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Abstract: Vietnam is now at the critically important juncture as the country is preparing the National Socio-economic Development Strategy 2011-2020 (NSDS). The NSDS will guide the two five-year plans in the next decade, and provide key inputs for the Eleventh Party Congress, scheduled to be held in January 2011. This paper seeks to provide inputs for the debates and discussion along the preparation of the national development strategy. The paper focuses on the relevance of industrial policy for national economic development and the role of large economic groups as an instrumental tool for implementing industrialization policy for the purpose of national economic development. The chapter reviews the policies adopted by Vietnam during the course of economic development through the lens of 'industrial policy' emulating the industrial policy framework adopted by other countries by focusing on the role of large economic groups as an instrument for industrialization. The authors argue that industrial policy is still relevant for Vietnam and large economic groups. While this could be viewed as a double-edged sword, it is still relevant and feasible for industrial policy implementation.

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Chapter 4

VIETNAM'S INDUSTRIAL POLICY AND LARGE ECONOMIC GROUPS: A DISCUSSION

Nguyen Ngoc Anh and Nguyen Duc Nhat

4.1 Introduction

Vietnam is now at the critically important juncture as the country is preparing the National Socio-economic Development Strategy 2011-2020 (NSDS). The NSDS will guide the two five-year plans in the next decade, and provide key inputs for the Eleventh Party Congress, scheduled to be held in January 2011. After more than 20 years of economic reform, changing from a centrally planned economy into the market economy, Vietnam has undergone significant economic growth and is expected to become a 'middle-income' country in the next decade. The country's patterns of growth will change as income levels change. Therefore, to avoid the middle-income trap by sustaining high rates of economic growth and poverty reduction, Vietnam realizes that it needs to re-structure the economy and become an industrialized country.

The importance of industrialization as an engine of economic growth and development has long been recognized by today's industrialized and newly industrialized countries. A number of explanations have been offered to explain the empirical correlation between the degree of industrialization and per capita income in developing countries. Productivity is higher in the manufacturing sector than in the agricultural sector. Manufacturing is assumed

to be more dynamic than other sectors. A transfer of productive resources to more dynamic sectors contributes to growth. Capital accumulation can be more easily realized in manufacturing than in agriculture. The manufacturing sector offers special opportunities for economies of scale, which are less available in agriculture or services (Szirmai, 2008). Manufacturing generates employment at higher skill levels, facilitates better linkages across the services and agricultural sectors, between rural and urban areas, and between consumer, intermediate and capital goods industries. Prices of manufactured exports are less volatile and less susceptible to adverse business cycles, to long-term deterioration than those of primary goods, making it particularly strategic in highly commodity-dependent developing countries like Vietnam. In addition, industrialization is a critical tool in poverty eradication, employment generation, and regional development policies. Finally, it can spur technological upgrading and innovation as well as productivity gain and is hence able to play the development role more suitably than the agricultural sector (See Table 4.1).

Table 4.1: Characteristics of Agricultural versus Industrial Sectors

Characteristics of the Agricultural Sector	Characteristics of the Industrial Sector
Diminishing returns	Increasing returns
Commodity competition	Dynamic imperfect competition
Extreme price fluctuations	Stable prices
Generally unskilled labor	Generally semi-skilled or skilled labor
Irreversible wages	Reversible and more stable wages
Innovation leads to lower prices	Innovation leads to higher revenues
Creation of a feudalist class structure	Creation of a middle class

Source: Authors.

Realizing the critical role that industrialization (and manufacturing) plays in economic development, virtually all of today's industrialized nations actively supported and protected their industries through specific policies and institutions throughout their history of industrialization (Lall, 2004, Chang, 2002 and Chang, 2002). Following the initial success of economic reform, the government of Vietnam has recognized the importance of industrialization (and modernization) which is seen as a central part of the development agenda, and to facilitate the transformation of the country's economic structure to that of a modern industrial economy. Vietnam has been experimenting with a number of diverse trade and industrial policies but much of it has been based upon wishful thinking rather than serious consideration and concerted strategy. Earlier efforts include a number of measures instituted to nurture infant industries.¹ Nonetheless, the industrial capacity created did not always correspond to local demand and supply conditions and the developmental contribution of the industrial sector has been well below its potential. However, the world has witnessed profound changes in the last few decades. Like other late industrializing countries, Vietnam is now in a world in which conditions for implementing industrial policy have changed to the extent that it may be very difficult to adopt the industrialization strategy followed by now-industrialized countries and the Asian Tigers. According to Lall (2004), today's world is different from that when the strategies of Asian Tigers were formulated. There are several factors affecting the changed environment for implementing industrial policies. Industrial strategy must be based on the analysis of the international situation and Vietnam's current and future position in it.

1. These includes: over-valued (fixed) exchange rates that kept imported capital goods and intermediate inputs relatively cheap; FDI licensing only in selected sectors; import duties, drawbacks and rebates; licensing arrangements; the provision of direct loans and equity capital; and quotas allowing access to foreign exchange for imported inputs and remittances at subsidized official rates.

The Global Financial and Economic Crisis

Since 2008 the world has just gone through a severe economic and financial crisis since the last great depression. Although having its origin in the developed world, the global crisis has far-reaching consequences, and is also expected to shape the growth and development prospects for developing countries including Vietnam for the foreseeable future. The formulation and implementation of industrial policies for Vietnam should be put in this context. One of the often cited structural causes of the current global crisis is the unsustainable global imbalances between over-consumption in the US (large current account deficit) and over-saving in emerging China and other East Asian countries (large current account surplus). Such unsustainable global imbalances must be rebalanced either with a gradual decline or a sudden fall caused by a global crisis for example. As a result, the world consumption map may evolve into either a multi-polar (with the US, EU, Japan, and emerging consumption Asia, which is the more likely scenario) or Asia-centered single-polar map. In either case, the emergence of a consumption center in Asia (China, India and other current account surplus countries) may have important implications for Vietnam's export strategy, production and industrialization.¹

The Accelerating Speed of Technical Change and Globalization of Production

These are the two important and defining characteristics of the fast changing economic world today. Rapid technical change reduces the scope for, and raises the risks of, some forms of industrial policy as free market forces are not conducive to costly and prolonged learning processes. Choosing wrong sectors would lead to costly consequences for national development. Similarly, globalization of production network renders some past industrial policy instruments less useful or most risky and costly. The more detailed implications that may have relevance for Vietnam can be found in a study by Yusuf

1. See Nguyen et al. (2010) for further discussion about global imbalances and their implications for Vietnam.

et al. (2004) which concluded that in the face of a global environment, economies in East Asia need to adapt to the changing character of global production networks and to nurture and develop technological capabilities in order to sustain their growth prospects.¹

Policy Liberalization

In 1995, Vietnam submitted its application for accession to the World Trade Organization (WTO) and became the 150th WTO member state in 2007. Vietnam's trade liberalization and accession to WTO in particular has consequences for implementing industrial policies. Like other transition countries, Vietnam in its attempt to integrate back into the world economy after years of isolation has been reducing trade and investment barriers. Many effects of liberalization have been beneficial, allowing Vietnam to exploit its existing comparative advantages that were held back by inefficient controls in the planned economy. Increased exposure to competition both within domestic and international markets has forced enterprises to raise efficiency or go out of business. However, policy liberalization is causing devastating damage to some industries in Vietnam. Most important, the international commitments under WTO agreements as well as multilateral and bilateral agreements (i.e. ASEAN, US-Vietnam BTA) to remove trade interventions, streamline FDI licensing and local content requirements, open up and regulate government procurement, impose strict intellectual property rights, and liberalize the service sector takes away the most powerful tool for promoting new activities and developing infant industries.²

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1. Multinational corporations (MNCs) of the advanced countries including US, Japan, and Western Europe have been adopting global production network concept in their operation. This suggests that successful participation into global production networks is one of the necessary conditions for industrial upgrading and therefore for economic development of emerging economies including Vietnam.
 2. These commitments will narrow the role of government in economic life, and subject the economy to competition and globalization more strongly. To sum up, liberalization, technical change and globalization mean that countries are faced with much stronger technological and competitive challenges than

Emergence of New Big Players in the Global Economy

The emergence of big players in the world economy particularly China and to some extent India, has become a cause for concern around the world with critical implications for developing countries including Vietnam (see Winters and Yusuf, 2007; Lora, 2005; Mayer and Wood, 2009). The economic resurgence of China has sometimes been noted as a threat to Southeast Asia in particular, as fears abound of a diversion of FDI and a competitive disadvantage in exports (Ravenhill, 2006). China has been the world's fastest-growing economy since the close of last century, with an average real growth rate of 9.4 percent per year. According to Mayer and Wood (2009) the entry of China into world markets over the past three decades has affected the broad sectoral structures of other economies, especially developing ones. In particular, they argue that the adversary effects of China on the labor intensive manufacturing and the primary sectors in other developing countries have aroused concerns and suspicions about retarded industrialization, reduced employment and increased inequality in Africa, Latin America and the rest of Asia. The labor-intensive manufacturing is often said to have been harmed by competition from China.¹ In a nutshell, Vietnam, like other

before. In theory, the new forces encourage and facilitate learning. They increase the efficiency with which knowledge is transmitted across countries, and remove many of the policies that cut countries off from information flows and distorted the incentives to utilize them. The exploitation of new technologies is undertaken with increasing rapidity in different locations by MNCs or by local firms. Level playing fields remove information barriers and lower transaction costs to enterprises. The same trends make it more difficult to mount industrial policy, partly for economic reasons and partly for political ones. They raise the speed of technical change, the quantity of information available and the breadth and depth of skills and institutions needed to cope. If countries are thrust into this without the ability to cope, and without the tools to build that ability, they will remain beggars at the technological feast. In fact, they will be more marginal than before, since rapid exposure to competition would devastate their fledgling industrial sectors and destroy the small base of capabilities.

1. The primary production sector on the other hand is often said to have gained from increased demand from China. According to Mayer and Wood (2009), China's opening to trade effectively lowered the world average land/labor

latecomer industrializers, has to dance “with the Giants without getting one’s toes stepped on” (Winters and Yusuf, 2007).

This chapter seeks to provide inputs for the debates and discussion along the preparation of the national development strategy. The chapter focuses on the relevance of industrial policy for national economic development and the role of large economic groups as an instrumental tool for implementing industrialization policy for the purpose of national economic development. The chapter is organized as follows. The first section reviews the policies adopted by Vietnam during the course of economic development through the lens of ‘industrial policy’ emulating the industrial policy framework adopted by other countries. The second section focuses on the role of large economic groups as an instrument for industrialization. The chapter is more of a selective review, discussing issues relevant for the policy review, debate and discussion in Vietnam. The authors argue that industrial policy is still relevant for Vietnam and large economic groups. While this could be viewed as a double-edged sword, it is still relevant and feasible for industrial policy implementation.

ratio and increased the share of workers with a basic education in the world labor force. The relative endowments of other countries were thus shifted in the opposite directions, which tended to move their comparative advantage away from labor-intensive manufacturing, which requires a lot of workers with a basic education but not much land. The corresponding increase in comparative advantage for developing countries was mainly in primary production, which uses a lot of land; for developed countries, it was mainly in skill-intensive manufacturing and services, which need workers with more than a basic education. The mechanism by which this shift in world average endowments took effect was a vast expansion of China’s exports, concentrated on labor-intensive manufactures, in which its own endowments give it a comparative advantage, and of its imports, which are concentrated on primary products and skill-intensive manufactures, in which it has a comparative disadvantage. These changes in trade flows altered relative prices on world markets and shifted the demand functions faced by producers in other countries – inwards for labor-intensive manufactures, and outwards for primary commodities and skill-intensive manufactures. Fu et al. (2009) show that China’s exports depressed global manufactures prices.

PART I – INDUSTRIAL POLICY

4.2 Industrial Policy and Development in East Asian Countries

Extensive debate has surrounded both trade and industrial policies in economic development.¹ There has been a large and growing body of theoretical and empirical literature on the limits and merits of industrial policies, rendering it impossible to cover in details, all of the theoretical and empirical implications within the space of this paper. This section reviews the basic economic theories/rationales for government intervention, briefly visiting the contemporary debate on whether industrial policies should be comparative advantage-conforming or comparative advantage-defying (Lin and Chang, 2009). After a brief discussion of the definition of an industrial policy, I will consider arguments for and against industrial policy. Against this backdrop, we will evaluate whether industrial policy should be adopted by developing countries with special attention paid to the experience of the Latin American and East Asian countries.

