coef.	Robust Std. Err.	z	P> z	[95% Conf. Interval]		
pci							
L1.	.4742086	.2249807	2.11	0.035	.0332545	.9151627	
vcci_visit	.5701594	.4854597	1.17	0.240	-.3813241	1.521643	
_lyear_2008	-2.664494	.5028629	-5.30	0.000	-3.650087	-1.6789	
_lyear_2010	-1.274766	.4603508	-2.77	0.006	-2.177037	-.3724948	
_lyear_2010	-1.705363	.4933799	-3.46	0.001	-2.672369	-.7383557	
Instruments for first differences equation							
Standard							
D. (_lyear_2006 _lyear_2007 _lyear_2008 _lyear_2009 _lyear_2010 vcci_visit)							
GMM-type (missing=0, separate instruments for each period unless collapsed)							
L(2/.)pci							
Arellano-Bond test for AR (1) in first differences: z = -2.79 Pr > z = 0.005							
Arellano-Bond test for AR (2) in first differences: z = 0.62 Pr > z = 0.532							
Sargan test of overid. restrictions: chi2 (5) = 1.05 Prob > chi2 = 0.958							
(Not robust, but not weakened by many instruments.)							
Hansen test of overid. restrictions: chi2 (5) = 1.05 Prob > chi2 = 0.958							
(Robust, but can be weakened by many instruments.)							

Table A4.3 shows two key results. First, it confirms the persistence of PCI scores:  $\alpha$  is positive and statistically significant. Second, it provides some evidence that visits from the PCI team may improve the PCI score. The estimate of  $\beta$  is 0.57, suggesting that a visit from the PCI team increased a province's PCI score by 0.57 in the year of the visit. However, the estimate is not statistically significant at conventional confidence levels.



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