4.2.1 Definition of Industrial Policy

There are a number of definitions of industrial policy and there is no consensus on what exactly constitutes industrial policy. Some authors argue that the appropriate term for industrial policy should be ‘selective industrial policy’. According to Chang (1994), selective industrial policy implies a certain group of policies that are inclined to privilege the development of a particular industry or sector over others in order to enhance national economic or social welfare in the long run. Methods to reinforce selective industrial policy may include trade subsidies, licenses, and the management of credit and capital allocation, prices and investment. There are two main definitions of

1. The term “Washington Consensus” can be broadly interpreted to mean secure property rights, fiscal discipline, sectoral neutral tax and expenditure policies, financial liberalization, unified and competitive exchange rates, openness to foreign trade and investment, privatization, and deregulation.

industrial policy, focusing on either the industry or the market. Examples of the first type include the definition by Chang (1994) as “a policy aimed at particular industries (and firms as their components) to achieve the outcomes that are perceived by the state to be efficient for the economy as a whole” or by Pack (2000) as comprising of “a variety of actions designed to target specific sectors to increase their productivity and their relative importance within the manufacturing sector.” On the other hand, emphasizing the distortion effect of the intervention on the market, Lall (1996) defines industrial policy as “comprising all actions taken to promote industrial development beyond that permitted by free market forces”.¹

4.2.2 Arguments for and against Industrial Policy

The role of the State in a market economy is one of the most controversial issues in economic theory. Indeed, the strength of the argument of industrial policy depends on the appraisal of the possible benefits of industrial policies. There are a number of arguments for mounting industrial policies that can be found in economic theory. Rodrik (2008) draws an analogy between industrial policies and other government interventions in such areas as education, health, social insurance and even macroeconomics stabilization, all of which are motivated by externalities, asymmetric information.² We could identify a number of circumstances where selective government intervention via industrial policy may be designed to obtain an increase in social welfare. They include the infant industry argument, economies of scale, knowledge as a public good, and imperfection of factor markets.³

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1. The World Economic Forum (2002) defines industrial policy as “interventions to skew the market’s outcome in a nation’s favor.”
 2. Education and health interventions are motivated by human capital externalities, social insurance by asymmetric information, and stabilization policy by aggregate-demand (Keynesian) externalities.
 3. A framework for analyzing the selective industrial policy should compare the benefits generated by a promoted industry with those that could have been generated if the resources had been allocated to another sector of the economy.

One of the most accepted justifications for government intervention through industrial policy is the “infant industry” argument. According to Chang (2002), the argument was first developed by Alexander Hamilton but is often attributed to Friedrich List. The infant industry argument suggests that protection of domestic industries from foreign competition is justified during the early stages of development of a new industry until sufficient scale and technological development have been achieved.¹ The infant industry argument is based on a dynamic theory of comparative advantage – looking at the long-run interest for the national economy. The most efficient long-run strategy may well be different from what is best initially.² The main debate concerning the “infant industry” argument concerns the degree of protection that should be imposed and exactly when to phase it out. Tension that is often reflected with government

1. It has been argued that this was precisely the industrial development strategy that was pursued by countries like the US and Germany during their rapid industrial development before the turn of the 20th century. Both the US and Germany had high tariffs during their industrial revolution periods. These tariffs helped protect fledgling industries from competition with more efficient firms in Britain and may have been the necessary requirement to stimulate economic growth. This strategy was later adopted by Japan and Korea.
2. *Imperfection in the capital and goods market is another justification for government intervention. If there is a divergence (due to the lenders' inability to make proper evaluations, to their "irrational" aversion to risk, or to their systematic over-estimation of the risk, or due to information asymmetry between lenders and borrowers) between the social opportunity cost of funds and the available market rate at which the potential borrowers can access, then government may intervene with subsidies, tax credit if the private rates are not appropriate. Another argument that is often used to justify government interventions in economic life is the public good nature of knowledge creation in certain specific industries such that the benefits of research and development efforts may be spread throughout society inevitably. Government intervention in this regard through selective industrial policies may include subsidies for private research and development costs. Particularly, encouragement may be created for firms to internalize the externalities associated with the creation of new technologies through the promotion of joint ventures for research and development. Use of production or export subsidies or protection of the domestic markets through selective industrial policies can also overcome this form of market failure. As a summary, Rodrik (2008) argues that it is not a question of whether we should have industrial policies, rather it is a question of how.*

“picking winners” – choosing exactly which industries to nurture – illustrates the complexities of a broad interpretation of the infant industry argument.

In addition to the infant industry argument, government intervention may also be justified by economies of scale (both static and dynamic). For a certain sector where the entry costs is high or the learning curve is steep, leaving only a few firms capable of entering the sectors, there is a case for government industrial policies in the form of entry subsidies for the learning phase or entry phase. The government may also intervene for strategic reasons. Selective industrial policies may be undertaken by the government to support local firms in their efforts to compete with rival foreign firms. Classic examples include Boeing and Airbus, and the more recent success of Chinese aircraft industry. Entry subsidies may be considered because of the potential monopoly profits obtainable by one firm.

The issue of whether it is better for a country to engage in free trade with other countries, or to limit trade through industrial or trade policies has been a contentious one for both economists and policymakers. One counter-argument to the infant industry argument above is that by protecting infant industries, countries are not allocating resources in the short-run on the basis of comparative advantage. The standard neoclassical trade models of trade show that resources will be allocated most efficiently if countries produce those goods in which the before-trade prices are lower than in the rest of the world.

4.2.3 Experiences from East Asian Countries

Although, the East Asia region also suffers from some economic setback such as the lost decade of economic stagnation in Japan (in the 90s) and the Asian Financial Crisis in 1997, it continues to be the best performer in terms of sustained economic growth and poverty reduction in comparison to Latin America or Africa. Many researchers, policy makers and governments have turned to East Asia to explore why East Asian countries are so successful

and if East Asian countries could serve as a model for economic development. These countries have derived great benefits from increasing integration with the international economy, without giving up national autonomy in the economic or cultural spheres, by pursuing decidedly non-neutral policies with respect to the promotion of specific sectors and activities. This chapter addresses a series of questions in an attempt to assess the relevance of their experiences for Vietnam. These questions include:

- Was industrial policy, defined as selectively promoting individual sectors, a major source of growth in these East Asian economies?
- Can these outcomes be duplicated in Vietnam today, or do special circumstances or changes in the international policy environment prevent replication of the East Asian experience?
- Given the revealed costs and benefits, is replication advisable? And, if not, are there other, positive, lessons that Vietnam can take away from the historical experience of the East Asian countries?

According to previous studies (e.g. Crafts 1998; Wong and Ng 2001; World Bank, 2003) the economic growth and development in East Asian countries (Japan and the “Four Tigers” and to some extent Malaysia, Thailand and Indonesia) during the last decades of the last century is a miracle. The income per capita increased more than tenfold in Japan and the “Four Tigers” between 1950 and 1995, and more than doubled in Malaysia, Indonesia and Thailand in the two decades after 1973 (Crafts 1998; Wong and Ng, 2001). In addition, growth was relatively equally distributed, bringing reductions in absolute poverty and improvements in living conditions. The economic take-off and success of China over the last two decades has added to the regional success.

Although the conditions for implementing industrial policies that were adopted by the Asian Tigers have changed as

discussed above, and several authors (Noland and Pack, 2005) have argued that developing countries can no longer implement the successful policies of the Asian Tigers, there are still a number of lessons that can be learnt from the experience of these countries. According to the World Bank (1993), the Asian Tigers all had sound macroeconomic management, a good initial base of human capital and strong export-orientation. They provided stable and predictable incentive frameworks for investment. They had high rates of savings and investments — some of the highest in recent history — which financed investments in the hardware and software of learning. They invested in administrative and institutional capital, both necessary in making markets work better and in mounting effective policies. Their governments had close and continuous dialogue with the private sector, and the granting of privileges was closely monitored and made to depend on export performance. They used “contests” to monitor performance and to ensure that favors were returned, unlike in other countries where privileges were generally granted to industry with no monitoring or performance requirement. Finally, they benefited from their location, being near Japan and what became the world’s most dynamic region. They interacted with, and learned from, each other. They gained from the spillovers of a favorable investment image” (Lall, 2004).

What was ignored by neoclassical analysts was that these common elements went together with striking differences in development “visions,” which shaped crucial elements of their strategies, each involving different kinds and levels of intervention. It is difficult, in fact, to describe their policies as “remedying market failures” in the conventional sense. The Tigers were not trying to make markets work better to achieve some static equilibrium. They were choosing between countless potential equilibria, and bending their resources to obtain the ones they had (more or less clearly) selected. Though there were generic problems they addressed in similar ways (improving the technology infrastructure or providing basic education and training), they used various tools of policy differently to pursue their different visions (Lall, 1996). Since they were all successful (to a greater or lesser extent), because of the

coherence of their policies and good administrative capabilities, it was clear that there are not only “many roads to heaven” but also many heavens. The tools were not that different from those used in less successful economies — the secret lies in the combination of policies and the efficacy of their implementation.

4.2.4 Key Considerations for Successful Government Intervention

There are two types of government intervention, often known under the terms *functional intervention* and *selective intervention*. While functional interventions are designed to remedy generic market failures without favoring one activity over another, selective interventions are designed to remedy market failures for specific activities/sectors/industries/activities. Functional interventions are often preferred to selective interventions because of the risks (of “picking winners”) associated with the latter. It should, however, be noted that economic theory provides valid arguments for selectivity under certain types of market failures. According to the World Bank, in order for national industrial policy to be successful, it is necessary to have three sets of factors viz. incentives, capabilities, and institutions.

Incentives as provided by industrial policies will guide the allocation of resources and also the efforts invested in developing competitive capabilities.

Capabilities arise from physical investment, infrastructure, human capital development, and technological effort.

Institutions of various kinds facilitate capability formation and production where purely market-based forces are deficient.

Successful implementation of industrial policy requires not just one set of factors but also the interplay between these sets of factors. A balance of appropriate incentives, capability development and institutional support is necessary. The nature and balance depend on each country’s endowments, levels of development and inherited structure and institutions.

The above discussion of successful industrial policy rests on the assumption of effective government. In practice governments often lack the skills, knowledge, objectivity, or autonomy to carry out interventions effectively and efficiently. Therefore, consideration of government failures should clearly be an integral part of industrial strategy. Neither markets nor governments can be assumed to be perfect. The examples of highly successful industrial intervention in East Asia (to be discussed in the next section) suggest that under certain circumstances government failures can be minimized and market failures remedied. But many examples of failed government intervention are found in Latin America and Africa. Therefore, the role and capacity of government is critical for successful industrial development.

4.3 A Review of Vietnam's Industrial policy

4.3.1 A Brief Overview of Economic Reform and Performance

The failure of the centrally planned model that Vietnam followed to develop its national economy after the national reunification in 1975 forced Vietnam to undertake economic reforms, with the first serious reform known as Doi Moi in 1986 and later the even more radical market-oriented reform of 1989 marked a turning point in the history of Vietnam's economic development. After some initial success, complacency built up and the reform process in general slowed down during the period 1996 - 99, especially after the Asian Crisis. However, since 2000 there have been renewed commitments to reform, with some being achieved especially in the development of private sector and trade liberalization.¹ During the years immediately after the initiation of economic reform, the focus was on macroeconomic stabilization and price liberalization. Several measures to establish market institutions for the economy were introduced including the recognition of a multi-sector economy and property rights.

1. The privatization process has been accelerated when the Government allowed some large and "monopoly" firms in banking, insurance, petroleum, and telecommunication sectors to be privatized since 2006.

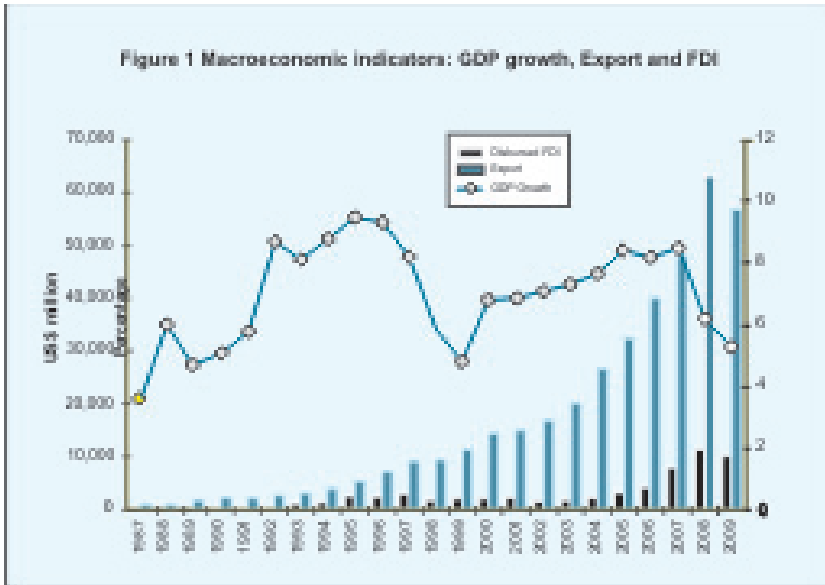
Vietnam has substantially liberalized its trade and investment policies since the late 1980s. During the early years of economic reform, Vietnam liberalized its trade regime through signing trade agreement with about 60 countries. It has also implemented preferential trade agreement with the European Union since 1992. Later on, the country actively sought membership of regional and global organizations.¹ Vietnam has become a member of the Association of Southeast Asian Nations (ASEAN) since June 1995 and the Asia Pacific Economic Co-operation (APEC) since 1998. In 2000, Vietnam signed a historic comprehensive trade agreement with the USA to normalize trade relations between the two countries. Recently, Vietnam has also joined regional integration clubs such as ASEAN-China Free Trade Area and ASEAN-Japan Comprehensive Economic Partnership. Most recently, in 2007 Vietnam became the latest member of the World Trade Organization.

Since its 1989 reforms, Vietnam has recorded remarkable achievements in terms of GDP growth, macroeconomic stabilization, export expansion, and poverty reduction. It is now generally recognized that Vietnam is among the best developing countries in terms of achieving relatively high economic growth and reducing poverty incidence. Over the period 1990-2008, Vietnam's GDP growth rate averaged at over 7 percent per year. Today, Vietnam's growth rates remain among the highest in the region (second only to China). Figure 4.1 shows that except for the first two years (1990 and 1991) after economic reform where the GDP growth rate was around 5 percent, from 1990 to 1997, the GDP growth rate stayed at around 8 percent per annum on average. The GDP growth rate, however, went down between

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2. International integration processes picked up from the early 1990s after the collapse of the Berlin wall and Vietnam lost its traditional markets in Eastern Europe and Soviet Union in the late 1980s. The US trade embargo against Vietnam was only lifted in 1994, and the relationship with the US was normalized in 1995. Another important achievement and event is that since 1993, Vietnam has basically opened development assistance resources (ODA) which have contributed to the substantial increase of financial resources for Vietnam's development investment.

1997 and 1999, partly because of the Asian financial crisis, and partly because of the dissipation of reform effects. Since 2000, the economy has regained its momentum, growing at 7 percent per year, reaching 8.5 percent in 2007, before dropping back to an estimated 6.2 percent in 2008 due to the impact of the Global Financial Crisis. High and continuous GDP growth rates and successful economic development over the period has resulted in overall improvement of people’s welfare and significant poverty reduction. Successive Household Living Standard Surveys of Vietnam shows total poverty incidence to have declined from 58 percent in 1993 to 37 percent in 1998, 29 percent in 2002, 19.5 percent in 2004 and 16 percent in 2006 (SRV, 2003; Nguyen Viet Cuong, 2009). Besides, there are improvements in other dimension of people’s welfare such as the high percentage of literate adults (over 90 percent), higher life expectancy (over 70 years), a lower under-five mortality rate (40 per 1000 live births in 2003).

Figure 4.1: Macroeconomic Indicators: GDP Growth, Exports and FDI



Source: GSO

As a result, after 20 years of reform, Vietnam has put in place the fundamentals of a market economy and opened up the economy to international flow of capital and trades in goods and services. The emergence of the market-based economy with appropriate institutions, stable macroeconomic environment and the support of the government for business development have allowed Vietnam to (i) unlock the potential of the agriculture sector, turning Vietnam from a food-hunger country to the world third largest rice exporter; (ii) encourage the development of a vibrant domestic private sector; (iii) attract a large amount of foreign investment; (iv) realize its comparative advantages and gain more benefits from international trade. These factors underlie the economic success that Vietnam has achieved since the early 1990s.

4.3.2 Vietnam's Industrial Structure and Competitiveness

During the course of transition to a market economy, the structure of the economy witnessed gradual changes in sectoral and ownership structure. As tabulated in Table 4.2, during this period, the structure of the economy has shifted towards industrialization and modernization. The proportion of agriculture, forestry and fishery in GDP has declined from 27.4 percent in 1994 and 20.3 percent in 2007. The share of industry and construction in GDP has risen from 28.8 percent in 1995 to 38.1 percent in 2001 and 41.5 percent in 2007. Importantly, the share of the manufacturing sub-sector within the industry and construction sector increased from 15 percent in 1995 to 21 percent in 2008. The share of the services sector remains between 30 percent and 40 percent in recent years.

Table 4.2: GDP Structure by Economic Sector, 1990 – 2008
(Current Prices)

	1995	2001	2002	2003	2004	2005	2006	2007	2008
GDP (current prices)	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
Agriculture, Forestry & fishery	27.18	23.24	23.03	22.54	21.81	20.97	20.40	20.34	22.10

Industry and Construction	28.76	38.13	38.49	39.47	40.21	41.02	41.54	41.48	39.73
Manufacturing	14.99	19.78	20.58	20.45	20.34	20.63	21.25	21.26	21.10
Services	44.06	38.63	38.48	37.99	37.98	38.01	38.06	38.18	38.17

Source: GSO statistical data, various years

Although Vietnam has witnessed significant changes in the structure of the economy, it is important to investigate its industrial capacity and performance. In its Industrial Development Report series, UNIDO publishes the competitive industrial performance (CIP) index to benchmark industrial national performance in the global economy. In order to assess the overall competitiveness of Vietnam industrial sector, following the UNIDO methodology, we calculate an updated CIP index for Vietnam and a group of benchmarking countries for 2008. The composite index consists of both trade and industry components. Although the industry component is important in reflecting the capacity of the industrial sector, it is the trade component that will reflect the competitiveness of the industrial sector. Instead of calculating the index for all countries in the world, in this section, we focus only on a number of countries. The benchmarking countries (comparators) are selected to reflect the various groups of countries that are comparables to Vietnam in some way, namely neighboring countries, potential competitors, role model countries and large scale countries. As can be seen in Table 4.3, Vietnam ranks 16 out of 17 countries. The ranking positions are stable over time, which confirms that industrial competitiveness is a path-dependent process where economic transformation takes time. The Table indicates that during the last decade, Vietnam although having significantly developed its manufacturing capacity, was not able to improve its ranking, remaining at the 16th place out of 17 countries.

Table 4.3: Competitive Industrial Performance, Selected Countries

Economies	2000				2008			
	Trade Index	Industry Index	CIP	Ranking	Trade Index	Industry Index	CIP	Ranking
Brazil	0.2781	0.1416	0.2099	11	0.2344	0.1223	0.1784	12
Chile	0.0160	0.1110	0.0635	17	0.0147	0.1034	0.0590	17
China	0.3410	0.3730	0.3570	7	0.4279	0.4123	0.4201	4
Costa Rica	0.3403	0.2141	0.2772	9	0.3357	0.1330	0.2343	9
India	0.2000	0.1226	0.1613	14	0.2544	0.0936	0.1740	14
Indonesia	0.1897	0.2568	0.2233	10	0.1353	0.2290	0.1822	11
Korea, R.	0.5101	0.5500	0.5300	3	0.5477	0.6291	0.5884	2
Malaysia	0.4992	0.4902	0.4947	4	0.3338	0.3898	0.3618	6
Mexico	0.4488	0.2696	0.3592	6	0.4198	0.2790	0.3494	7
Morocco	0.1810	0.0659	0.1235	15	0.2177	0.0312	0.1244	15
Philippines	0.5009	0.1968	0.3488	8	0.4777	0.1988	0.3383	8
Singapore	0.9796	0.8983	0.9390	1	0.9226	0.8185	0.8705	1
South Africa	0.2166	0.1314	0.1740	12	0.2660	0.0833	0.1746	13
Taiwan	0.5636	0.5609	0.5623	2	0.5371	0.4663	0.5017	3
Thailand	0.3739	0.3842	0.3790	5	0.3899	0.4075	0.3987	5
Tunisia	0.2390	0.0925	0.1658	13	0.2903	0.0763	0.1833	10
Vietnam	0.0291	0.1007	0.0649	16	0.1144	0.0904	0.1024	16

Sources: Calculations based on UN Comtrade data, World Bank's World Development Indicators, and Key Indicators

Although the composite index (Table 4.3) gives an overall picture of competitiveness, it is important to investigate various aspects of the industrial competitiveness for Vietnam. First,

manufacturing value added (MVA) is the basic indicator for industrial performance. MVA growth in Vietnam over the last years has been impressive – MVA increases 2.4 times in only eight years from US\$5.8 billion in 2000 to US\$14.0 in 2008 (see Table 4.4 below). Only MVA growth rates in China is comparable to that of Vietnam for the period. Although the growth rate of Vietnam is high, Vietnam started from a very low base, which allowed Vietnam to grow fast during the last decade. The question is really whether Vietnam can keep up such impressive growth levels as its MVA base expands. Like the case of Cambodia, Vietnam is fast growing but from a very small manufacturing base, which calls for caution when reading growth rates. Putting this in perspective, Vietnam’s MVA base is still half of that of the Philippines, and more than 5 times smaller than that of Thailand, a country with almost 20 million fewer inhabitants than Vietnam. In light of the positive signs of industrial progress, it is important to note that Vietnam’s share of global MVA is 0.18 per cent, up from 0.1 per cent in 2000. If we adjust for the size of the economy, then it is even clearer that Vietnam is still far behind the best industrial performers in the region. Although Vietnam’s MVA per capita tripled between 2000 and 2008, this has not affected its position in the regional MVA per capita ranking where it is barely ahead of Cambodia and US\$100 behind the Philippines (see Table 4.4 below).

Table 4.4: Manufacturing Value Added for Vietnam and Comparators, 2000-2008

Economies	MVA (US\$ billion constant 2000 prices)			Global MVA share (%)			Annual Growth Rate (%)		
	2000	2005	2008	2000	2005	2008	2000-05	2005-08	2000-08
Brazil	96,2	111,0	121,2	1,62	1,78	2,09	2,90	3,00	2,94
Chile	13,3	15,9	17,7	0,22	0,23	0,22	3,72	3,72	3,72
China	384,9	630,8	920,3	6,50	9,55	14,24	10,38	13,42	11,51
Costa Rica	3,7	4,3	4,9	0,06	0,05	0,05	3,26	4,31	3,65
India	65,8	91,0	114,6	1,11	1,53	1,72	6,72	7,99	7,19

Indonesia	45,8	58,4	66,2	0,77	1,02	1,37	4,98	4,30	4,72
Korea, R.	134,6	184,4	220,1	2,27	2,71	2,25	6,51	6,08	6,35
Malaysia	28,9	36,3	40,6	0,49	0,53	0,49	4,63	3,79	4,31
Mexico	107,2	108,9	117,8	1,81	1,95	1,90	0,31	2,67	1,19
Morocco	5,7	6,8	7,7	0,10	0,11	0,11	3,46	4,29	3,77
Philippines	16,9	20,9	23,4	0,29	0,30	0,36	4,33	3,93	4,18
Singapore	23,9	29,3	33,4	0,40	0,40	0,34	4,22	4,36	4,28
South Africa	22,9	26,3	30,2	0,39	0,52	0,41	2,75	4,82	3,52
Taiwan	76,3	95,1	111,4	1,29	1,08	0,82	4,50	5,41	4,84
Thailand	41,2	56,4	65,7	0,70	0,80	0,90	6,48	5,17	5,99
Tunisia	3,5	4,1	4,8	0,06	0,06	0,06	3,05	4,89	3,73
Vietnam	5,8	10,0	14,0	0,10	0,14	0,18	11,65	11,71	11,67

Sources: UNSTATS and World Bank's World Development Indicators (2000-2008).

Another dimension of competitiveness of the industrial sector is the export of manufactured goods. Table 4.5 shows that Vietnam is among the highest growth countries in terms of annual growth rate, over 20 percent per year during the last decade. Exports of manufactures grew at 23.59 percent per year from US\$6.8 billion in 2000 to US\$36.94 billion in 2008. This impressive rate has made Vietnam the country with the second highest export growth rate in the world, only behind China. In spite of its fast growth rates, Vietnam's manufactured export volume is quite small compared with other countries in the study. Vietnam's export share accounts for only a small proportion in world markets, only 0.74 percent of world trade for manufactures in 2008. In terms of manufacturing capacity in relation to exports, as indicated in Table 4.6, the value of manufactured exports per capita of Vietnam has increased from US\$87 billion in 2000 to US\$429 billion in 2008. However, Vietnam still fares poorly compared to other countries, standing on the 16th place out of 17 countries in the survey sample.

Table 4.5: Manufactured Exports for Vietnam and Comparators, 2000-2008

	Value of manufactured exports (US\$ billion)			World market share (%)			Annual growth rate (%)		
	2000	2005	2008	2000	2005	2008	2000-2005	2005-2008	2000-2008
Brazil	45,79	88,54	137,71	0.92	1.78	2.77	14.14	15.86	14.79
Chile	8,80	19,81	33,10	0.18	0.40	0.67	17.61	18.67	18.01
China	228,84	722,85	1,369.3	4.61	14.55	27.56	25.86	23.73	25.06
Costa Rica	4,02	5,38	7,31	0.08	0.11	0.15	6.03	10.73	7.77
Indonesia	42,61	54,68	82,82	0.86	1.10	1.67	5.11	14.84	8.66
India	35,45	87,12	157,45	0.71	1.75	3.17	19.70	21.81	20.49
Korea, Rep.	166,94	277,86	409,86	3.36	5.59	8.25	10.73	13.83	11.88
Morocco	5,64	8,84	15,28	0.11	0.18	0.31	9.39	20.01	13.26
Mexico	143,94	174,62	229,44	2.90	3.51	4.62	3.94	9.53	6.00
Malaysia	87,322	119,87	139,70	1.76	2.41	2.81	6.54	5.23	6.05
Philippines	36,58	39,74	45,30	0.74	0.80	0.91	1.67	4.46	2.71
Singapore	130,06	216,46	306,94	2.62	4.36	6.18	10.73	12.35	11.33
Thailand	58,53	96,48	150,50	1.18	1.94	3.03	10.51	15.98	12.53
Tunisia	4,99	8,93	15,83	0.10	0.18	0.32	12.31	21.02	15.50
Taiwan	144,38	182,99	223,82	2.91	3.68	4.50	4.85	6.94	5.63
Vietnam	6,78	17,49	36,947	0.14%	0.35	0.74	20.85	28.29	23.59
South Africa	18,63	33,06	51,58	0.37%	0.67	1.04	12.16	15.98	13.58

Source: UN Comtrade database.

Table 4.6: Manufactured Exports per capita for Vietnam and Comparators, US\$, 2000-2008

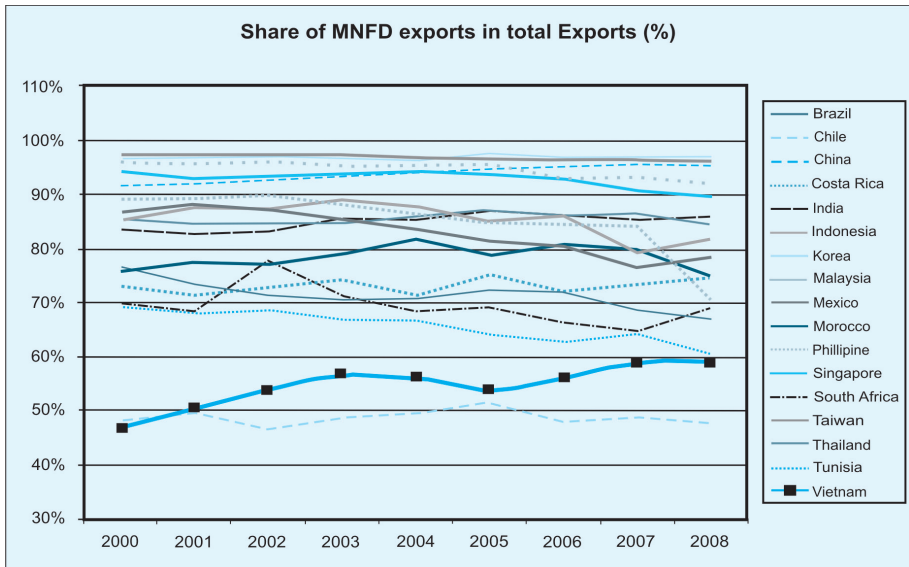
Ranking		Country	Current US\$ per capita	
2008	2000		2008	2000
1	1	Singapore	63425	32290
2	3	Korea, Rep.	8432	3551
3	2	Malaysia	5176	3752
4	7	Thailand	2234	939
5	4	Mexico	2157	1469
6	8	Chile	1976	571
7	5	Costa Rica	1617	1024
8	9	Tunisia	1533	523
9	11	South Africa	1059	423
10	15	China	1033	181
11	6	Taiwan	960	973
12	12	Brazil	717	262
13	10	Philippines	501	471
14	14	Morocco	489	198
15	16	Vietnam	429	87
16	13	Indonesia	363	207
17	17	India	138	35

Source: UN Comtrade database.

The share of manufactured exports in total exports shows the industrial structure of a country. The higher the share of a country's manufactured exports in total exports, the more industrialized

that country becomes. Figure 4.2 shows the quick industrializing process in Vietnam; its share of manufactured exports had risen from 47 percent in 2000 to about 60 percent in 2008. However, Vietnam still lags behind all other comparators, except Chile. Although decreasing slightly, the share of manufactured exports in total exports of other regional comparators (except Indonesia) is much higher than Vietnam, especially the Philippines (above 92 percent). There is no much difference between Vietnam and other resource-based countries (in this group and for all comparators, Chile is the bottom country).

Figure 4. 2: Share of Manufactured Exports in Total Exports, Selected Countries (Percent)



The technology content of Vietnam’s exports has not been discussed so far, which is an essential element of industrial capacity and competitiveness. In order to analyze the evolution of the technology content of Vietnam’s manufactured exports, the technological classification of UNCTAD has been adopted, which groups traded commodities into high-tech, medium-tech, low-tech and resource-based. Table 4.7 shows the structure of manufactured export of Vietnam and comparators in 2000 and 2008.

From Table 4.7, it is clear that Vietnam has the largest share of low-tech products in manufactured exports. From 2000 to 2008, low-tech exports are still above 65 percent of total manufactured exports. The shares of high-tech and resource-based exports also fell slightly while that of medium-tech exports rose from 10 percent in 2000 to 15 percent in 2008. Overall, Vietnam's export structure in 2008 is still rather similar to that in 2000. Given structures are difficult to change because they reflect slow and incremental learning processes that result from resource endowments, capabilities and technological activity, it is still a good sign that the share of medium-tech exports is gradually increasing while that of resource-based exports is falling. The actual value of Vietnam's manufactured exports also confirms this. The value of medium-tech exports in 2008 increased more than 8 times in comparison with that of year 2000. High-tech and low-tech exports increased more slowly, about 5 times, while resource based exports increased less than 5 times. In fact, Vietnam is one of three countries, the others being China and India, that had dramatic increases of actual value for manufactured exports. Tunisia also had impressive increase of high and medium tech, in terms of actual value.

Table 4.7: Technological Structure of Manufactured Exports, 2000 and 2008 (Percent)

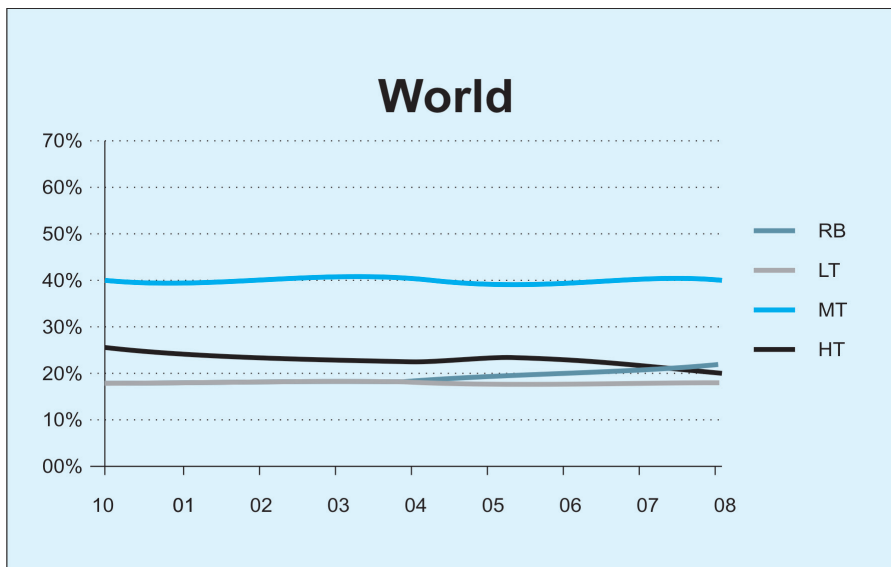
Country	2000				2008			
	HT	MT	LT	RB	HT	MT	LT	RB
Vietnam	11	10	65	14	10	15	67	8
China	21	24	45	9	30	28	33	9
India	5	13	47	34	8	20	27	45
Brazil	15	33	17	35	10	37	11	43
Chile	1	13	6	80	1	10	3	86
South Africa	5	35	17	43	4	47	11	38
Indonesia	15	20	32	34	6	23	23	48

Malaysia	55	21	10	14	34	24	13	29
Philippines	69	12	12	7	62	16	8	14
Thailand	32	27	22	19	23	38	16	24
Korea	35	35	18	12	28	44	12	16
Singapore	59	21	7	13	45	22	7	27
Taiwan	43	28	24	4	36	32	19	13
Costa Rica	47	20	19	14	36	25	19	21
Mexico	24	52	18	6	19	58	13	10
Morocco	10	13	50	27	6	26	30	38
Tunisia	3	22	58	17	5	34	39	22

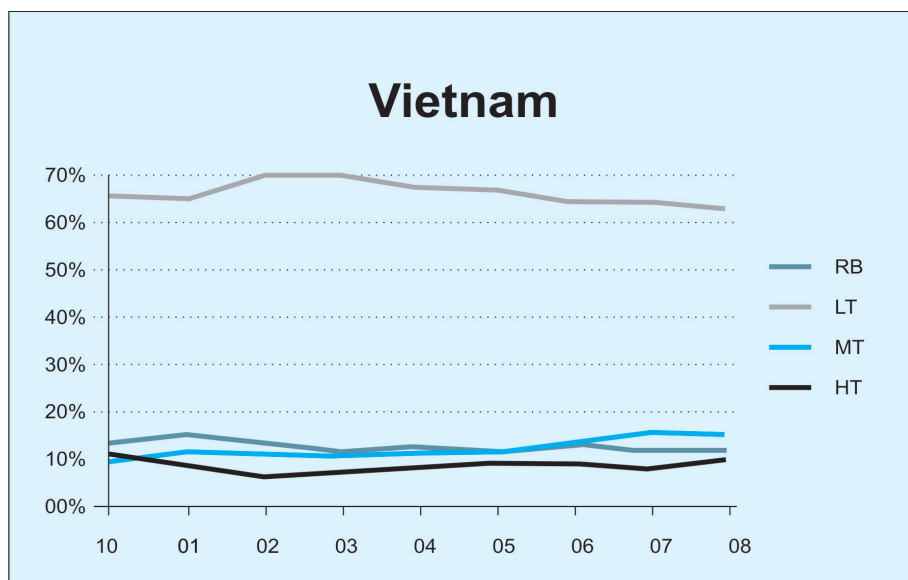
Source: UN Comtrade database.

Figure 4.3 presents the world's manufactured export structure and that of Vietnam during the period 2000-2008. It is important to note that the export structures in both graphs do not vary much within these years; thus, aligning the export structure of Vietnam to that of the world will surely be a time-consuming and difficult process. Another point worth noticing is the rapid rise of the world's resource-based exports. Until 2003, this product group still had the lowest share among the four in the world's export structure. However, it has surpassed low-tech exports in 2004 and later high-tech exports in 2008 to become the second most-demanded product group globally. On the Vietnam side, the notable change in export structure occurred in 2006 when medium-tech exports exceeded resource-based exports to have the second highest share among the four groups.

Figure 4.4: Manufactured Export Structure, Vietnam and World, 2000-2008



Source: UN Comtrade



Source: UN Comtrade

4.3.3 Vietnam's Industrialization Policy

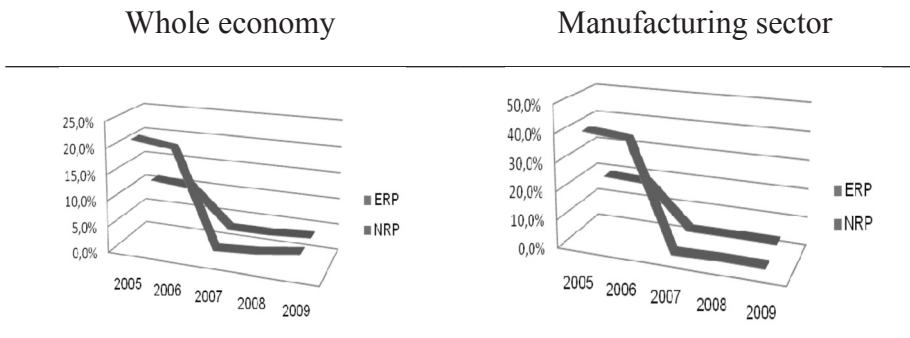
It has been widely commented that even after nearly two decades of reforms, many of the interventionist policies of the old command system have not been totally dismantled in the country. Vietnam's industrial policymakers remain stuck to a significant degree in strategies based on import substitution and continued state dominance of all but the peripheral small firms and those controlled or managed by foreign investors (Perkin 2001). Vietnam's Socio-economic Development Strategy for the period 2001-2010 has set the target for Vietnam to "become an industrialized and modern country by 2020". To achieve this target, specific measures were spelt out; amongst which, state sector reform and development of import-substituting industries continues to be of high priority. According to the 2001-2010 strategy, "the leading role of the State economic sector is to be enhanced, governing key domains of the economy; State enterprises are to be renewed and developed, ensuring production and business efficiency". It also puts a clear emphasis on the "rapid development of industries which can make the best use of Vietnam's competitive advantages, control the domestic markets and push up exports", as well as "selective construction of some heavy-industry manufacturing units". In this section, we review the development of relevant industrial policy to assess if such policy could deliver the expected outcomes as envisioned above.

Trade Policy

Trade policy is one of the most often used instruments to implement industrial policies. However, the policy formulation and implementation of trade policies of Vietnam seem to serve other objectives besides industrial development. Before joining the WTO in 2007, Vietnam's trade policy can be described as a mixture of import-substitution and export promotion. Products and sectors that were protected include the agricultural sector, some labor-intensive products such as textiles, garments, furniture and some technology-intensive products such as

automobiles. Maximum tariff levels were imposed on alcohol, petroleum products, automobiles, motorcycles, cosmetics, glass, and glass products.¹ Low or minimum tariff rates were levied on raw material inputs, machinery, and equipment; especially those not manufactured by Vietnam. Products like sugar, petroleum products, cement and clinker, some common chemicals, chemical fertilizer, paint, tubes and tires, paper, silk, construction ceramic, construction glass, construction steel, some types of engines, automobiles, motorcycles, bicycles and parts, and ships and vessels were subject to quantitative restrictions on imports. The prevalence of and inconsistent application of protection followed by Vietnam has led Athukorala (2006) to conclude that “Vietnam has a tendency to protect any industrial sector but do not have the focused protection policy for the sectors which most influence the economy”.

Figure 4.5: Vietnam’s Nominal and Effective Rates of Protection, 2005 – 2009



Source: Adapted from Trinh (2010).

1. It should also be noted that import tax collection is still a major source of revenue for the government. This in part will limit the effectiveness of the industrial policy. There are, however, unintended effects of such policies on economic efficiency and consumer welfare, which need to be balanced. High tariffs, import restrictions and non-tariff barriers against imports are intended to protect domestic producers of similar products. But protection is also a form of subsidy whose costs are borne by domestic consumers. When protection is given to industrial goods, for example steel, cement, or plastics, the price is paid by other downstream producers, which makes protection self-defeating.

Vietnam is now committed to creating a more open and competitive economy through implementation of the AFTA agreements, the US-Vietnam Bilateral Trade Agreement (BTA). Most recently, the WTO accession in 2007 has changed the rules for industrial policy. Protection will no longer be easily available for Vietnam's enterprises, and their products will have to compete with more competitive imported products. Trade policy may no longer be an instrument of broader industrial development strategies and any discrimination against imported products or foreign producers can trigger sanctions by other countries against Vietnam. The commitments of Vietnam under various bilateral and multilateral arrangements and agreements have led to serious reduction in the effective rate of protection for Vietnam. In a recent study, Bui Trinh (2010) has shown that both nominal and effective rate of protection for Vietnam in general and the industrial sector in particular has dropped significantly. In summary, trade policy can make little contribution to the implementation of industrial policy of Vietnam. This is partly due to the global trend in reducing trade barriers but also due to the poor co-ordination between policies and agencies.

Policy towards the Business Sector

An important structural shift, reflecting the important shift in economic policy, is the change in the ownership structure of the economy. The shift in the GDP structure in terms of ownership remains slow as reflected by the relatively stable and significant share in GDP by the state-owned sector, partly because of the slow progress of the SOE equitization program. Table 4.8 shows that the share of the state-own sector has decreased from over 40 percent in 1995 to 34 percent in 2008. The FDI sector has continuously increased its share from 6.3 percent in 1995 to 18.6 percent in 2008, demonstrating its greater role as the economy integrates into the world economy. The private sector has also increased its role, accounting for nearly 10 percent of the economy. The business sector remains an important sector of the economy, accounting for 30 percent of GDP.

Table 4.8: GDP Share and Growth Rate by Ownership, 1995 – 2008
(Percent)

	1995	2000	2001	2002	2003	2004	2005	2006	2007	2008
GDP (Current prices)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
State sector	40.18	38.52	38.40	38.38	39.08	39.10	38.40	37.39	35.93	34.35
Non-state sector	53.51	48.20	47.84	47.86	46.45	45.76	45.61	45.63	46.12	46.97
Collective sector	10.06	8.58	8.06	7.99	7.49	7.09	6.82	6.53	6.21	6.02
Private sector	7.44	7.31	7.95	8.30	8.23	8.49	8.89	9.41	10.19	10.81
Household sector	36.02	32.31	31.84	31.57	30.73	30.19	29.91	29.69	29.72	30.14
Foreign invested sector	6.30	13.27	13.76	13.76	14.47	15.13	15.99	16.98	17.96	18.68

Source: GSO and calculations by authors.

The emergence of the private enterprise sector since the reforms is an important development. The 1990s also saw the emergence of the private sector, thanks to first the introduction of the company law and private enterprise law in 1991 (later amended in 1994). These two laws together with the adoption of the new land law in 1993 and the labor code in 1994 provided an important stimulus for the development of the private sector. However, the most significant reform in the development of the private business sector came in 2000 with the new Enterprises law. During 2000-2004, about 90,000 private enterprises were registered under the new Law, (doubling the number of companies registered during the 9 years of the two previous laws) with the total capital equivalent to about US\$13 billion. This sector is making rapid gains in terms of both its contribution to output growth and its growing freedom from the restrictions placed on it under central planning.¹

1. Some evidence suggests that the private sector may not be quite as healthy and robust as the numbers imply. See the paper by IFC “Beyond the Headline Numbers: Business Registration and Startup in Vietnam”. <http://www.ifc.org/>

The government continued its import-substitution policy to protect those SOEs, which are mostly capital-intensive: producing steel, motorcycle, and industrial equipment. Investment poured into this sector, instead of moving toward developing a stronger private sector. The most important incentive is the perception that SOEs will not be allowed to fail. SOEs are protected by a variety of methods, including tariffs and non-tariff barriers, which shield them from import protection. The strong government commitment to the survival of SOEs, together with the SOEs' alliances with powerful ministries, forms a potent shield that protects the SOEs against competitive market forces. Rhetoric about private sector development notwithstanding, a level playing field for all is yet to be firmly established in Vietnam's economy. However, despite having gone through many rounds of reforms and receiving numerous incentives from the State, the SOEs in Vietnam remain a pampered, yet less competitive sector of the economy.

The Law on FDI was first promulgated in 1987 and later amended in 1990, 1992, 1996 and 2000. This law helped Vietnam to attract a large volume of foreign capital when domestic savings were not enough to meet investment needs. In 1987, the private sector virtually did not exist in Vietnam. By allowing foreign direct investment, Vietnam in effect imported/implanted the private sector for the first time after the unification of the country. Since then, FDI has indeed become an integrated part of the Vietnamese economy and an important factor in Vietnam's economic growth during the 1990s. In order to create a more level playing field and to ensure that its laws allowed for national treatment for FDI enterprises prior to Vietnam's 2006 accession to the World Trade Organization, Vietnam promulgated, in 2006, two important laws, the Investment Law and the new Enterprise Law,¹ creating

[ifcext/mekongpsdf.nsf/AttachmentsByTitle/PSDP-20/\\$FILE/PSDP-No-20-EN.pdf](http://ifcext/mekongpsdf.nsf/AttachmentsByTitle/PSDP-20/$FILE/PSDP-No-20-EN.pdf)

1. Specifically, on November 29, 2005, the National Assembly of Vietnam adopted the Law on Investment No. 59/2005/QH11 ("New LOI") and Law on Enterprises No. 60/2005/QH11 ("New LOE") which applies to all enterprises established by domestic and/or foreign investors.

a corporate law regime that applies to both foreign and domestic enterprises.¹

In 2006, of the three economic sectors, the state sector was still the most important source of investment in the country. State investment is made either directly into public infrastructure or through loans to SOEs, or in the form of grants to municipalities and private enterprises. But the state's share in investment has declined from 60 percent in 2001, to 29 percent in 2008 as private domestic investment increases and the inflow of foreign direct investment (FDI) increases. The recent decline in the state's share is due more to the increased private investment than to new inflows of foreign investment. The domestic non-state sector recorded a continuous upward trend as a significant source of investment. Private sector investment has increased from 27.6 percent in 1995 to 40 percent by 2008.² Both continued with state involvement, and increased savings and investments by Vietnam's private sector have contributed to continuing high rates of economic growth.

During the 1990s and early 2000s, FDI's share of total investment declined somewhat. FDI accounted for 30 percent of investment in the mid-1990s, but fell to 20 percent in the wake of the Asian Financial Crisis. Since then, the share of FDI in total investment kept falling until 2006. Very recently, new large FDI inflows have been recorded, in part as a result of reforms committed to as part of WTO accession that relaxed rules restricting FDI and hence making Vietnam a more attractive FDI destination. In 2007 and 2008, FDI became the most important source of

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1. Besides FDI, Vietnam also started to receive ODA from international donors since 1993 and the amount committed and disbursed has been increasing since then. These capital sources contributed to infrastructural construction such as transport and communication, information, agricultural and rural development, public health, education and training, administrative reform, legislation, and structural reform.
 2. Jensen and Tarp (2006) point out that private savings to fund private sector investment comes as much from retained earnings of firms as from savings by households. Reinvestment of corporate profits appears to be an important mechanism to maintain high rates of investment and growth.

investment. The sudden increases in the share of FDI during 2007-2008 can be partly explained by the WTO accession of Vietnam which created expectations among international investors about the good prospects of Vietnam.¹ Although Vietnam has been successful in attracting FDI in recent years, the real benefits from FDI still seem controversial. Previous studies have found little evidence of technical spillover from FDI-related enterprises to local counterparts (Nguyen et al., 2008). In addition, the country has become heavily dependent on FDI as an important source of input to sustain economic growth.

Sectoral Interventionist Policies

The economic reform implemented by Vietnam has created a large and increasingly important non-state sector. The economic reform to transform its economy from a command economy to a market-based economy is characterized by its use of market-creating measures. However, since the inception of economic reform, Vietnam has also attempted a number of active interventionist policies toward selected industries. Examples include preferential treatment (i.e. tax holiday, reduced land rent etc.) toward FDI in some sectors which later have also been extended to the domestic private sectors (i.e. industrial zones). However, the results are mixed. For the motor bike industry, the government has been successful with its policy of imposing local content and the motor bike sector of Vietnam has been gaining some regional prominence. The success of the industry is in large part due to Vietnam's large domestic market. However, for the automobile sector, it can be characterized as a failed industrial policy attempt. Given its small domestic market, the government granted investment licenses to 11 car-makers. As a result, the local content policy for the automobile companies has not been successful.

Other Policies: Education, Innovation, Science and Technology

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1. Vietnam requires registration of intended FDI, and not all of those registrations are implemented.

Industrial policy and trade policy are not stand-alone policies (Valila, 2009). They have to interact with other policies being formulated and implemented. How do these policies interact with each other and how do they influence the possibility of attaining industrial policy objectives? For industrialization to be realized, at least two other policies, namely; education policy and Science and Technology (S&T) policy have to play important roles. Although there has been great improvement during the last 10 years, the S&T and education policies have not yet contributed adequately to the success of Vietnam's industrial policy. In order for industrial policy to be successful and for the industrial base to develop to the point that it can be self-sustained, Vietnam needs to have good domestic capacity to develop the industrial base. However, the investment by the country into R&D, innovation and higher education does not seem to complement other interventionist industrial policies and support the development of the industrial base. Although Vietnam has spent 2 percent of its state spending on science and technology equivalent to 0.5 percent of GDP since 2001, in absolute amount the figure is modest as compared to other countries. In particular, investment in R&D was nearly \$400 million in 2007 only.¹ The non-state sector invests around another 0.1 percent of GDP in S&T thus increasing national investment in S&T to a total of 0.6 percent of GDP. To put these figures in perspective, the EU invests 1.95 percent of its GDP, Japan 3.15 percent, China 1.31 percent, the US 2.59 percent, and South Korea nearly 5 percent. In terms of capacity, Vietnam invests around US\$5 (2007) per capita while China invests US\$20 in 2004 and South Korea US\$1,000 in 2007. In addition, this tiny amount of S&T investment is spread thinly among central and local government agencies. This would in turn render the S&T and innovation policies ineffective. To increase the investment for S&T activities, the government is looking to the private sector with the hope that the ratio of public to private investment in R&D would be 1:2 by 2010. However, due to its public nature and risks associated with S&T policies and investment, it would be difficult to achieve this target.

1. <http://english.vietnamnet.vn/reports/2008/11/811926/>

Table 4.9: Composition of Graduates from Vietnam’s Higher Education System

Year	2005	2007	2008
Graduates in general programmes (%)	2.99	3.36	3.60
Graduates in education (%)	34.18	37.22	33.22
Graduates in humanities and arts (%)	4.34	3.22	3.93
Graduates in social sciences, business and law (%)	29.71	27.64	27.29
Graduates in science (%)	0.00	0.00	0.00
Graduates in engineering, manufacturing and construction (%)	21.25	20.46	19.76
Graduates in agriculture (%)	4.78	4.86	5.02
Graduates in health and welfare	2.74	3.24	3.19
Graduates in services	0.00	0.00	3.99
Total graduates in all programmes	100	100	100

Source: UNESCO

Table 4.9 shows the structure of Vietnam’s recent higher education graduates. As can be seen, the number of graduates in engineering accounts only for 20 percent of total graduates, which is much lower when reference is made to the remarkable number of graduates in Singapore when the country was industrializing. A large number of graduates are from the social sciences and business studies. This structure to some extent reflects the current incentives/enumeration between sectors of the economy. As such the structure does not seem to fit with the purpose of promoting and developing the industrial base for the country.

4.3.4 Lessons from the East Asian Policy Experience

The experience of high and equitable growth in East Asia has been the topic of extensive research during the last few decades. One of the most hotly debated questions in the economic

literature is the exact nature of government intervention in East Asia. Following the influential World Bank report *The East Asian Miracle* in 1993, there has been general agreement that governments intervened extensively in most East Asian economies, with the exception of Hong Kong. Still, heated debate exists over the exact nature of the contribution of industrial policy to growth in East Asia and the desirability of following similar policies particularly in developing countries. The goal in this section is to make sense of what is relevant to the current challenges faced by Vietnam in light of the East Asian experience, and to evaluate if and which of the industrial policies should be recommended.

The economic literature points out that the experience of the East Asian is very diverse. The selection and implementation of policies varied enormously and was highly dependent of the conditions facing each country. However, there is a general consensus about the ability of the most successful East Asian countries to get the fundamentals right. In particular, the World Bank's *East Asian Miracle* report in 1993 acknowledged the important role played by governments in Japan, Korea, Taiwan and other Asian economies, not only by getting the fundamentals right, but also through active interventions to promote exports and encourage savings and investment. With some exceptions, they enjoyed macroeconomic stability, promoted education at all levels, invested heavily in infrastructure, and possessed good institutions and civil services committed to development, and oriented toward export sectors. Indeed, government intervention played an important role in mobilizing savings, promoting exports or creating a skilled workforce. The political context made it possible for governments to play such an extensive role, while keeping pressure on them to focus on development and thus build legitimacy. Efforts to promote industrial sectors, without having the fundamentals in place have been unsuccessful (for example, in the Philippines). Governments intervened extensively, but in a "market friendly" way, avoiding major distortions. However, it is hard to find conclusive evidence that the promotion of specific sectors contributed to

growth. The World Bank report and other studies did not find a direct link between selective promotion of individual sectors and productivity-based growth.¹ With a few exceptions, there is no clear evidence that selective promotion of specific was the main driver for growth in East Asia. Where selective policies worked, governments attached discipline to the incentives in order to monitor performance and retired support to firms to firms that did not meet the goals – something that was lacking in the Latin American development experience. Also, East Asian governments showed pragmatism and modified policies, compared to other countries where the direct public support to firms has been more persistent and difficult to dismantle.

Policies have also evolved over time, as the domestic and international context changed. There are a number of notable developments recently. First, East Asian countries have interestingly liberalized their economies, lowered their trade barriers, and changed their regulations to promote competition and a more efficient use of resources. Currently, governments are more focused on creating a good investment climate for private firms. Secondly, the paradigm of industrial policy has also evolved. The emphasis is less on direct government selection of promising sectors, and more on the use of indirect mechanisms to promote technological upgrading, by means of attracting FDI and developing local technological capabilities. Third, the world's production and trade patterns have changed. As global

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1. It should be noted that East Asia was not the only region in which governments intervened with the goal of promoting industrialization and growth. In 20th century, Latin America and in some countries such as Brazil at the end of the 70s pursued a similar strategy. However, as the pace of technological change accelerated Latin American countries were not able to adapt fast enough. Several reasons exists to explain the difference between Latin America and East Asia: poor macroeconomic management, falling investment in education at all levels, technology policies that failed to create incentives in firms to innovate, and the lack of discipline in government support to firms. The East Asian Miracle ultimately recommended the path followed by Thailand, Malaysia and Indonesia that relied more on FDI and less on directed credit, as a suitable model for developing countries.

integration increases it becomes more difficult for governments to predict the best sectors of an economy for which a country can produce with relative advantage. As an example, the initial success of the software industry in India was facilitated in part by the easing of government intervention. New production patterns put governments willing to promote individual sectors in a difficult position. This is true even for sectors with simpler technologies, such as apparel, as production chains become increasingly dispersed and the most labor-intensive tasks are rapidly relocated based on trade preferences. The fast-paced technological change and knowledge flows around the world also present advantages and disadvantages for developing countries. Countries can gain better access to technologies, but they also have to compete with each other for access to markets, technologies and investment.

In order to assist policy makers and researchers to assess Vietnam’s current industrial policy in comparison with policies adopted by other East Asian countries during their implementation of industrial policies, we compile various industrial policy measures and compare them in Table 4.10. As can be seen, although there are some selective industrial policies, Vietnam does not seem to have a coherent set of policy to develop the industrial sector.

Table 4.10: Comparing Vietnam’s Industrial Policy with East Asian Miracle Countries

East Asia Miracle Countries	Vietnam
Fundamental Characteristics and Policies	
High investment rates/ high saving and investment rates	High investment but low saving
Responsible tax and expenditure policies – no large deficits leading to inflation.	Large budget deficit and current account deficit

Stable macroeconomic environment/ Macroeconomic stability - Free from high inflation or major economic slumps	Bumpy economic development – inflation and slump in the last few years
Realistic exchange rate policy to ensure that it was profitable to export	Fixed and unrealistic exchange rate for promoting export
Limited price distortions	Price control on some commodities
Agricultural development	Promotes agricultural development, but requires significant improvement
High share of trade in GDP	Similar
Stable and secure financial systems	Developed financial system is yet to be developed
Improved education/ high investments in human capital	Not really – big problem in higher education and vocational training system
Policies to obtain maximum benefit from investment and education	Unclear
Openness to foreign technology /encouragement of technological borrowing - technology licensing - Japan, Korea, Taiwan (China)	Mixed
Emphasis on exporting which provided a spur to productivity enhancing efforts including:	Similar
Direct Foreign Investment – Singapore – model for Special Economic Zones in China.	Limited evidence of spillover effects Distorted model of economic zones into industrial zones in Vietnam (Vo Dai Luoc)

Imports of equipment and intermediates embodying new technology	Similar, but luxury consumption imports
Knowledge transfers from purchasers of exports	Similar, but limited
Specific Policies	
Mild financial repression	Absent
Export-push trade policies	Available, but liberalized to fast and limited domestic market protection
Selective industrial promotion	YES - but ...
Directed credit	Available, but to the benefit of SOEs

Compiled by authors

PART II – LARGE ECONOMIC GROUPS

4.4 Large Economic Groups and Industrial Policy

A long-time industrial policy objective in Vietnam has been to build up internationally competitive conglomerates (i.e. large corporations and large economic groups) to be the flag-carriers/national champions of the Vietnam's economy.¹ In Vietnam, economic and business groups come in all forms and types, including state-owned and private ones. The questions relating to large economic groups, especially the state-owned groups are drawing increasing attention after the near-collapse of one of the biggest state-owned economic groups in Vietnam – Vinashin, the biggest shipbuilder and a large economic group. This section investigates whether large economic groups, especially state-owned large economic groups could be used as an effective tool to implement industrial policy for national economic development. This is because if Vietnam is willing to let the market to run its course, it may take too long for the industrial base to develop and catch up with other countries. Thus, large economic groups in general and large SOEs may be used in a strategic sense to meet a strategic target.

Traditionally in economic literature, business groups are generally considered economically inefficient. However, recent research has provided a new understanding of the importance

1. 'Large Economic Group' is a word for word translation from Vietnamese into English. In the literature, this form of organization is commonly known as business group. In this chapter, large economic group and business group are used interchangeably. In 1994, the Prime Minister issued Decision 90/TTg and Decision 91/TTg, to group about half of the SOEs under a number of large-size umbrella companies known as General Corporations (GC). Decision 90 (issued on March 7, 1994) created 76 GCs, usually called GC90, each with at least 5 voluntary members and minimum legal capital of VND100bn, and Decision 91 called for much larger corporations with at least 7 SOEs members and a minimum capital of VND1000bn, resulted in only 17 GCs, which are called GC91. All 17 GC91 and 76 GC90 combined have a total members of 1,392 SOEs, accounting for 24 of all SOEs in terms of number and 66 and 55 in terms of capital and employees, respectively.

of this organizational form (Ghemawat and Khanna, 1998; Granovetter, 1994; Guillen, 2000; Khanna and Palepu, 1997). These studies suggest that business groups act as substitutes for imperfect capital, labor, and product markets in many countries, thereby enjoying competitive advantages that are not available to independent firms (Leff, 1978). These groups have typically been viewed through a transaction cost economics perspective where they are perceived as responses to inefficiencies in the market. Moreover, the recent literature on Chinese business groups is also reviewed here to shed light on the issues relevant for Vietnam.

4.4.1 A Snapshot of Vietnam's Large Economic Groups

Defining Large Economic Groups in Vietnam

Defining a business group is not a simple task since group definition varies substantially across countries (Khanna, 2000). As pointed out by Chang (2002), the exact features of business groups differ from one country to another because of distinct economic, social, and cultural environments. However, they have important similarities, and the most notable is that “business groups pursue unrelated diversification under centralized control”.¹ In most countries, group membership is typically informal and Chile is one of the few countries in which groups are legally defined entities (Khanna and Palepu, 1999). There are a number of business group definitions in the literature. Leff (1978)

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1. Khanna and Yafeh (2005) describe several types of business groups. “In some, equity ties play a central role: among these, there are vertically-controlled groups (“pyramids”), and there are horizontally-linked groups, where cross shareholdings are important. In other business groups, in addition to formal (for example, equity) ties, informal ties are important: group firms can be related to each other through family and social ties, a common sense of identity, trade relations, and other dimensions. In certain countries, business groups are a politically important force; in others less so. And some groups are deeply involved in banking and financial services, whereas others are not. Nevertheless, operation across a large number of (often unrelated) industries (diversification), and family ownership combined with varying degrees of participation by outside investors are common characteristics of many business groups around the world.”

refers to a business groups as “a group of companies that does business in different markets under a common administrative or financial control” and states that group members are “linked by relations of interpersonal trust, on the basis of a similar personal, ethnic or commercial background”. Granovetter (1994) defines a business group as “a collection of firms bound together in some formal and/or informal ways”. Khanna and Rivkin (2001) state that a business group is a “set of firms which, though legally independent, are bound together by a constellation of formal and informal ties and are accustomed to taking coordinated action.” There are still other definitions of a business group in country-specific studies.

Defining large economic groups or business groups in Vietnam is even more difficult due to the existence of both state-owned and large private economic groups. In Vietnam, there are two kinds of business group: (i) State-owned economic group; and (ii) private economic group. At the moment, the state-owned economic group is officially defined by law. According to the current laws and regulations, state-owned economic groups will be established according to the Decree No. 101/2009/NĐ-CP on the pilot implementation of establishment of economic group, dated 5 November 2009, a state-owned economic group is a large-scale group of companies associated with each other under the parent-affiliate structure, creating a consortium of enterprises bonded by economic, technology, market and other business services (Article 4.1).

As at June 2010, there are 12 large state-owned economic groups and 11 large state-owned corporations.¹ Most of the 12 state-owned economic groups are established from large state-owned corporations. The structure of the state-owned economic groups is mostly of a parent-affiliate structure with a 100 percent state-owned parent company and a number of affiliate firms. The ownership of affiliate firms may vary and the parent company in

1. http://www.chinhphu.vn/portal/page?_pageid=517,33802599&_dad=portal&_schema=PORTAL (access on 25 June 2010).

many cases owned up to 100 percent equity. In contrast to the state-owned economic group, the laws and regulations on the legal form and establishment of private economic group have not yet been issued although private economic groups may/do exist informally or are under the process of formation and this is consistent with natural progression and international practices.¹ Besides the state-owned large economic groups, recently there has been the emergence of large private economic groups such as Viet-A; Sunfat, Hoa Phat, and Nam Cuong. Dong Tam, FPT, Hoanh Anh Gia Lai, Kinh Do, Hoang Long, and T&T.²

Large Economic Groups: Origin and Economic Power in Vietnam

The concept of economic group is new to Vietnam. The first reference to the concept of economic group was in the Enterprise Law which came into effect in 2006. However, the definition of such an economic organization was only vaguely defined.³ Only with the Decree No. 101/2009/NĐ-CP issued by the government on the pilot implementation of establishment of state-owned economic groups, dated 5 November 2009, did the concept of state-owned economic groups become clearer. Still, it leaves the concept of private economic groups undefined. To fully understand the evolution of the state-owned economic groups in Vietnam it is necessary to relate it to the course of state-owned enterprise reform.

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1. <http://dddn.com.vn/28361cat97/tap-doan-kinh-te.htm> and <http://news.vneconomy.vn/20100524110942816P0C1/natural-progression.htm>
 2. See <http://www.toquoc.gov.vn/Thongtin/Kinh-Te/Tap-Doan-Kinh-Te-Tu-Nhan-Dang-O-Dau.html> <http://www.sggp.org.vn/kinhte/2010/3/220622/> <http://www.xaluan.com/modules.php?name=News&file=article&sid=169864>
<http://vietnambusiness.asia/solutions-to-develop-economic-groups-discussed/>
<http://vietnambusiness.asia/state-owned-economic-groups-unclearness-in-governance/>
 3. <http://bee.net.vn/channel/2043/201007/Co-nen-thanh-lap-cac-tap-doan-kinh-te-1758513/>

Like the SOE sectors in other former socialist countries, the SOEs in Vietnam are often associated with inefficiency, corruption, and unfair competition against the private sector. In Vietnam, SOEs are being given many advantages and preferential treatment as compared to private enterprises in terms of access to credit, land use rights, trade protection, etc. Despite these advantages, their performance has been disappointing.¹ Attempts to reform Vietnam's state-owned enterprise sector, i.e. equitizing state-owned enterprises — or converting them into joint stock/limited liability companies, began as early as mid-1992, but progress was very slow.² According to the latest data from the Ministry of Finance (MOF), as of 31 December 2009, 5112 SOEs had been converted/equitized. By 2010, the Government has plans to convert the remaining 1,500 SOEs, of which 948 are proposed for equitization. The equitization process of Vietnam is characterized by slow progress as is evident in Table 4.11 and by July 2010 Vietnam would not meet the target that it set for itself. Most of the SOEs equitized up to 2006 were small, with 46percent having capital of less than VND5 billion, though the size increased marginally over time. The state has often retained a share of more than 50 percent in equitized SOEs.³

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1. Their failures were attributed to such factors as the lack of management autonomy and entrepreneurship (director or managers of SOEs typically behave as bureaucrats rather than entrepreneurs), soft budget constraints, self-sufficiency and also in many cases, the lack of competition. Reform of SOEs became essential (Tran Van Tho 2002).
 2. After 5 years of reform by the end of 1997, only 17 enterprises had been equitized.
 3. Different from the equitization in China, there are few outside investors in Vietnam's equitized SOEs. Early equitization was primarily internal, with employees acquiring more than half the shares in the equitized SOE. The government and employees together held almost 80% of the shares. Very few outsiders such as strategic investors were involved. Over time, the stake of employees declined modestly while that of company outsiders increased, reflecting in part the introduction of Decree 187 in 2004, which required equitized SOEs to auction shares to the public.

Table 4.11: State-owned Enterprise Conversions, Cumulative and Planned, 2007–2010

Item	SOEs converted	Of which equitized
Cumulative until 31 December 2007	4,979	3,369
Year 2005		724
Year 2006		640
Year 2007		150
Planned 2008–2010	1,535	948
Year 2008		73
Year 2009		60
Remaining to be converted/equitized until July 2010	1500 including 8 large economic groups and 80 state general corporation	

Sources: Ministry of Finance, Government of Vietnam, 2008 and various public media sources.

In response to the slow progress in reforming the SOE sector, the government started to establish large state-owned economic groups in an attempt to speed up and revitalize the momentum of the state-owned enterprise reform. The state-owned economic groups are sometime considered as a new bottle for an old wine of large corporations 90 and 91. These corporations were established in 1990 and 1991 as a measure to reform the SOE sector and often referred to as corporations 90 and corporations 91.¹

In East Asia, business groups are playing important roles in the national economy. The top 30 business groups accounted for 40 percent of Korea's output in the mining and manufacturing

1. See <http://www.vnn.vn/kinhte/2005/06/460353/>

sectors and 14 percent of GNP in 1996. Similarly, business groups that were listed on the stock exchange accounted for the following exchanges in total market capitalization in 2002; 24.3 percent in Thailand, 24.9 percent in Malaysia, 39.6 percent in Singapore and 56.2 percent in Taiwan (Chang, 2002). A natural question to ask in Vietnam is the importance of economic groups for the national economy. Unfortunately, there is no systematic data on the economic groups in Vietnam. As such, this section draws on the available data to sketch a picture about Vietnam’s SOE sectors and the large economic groups.

As can be seen in Table 4.12, the number of SOEs has decreased markedly. Since 2000 the SOE sector has seen its significance reduced in both absolute and relative terms. In 2000, the SOEs account for 13.6 percent of the total number of enterprises. In 2007, this figure dropped to merely 2.2 percent. Since 1998, a series of reforms, including small SOE privatization, liquidation of insolvent companies and equitization, has contributed to this reduction.

Table 4.12: Vietnam Enterprises by Ownership during 2000-2007

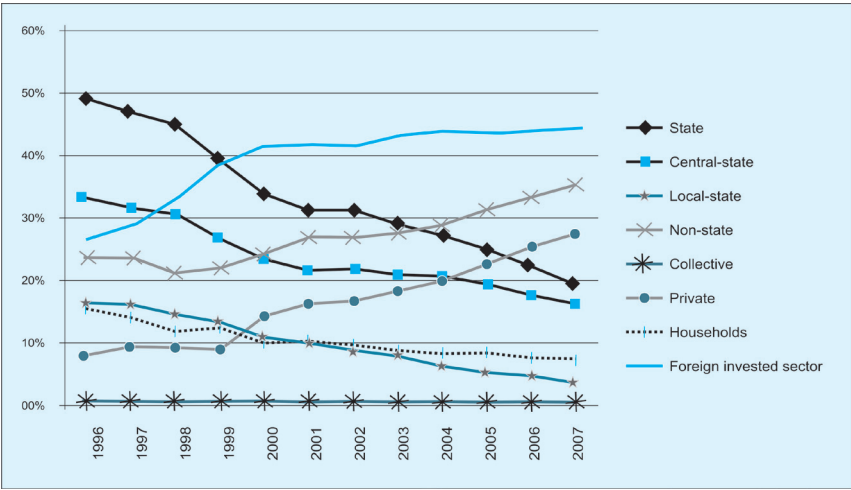
	2000	2001	2002	2003	2004	2005	2006	2007
Number of enterprise	42288	51680	62908	72012	91756	112950	131318	155771
State owned enterprise	5759	5355	5363	4845	4597	4086	3706	3494
Non State owned enterprise	35004	44314	55237	64526	84003	105167	123392	147316
FDI	1525	2011	2308	2641	3156	3697	4220	4961
Percentage								
Number of enterprise	100	100	100	100	100	100	100	100
State owned enterprise	13.6	10.4	8.5	6.7	5.0	3.6	2.8	2.2

Non State owned enterprise	82.8	85.7	87.8	89.6	91.6	93.1	94.0	94.6
FDI	3.6	3.9	3.7	3.7	3.4	3.3	3.2	3.2

Source: GSO statistical data, various years

The reduction in number of enterprises is also reflected in the decreasing share of the state-owned sectors in industrial output (Figure 4.5). By 2007, the SOEs still account for around 20 percent of total industrial output. This reflects the concentration of economic power in the hand of SOEs, i.e. only 2.2 percent of enterprises accounting for 20 percent of total industrial output.

Figure 4.6: Shares of Industrial Output by Ownership



Source: Source: GSO statistical data, various years

Tables 4.13 and 4.14 highlight further the concentration of economic power in a few SOEs. As indicated by Tables 4.12 and 4.13, the SOEs account for 38 percent of the largest 889 enterprises in terms of capital (with registered capital more than VND500 billion) and 86 enterprises in terms of the number of employees (over 5000 employees). Figure 4.6 indicates that among the 200 largest firms in Vietnam, 122 are SOEs of which 19 are economic groups.

Table 4.13: Distribution of Enterprises by capital and ownership 2007

	Total	Capital (VND billion)							
		< 0.5	0.5-1.0	1-5	5-10	10-50	50-200	200-500	Over 500
Number of enterprises	155771	18646	23631	72342	17269	16353	5286	1355	889
State-owned enterprises %	2.2	0.1	0.1	0.4	1.9	6.6	18.8	32.3	38.0
Non-State owned enterprises %	94.6	99.2	99.4	98.7	94.9	82.8	59.5	41.8	33.0
FDI %	3.2	0.7	0.5	0.9	3.2	10.6	21.7	25.9	29.0

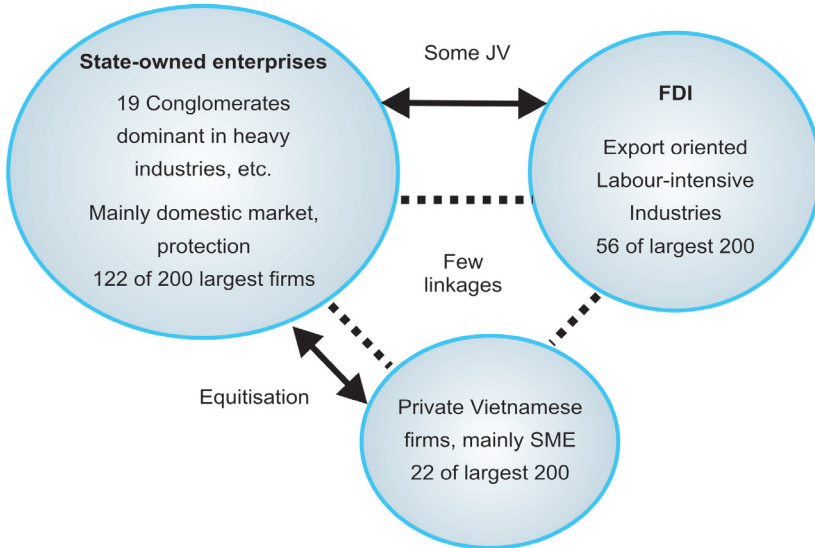
Source: GSO statistical data, various years

Table 4.14: Distribution of Enterprises by Number of Employees and Ownership 2007

	Total	No. of Employees								
		Under 5 employees	9-May	Oct-49	50-199	200-299	300-499	500-999	1000-4999	over 5000
Number of enterprise	155,771	34,856	51,041	50,588	13,333	1,962	1,694	1,283	928	86
State-owned enterprise %	2.2	0.0	0.1	1.2	9.4	20.6	25.9	27.8	34.7	43.0
Non-State-owned enterprise %	94.6	99.4	99.3	95.9	79.1	60.0	51.4	43.5	31.3	14.0
FDI %	3.2	0.5	0.6	2.8	11.5	19.3	22.8	28.7	34.1	43.0

Source: GSO statistical data, various years

Figure 4.7: Distribution of the 200 Largest Vietnamese Enterprises by Ownership



Source: GSO statistical data, various years

Vietnam's Economic Groups in Comparison with other Countries

Business groups exist throughout the world; we can find conglomerates in the West, “keiretsu” in Japan, Chaebol in Korea, “grupos economicos” in South American countries, and “business houses” in India. Business groups also emerged in the former socialist European countries as a result of rapid privatization of state-owned enterprises (Khanna and Yafeh, 2005). In this section we compare Vietnam’s large economic groups with groups in other countries, especially in Korea and China. In Vietnam it has been argued that the Vietnamese government has admired the success of Chaebol in Korea’s economic development and recently looked to China’s large business groups and national champion as a role model for Vietnam economic group. A key feature of China’s SOE reform is the state’s firm grip on large-scale, state-owned enterprises (SOEs).¹ Similarly, Vietnam’s intention is to develop

1. It would be safe to state that Vietnam would imitate policy actions by Chinese government.

<http://www.soas.ac.uk/economics/research/workingpapers/file28835.pdf>

large economic groups in order for the Party and the Government to control and lead the economy toward socialism. In particular, the Party, the State and the Government make it clear that the state-owned economic sector will play a leading and dominant role in the economy. Therefore, it is of great value to investigate the development of large Chinese SOEs.

Korea's Experience with Chaebols

As discussed in Lee (1997), Chaebols are the large, conglomerate family-controlled firms of South Korea characterized by strong ties with government agencies. These government-favored Chaebols had enjoyed special privileges and grew large. By 1996, the 30 largest Chaebols accounted for 40 percent of Korea's total output (Ungson, Steers and Park, 1997).¹ A question that needs to be addressed is how the Chaebols grew large and how the Korean government used these Chaebols for its industrialization purposes? In the early phase of Korean economic development, Chaebols were used as an effective tool for economic development due to their ability to transfer and share financial resources, human resources, and management know-how across subsidiaries when external markets were poorly developed. Industrialization in Korea started with the launching of the first five-year economic development plan in 1962. Lacking adequate resources, experience, and market institutions, the government opted to seek rapid growth by pursuing initiatives to jump-start the industrialization process. The government

2. Chaebol refers to business association. There were family-owned enterprises in Korea in the period before 1961 but the particular state-corporate alliance came into being with the regime of Park Chung Hee (1961-1979). From being small/ medium size firms which were founded by indigenous entrepreneurs during the Japanese colonial period, Chaebols have grown rapidly with the strategic support of the state, bestowed in the course of an unprecedented economic development and the export-oriented industrialization policy adopted by Park Chung Hee (1961-1979) regime. Leading Chaebols, such as Samsung, Hyundai, LG, and Daewoo, had over 80 affiliated companies each participating in a wide range of industries, including semiconductors, consumer electronics, construction, shipbuilding, automobiles, trading, and financial services. Like many other business groups around the world, each Chaebol owned a complete complement of companies spanning many industries.

designated “strategic sectors” for the concentration of scarce resources. Firms that diversified into strategic sectors in response to the government’s initiative could readily secure funds, diversify and renew their business portfolios, and emerge as Chaebols (Korea Economic Research Institute, 1995).¹ On the Chaebols’ side, in the early period of development, Chaebols took advantage of the abundance of new business opportunities while exploiting their ability to overcome factor market imperfections through internal markets. In the early period of industrialization with abundant new business opportunities, the basis of competition was the ability to overcome factor market imperfections. With internal markets for capital, labor, and intermediate products, business groups were able to organize necessary resources and seize new market opportunities rapidly.²

By successfully transforming from exporters of cheap products to major global players in the past two decades, Chaebols have been regarded as drivers behind the unprecedented success of the Korean economy (Amsden, 1989; Chang and Hong, 2000). However, the perception of such large and diverse business groups has changed quite dramatically in the more recent period. Since the Asian Financial Crisis in 1997, Chaebols in Korea have been described as excessively diversified and poorly managed organizations and accordingly, seen as globally non-competitive.

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1. The government of South Korea also used many measures to protect its domestic market from foreign competition. Only until the 1980s when the domestic heavy industries experienced serious financial problems, which invoked skepticism about the government’s capability of leading economic development and under the pressure by major trading partners to liberalize its market, cut import tariff and reduce the government’s support to industry sectors; the South Korean government shifted the government’s role from a “development” to a “regulatory” approach.
 2. It is safe to argue in some cases that Chaebols grew not because they were profitable but merely because they could borrow vast funds as the government used preferential loans with low interest rates as an inducement for companies to invest in strategic sectors. Such loans had been the dominant source of capital for companies. For instance, government policy loans to these strategic sectors accounted for 63 percent of total bank loans and constituted a majority of the investments in heavy industries (Kim, 1997).

As a result, some scholars argued for the break-up of Chaebols to improve national competitiveness. The government forced many Chaebols to restructure their business portfolios. In fact, the 1997 Financial Crisis has brought vast changes to many Chaebols. Of the largest 30 Chaebols in 1996, about half of them have gone through bankruptcy proceedings or bank-sponsored restructuring programs. Some Chaebols have also voluntarily taken their own restructuring efforts, often on a large scale.

Chinese Policy towards Large State-owned Enterprises

Like Vietnam, state-owned enterprises (SOEs) played an important role in the economy of China. The reform of state-owned enterprises occurred contemporaneously with the rapid growth of the Chinese economy and contributed to raise the overall competitiveness of the Chinese economy. This reform brought about a drastic change in China's corporate structure, with the weight of SOEs in the Chinese economy declining.¹ In its move towards privatization, the state had a specific interest in the development of large companies and the creation of business conglomerates. At the 5th Plenary Session of the 14th Central Committee of the Communist Party in 1995, China adopted the "Zhuada Fangxiao" policy which means "keep the large and let the small go." This policy aimed for the full privatization of small companies, which comprise the majority, and the transformation of mid- and large-sized SOEs (via structural reform) into public limited companies, with the state only playing the role of shareholder. China also formulated a blueprint aimed at advancing three to five Chinese SOEs into the world's top 500 rankings by 2000. China also made a concerted effort to cultivate its own business conglomerates. By

1. Within the industrial sector, the share of SOEs in the total number of companies stood at 6.1% in 2007, a sharp decline from 39.2% in 1998, with its share in total employment plunging to 22.1% in 2007 from 56.1% in 1998. In contrast, total assets of SOEs registered a relatively mild decline to 44.8% in 2007 from 68.8% in 1998, indicating that SOEs still play a major role in the industrial sector. In terms of total output, SOEs saw their share fall to 29.5% in 2007 from 49.6% in 1998, indicating that SOE reform has not yet been completed with high shares of output.

benchmarking the industrial policies of Japan and Korea and their highly efficient and competitive business groups, China aimed at creating “National Champion” companies that could compare favorably with their rivals in Korea and Japan. This brought about vertical integration throughout major industries, which had also occurred in Japan and Korea. Mergers proved to be an effective way of fostering these business groups. In 1997 alone, as many as 3,000 firms were merged, and 15.5 billion Yuan worth of national assets were re-distributed. It was during this period that large-scale business groups were created through mergers in the areas of petrochemicals, steel and air transportation.¹

Comparison between Vietnam’s Economic Groups and Other Asian Counterparts

There are a number of differences and similarities between Vietnam’s economic groups and their counterparts in China and Korea. First, the control system of economic groups in Vietnam is different somewhat from that of Chaebols and similar to their Chinese cousins. In Korea, the Chaebols are controlled by founder families (Chung, 2004). While in Vietnam like China, the pyramid structure guarantees centralized control over the entire group.

Second, while the large business groups in other countries became formidable due to their innate competitiveness, the large

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1. In a recent paper published by the Wharton Business School in 2006 entitled “China: Reform from the Outside In”, the author described a recent wave of foreign purchase of equity in China’s biggest SOEs and has pointed out that by letting foreign ownership in Chinese SOEs, the Chinese Government intends to encourage foreign ownership to bring in new management approaches, better incentive systems, greater transparency, and a whole new level of corporate governance. The article points out the large foreign reserve by the Chinese government as evidence that the Chinese does not need investment capital. Rather, what they are after is ‘business expertise’, with a primary intention to move state-owned firms to sound commercial footing. By making the SOEs to become a shareholding company rather than a wholly state-owned enterprise, the Chinese government subjects them to Chinese securities law which require to install directors and corporate governance systems, which in turn helps to increase transparency and help companies become competitive in an open market.

economic groups in Vietnam were established mechanically through administrative fiat.

Third, while the ultimate goal of large business groups in other countries is to serve the interest of the shareholders by providing profit orientation, there is a confusion of goals and roles in the large economic groups in Vietnam.

4.4.2 Vietnam's State-owned Large Economic Groups as Industrial Policy

Since the promulgation of the government plan to establish large state-owned economic groups using large corporations, the policy has been under public scrutiny. The rationale for establishing such large economic groups has been questioned from the very beginning.¹ More recently, with the near-collapse of one of the largest economic groups, the supposed Vietnam's flagship shipbuilder VINASHIN, the problems of large economic groups have been hotly debated in Vietnam.² Despite the popular perception of the economic groups being problem-ridden, there is yet no conclusive verdict on the economic roles played by business groups around the world (Khanna and Yafeh, 2007). The value and the role of business groups depend on the institutional contexts in which they are embedded (Khanna and Rivkin, 2001). It is therefore useful to review the rationale, roles and dangers of large economic groups for national economic development and industrialization in Vietnam.

Market Failures and Institutional Voids

The existence of so many business groups around the world, especially in developing countries, points to the important role of large economic groups. Economic theory has it that the emergence and existence of business groups is due to the underdeveloped

1. See <http://bee.net.vn/channel/2043/201007/Co-nen-thanh-lap-cac-tap-do-an-kinh-te-1758513/> and <http://www.vnn.vn/kinhte/2005/06/460353/>

2. See <http://vnr500.vietnamnet.vn/content.aspx?id=707>

nature of the market mechanism in developing countries (see Leff, 1978; Goto, 1982). The theoretical literature attempts to explain why business groups would deviate from the norm of specialization in core competences. The market failure argument explains business groups as a logical response to technology borrowing and economies of scope, capital and managerial scarcity, and other kinds of informational and institutional voids (Amsden, 2001; Leff, 1978; Khanna and Palepu, 1997). According to Khanna and Palepu (1997), unlike developed countries where capital markets are efficient; labor markets are well functioning, and product markets are driven by reliable enforcement of liability laws, efficient flow of information and proactive consumers; developing countries are characterized by inefficient capital markets, lack of well-trained business people in the labor market, and lack of information and transactions-related institutions in the product market.

In contrast to the advanced countries where rule of law is enforced, in addition to a competitive environment relatively free of corruption, and a system of predictable contract enforcement; the governments in developing countries, including Vietnam, are highly bureaucratic and hence, intervene in business extensively. In such a situation, business groups can have superior access to capital markets and to internal labor and product markets. Vietnam is making its transition to the market economy only in the last 20 years, and market institutions are only emerging. In this context, the emergence of large economic/business groups (both private and state-owned) could be viewed as an appropriate response to inadequate market institutions. The internal markets (i.e. capital, labor and product) allow affiliate members of such business groups to overcome the market failures in developing countries.

In addition to the typical institutional voids identified above, there is a peculiar type of institutional void that exists in China and Vietnam (and other transition economies), the ownership void. Ma et al. (2006) argue that the ownership void exists due to the lack of unambiguously specified ownership of state-assets in transition economy. They argue that the role of business groups is

to facilitate economic reform and corporatization of state-owned enterprises. In China SOEs are owned by the State and hence, belong to all citizens. But in reality, these owners do not have the right to manage, control, use, transfer or sell the property. It is this particular situation that leads to an ownership void. Instead, these enterprises are run and managed by state agents who claim to act in the interest of the owners (citizens) but in many cases pursue their own private benefit at the expense of the owners. It is this ownership void that is the root cause for the widespread poor performance of SOEs in China (and also in Vietnam). Under this situation, the economic groups are created to fill the ownership void. These business groups are “created to serve as the second-order but direct owners of Chinese SOEs in the institutional transition and ownership transformation process” (Mat et al., 2006, p. 472).

Large Economic Groups as a Device for Industrial Policy and Economic Catch-up

Can large economic groups in general and state-owned groups in particular be developed for the purpose of national economic industrialization and catch-up? Despite its potential problems, economic/business groups in general can be used for economic catch-up, i.e. implementing industrial policy. The Korean case, discussed above, is a good example. When Korea started its industrialization in the early 1960s, it was evident that its growth potential was seriously constrained by limited financial resources. To overcome such constraints, it was a reasonable solution to pool the capital into just a few big businesses. In other words, the Korean government promoted a small number of big businesses to expedite economic growth. Therefore, the spectacular economic performance achieved in Korea has often been attributed to the growth of big business groups. More recently, it is China, another catching-up economy, that has been successful in promoting the development of the big business groups for national economic catch-up, while there bottom-up, the SME sector has also played an important role (Lee and Woo, 2002). For the case of China,

Keister (1998) is the first to conduct an in depth study to analyze how and why Chinese business groups were formed and what impact their formation has had on economic performance. She suggests that the formation of Chinese business group was a strategy of the government to reform SOEs and she described how the government actively encouraged the formation of business groups in China and protected them from competition.

How could state-owned economic groups be drivers of economic growth and development despite the popular perception that the larger the SOE sector the less efficient and dynamic they are? As pointed out by Chang (2007), there is no clear theoretical case either for or against SOEs – the performance of private sector firms will only be superior to SOEs only under restrictive condition as shown by the Sappington-Stiglitz fundamentals of privatization theorem and that the problems faced by large SOEs and large private enterprises are the same. There can be successful large SOEs as well as failures.¹ In terms of real case evidence, there are evidences from East Asian and European countries² that it is not simply that their SOE sectors are big, but they have been most dynamic, and have led the modernization of their industries. Taiwan has one of the largest public enterprise sectors in the non-oil-producing world. The Taiwanese SOEs were mostly in the upstream sectors producing intermediate inputs, and their efficiency has contributed to the competitiveness of the country's downstream industries which use their products as inputs (Wade, 1990). The Taiwanese government also started some risky, high-technology SOEs and spun off private sector firms from them, with some of the leading semi-conductor firms in the country were created in this way. Examples of successful and efficient large

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1. The government can implement industrial policy through large SOEs in such cases as (i) natural monopoly; (ii) market failure (capital, labor); (iii) externality and (iv) equity. The reasons that may underscore SOEs failure include; free-rider problem, principle-agency problem, and soft-budget constraints.
 2. According to Chang (2006) many of the countries which actively practiced industrial policies have used state-owned enterprises extensively. France, Austria, and Norway all had large SOE sectors

SOEs can be found in many countries around the world and in the region,¹ i.e. POSCO, the steel producer in Korea, Singapore Airlines in Singapore, and Thai Airways in Thailand.

Problems Associated with Large Economic Groups for Vietnam

Agency problems and costs: Like any formal business, large economic groups have to deal with the agency problems. The agency cost here could be shareholder-manager agency costs, the debtor-manager agency costs, and employment agency costs. Depending on whether the economic group is privately owned or state-owned, the agency costs may vary. The agency problem arises when there is a separation between owners and managers of a business as the managers would seek to fulfill their own objectives rather than those of owners. This type of agency cost problem is inherent not only in state-owned large economic groups but also in private owned (including publicly owned) firms and business groups. In Vietnam, the public held business group is relatively few in number. For the state-owned large economic groups in Vietnam, they also suffer from the agency problem of separation between ownership and control. But the problem for state-owned group is even worse due to the ownership void briefly discussed above. The owners are citizens but the groups are controlled and run by politicians or managers appointed by politicians. As a result, state-owned large economic groups and corporations are charged with tasks such as macroeconomic stabilization that have little business value. And this complicates the issue of accountability.²

3. Of course, this is not to suggest that an effective industrial policy regime requires a large SOE sector. Japan is an important exception to this pattern that proves this point. While Japan's SOE sector is not exceptionally small, it is not very large either, and in manufacturing industries, the role of SOEs has been minimal.

1. http://www.hanoimoi.com.vn/newsdetail/Kinh_te/313459/anh-ca-do-khoe-chinh-phu-moi-khoe.htm
http://www.tin247.com/thu_tuong_trieu_tap_lanh_dao_cac_tap_doan%2C_tong_cong_ty_nha_nuoc_ban_giai_phap_kiem_cho_lam_phat-3-66307.html
http://www.tin247.com/thu_tuong_yeu_cau_cac_tap_doan_khong_duoc_tang_gia!-3-1018.html

Further, the separation of ownership and control may also lead to the pursuit of other objective such as empire-building rather than profit making, i.e. focusing on growth.¹

In addition, large economic groups are not disciplined by market forces because the politicians that run them have the power to regulate the industry, or the state-owned large economic groups that have political connections and power that allow them to ignore regulations. In Vietnam, this problem is even worse as many people have questioned whether the government agencies and ministries have any power over large economic groups.² Another problem associated with large state-owned economic groups is the soft budget constraint (Kornai, 1986).

Restructuring the State-owned Enterprises and Large Economic Groups – The Way Forward

The analysis and review of the literature above have shown that large economic groups could potentially play an important role for Vietnam's economic development. However, evidence has also shown that using such large economic groups as an instrument for implementing industrial policy is not an easy task. The recent near-collapse of Vinashin highlights the potential risks, challenges, problems and costs associated with establishing, managing, controlling and using large economic groups. It also calls for a more systematic, more disciplined and more innovative approach in the governance of large economic groups. Although a systematic and comprehensive analysis is beyond the scope of this chapter, however attempts have been made to review the recent literature on state-owned corporate governance in China in order to shed some light on the problems that Vietnam is facing. A number of points are worth noting:

Khanna and Palepu (1999) point out that by simply dismantling the large and diversified large economic groups

2. <http://vneconomy.vn/20100311102242340P0C9920/thu-tuong-tap-doan-tong-cong-ty-nha-nuoc-can-tang-truong-it-nhat-10.htm>

1. See <http://vnexpress.net/GL/Kinh-doanh/2010/07/3BA1DF1E/>.

in order to reduce the huge debt problem, reduce inefficiency, promote entrepreneurship, and to create more focus and efficient enterprises may not work due to the institutional void discussed above. Instead, these authors suggest a number of alternatives. At a more general level, they suggest building a market infrastructure, especially soft infrastructure. At a more specific level, they suggest reforming business practices – accountability and corporate governance.

4.5 Conclusions and Future Directions for Research

As pointed out earlier, Vietnam is now at the critical juncture of its economic development as the country moves from a low-income country to a lower-middle-income country. During the last few decades, the government has implemented many economic reforms successfully. However, the new global economic environment and the new middle income context pose the question if Vietnam could continue its current course of economic development and avoid the middle-income trap. This chapter closely examines the empirical concept of industrial policy and its relevance for Vietnam's economic development. Review of relevant sources shows that Vietnam has not had a consistent and well-defined industrial policy/strategy. The last few decades of Vietnam's economic development policy can be more characterized as market-development reform (including institution building measures) rather than selective interventionist policy of the Korean, Malaysia, Taiwan types, although the government did have some ad hoc interventionist policies. In the new global economic environment, Vietnam may not have all the selective industrial policies that were available to other countries. Instead, one of the very important tools for Vietnam to implement its industrial policy is the large economic groups, especially the large SOEs. However, they are a double-edged sword that can only be used effectively and safely in the hand of a good master.

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