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**Public Administration Reform and Anti-Corruption
A Series of Policy Discussion Papers**

**Pro-Growth Anti-corruption and
Governance Reforms for Viet Nam:
Lessons from East Asia**

Dr. Mushtaq H. Khan

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United Nations Development Programme
25-29 Phan Boi Chau
Ha Noi, Viet Nam
Jairo Acuña-Alfaro, Policy Advisor
Public Administration Reform and Anti-Corruption
jairo.acuna@undp.org .
www.undp.org.vn

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Executive Summary

The discussion about governance and anti-corruption reform priorities in developing countries has been dominated by a theoretical perspective that can be described as ‘market-enhancing’ governance. These governance capabilities, also often described as ‘good governance’ capabilities could in theory make markets more efficient by reducing transaction costs. However, the experience of East Asia shows that ‘market-enhancing’ governance did not drive their growth. Indeed there are theoretical reasons why significant improvements in market-enhancing governance are unlikely to be achieved in emerging economies.

The East Asian experience suggests instead that sustained growth required ‘growth-enhancing governance’ capabilities which refer to *capabilities for correcting significant market failures that constrain growth*. The correction of market failures inevitably involves the creation of ‘rents’ (policy-created benefits) and the failure of policy can be seen as a failure to allocate and withdraw different types of rents effectively. Whenever policy creates rents it also induces ‘rent seeking’ (the expenditure of resources by those who want to get access to these rents). Policy can only be successful if the rent seeking does not subvert the policy intention.

These insights allow us to develop a deeper analysis of corruption. Corruption generally refers to the illegal use of public authority by politicians or bureaucrats for their personal benefit. But in the context of public policy corruption can be defined as illegal rent seeking, where individuals engage in illegal attempts to influence public policy. The standard anti-corruption strategies assume that corruption is ‘market-constraining’ where officials create legal obstacles for businesses that enable them to collect (illegal) bribes. The standard anti-corruption strategies therefore focus on liberalization, transparency, salary improvements for bureaucrats and greater accountability. However, these types of anti-corruption strategies have generally yielded poor results in most countries.

The simple analysis of corruption has not been very policy relevant because it has a poor analysis of other types of corruption, each with very different drivers. In particular, when market failures require formal and informal responses that create rents, ‘state-constraining’ corruption is an important variant. This type of corruption can coexist with growth if the corruption does not distort potentially beneficial public policy too much, but this type of corruption can also destroy growth. The policy response here has to focus on improving growth-enhancing governance capabilities to improve the management of critical rents and limit or prevent damaging rents. Other types of corruption include political corruption and predation and theft, none of which are amenable to standard policy tools.

To establish the importance of this approach for Viet Nam we show that though its recent growth is often presented as a market-driven growth experience, Viet Nam’s growth has depended on deliberate and sometimes fortuitous responses to market failures. These responses inevitably created rents. Some of these rents were potentially ‘growth-enhancing’ but others were economically damaging. As the hidden problem of corruption is related to the types of rents that exist in the economy, this approach tells us that anti-corruption strategies have to be aware of the different types of rents. Anti-corruption strategies have to be designed so that growth-enhancing rents are managed in a more effective way while damaging rents are limited or squeezed out.

About the author

Dr. Mushtaq H. Khan

The author is Professor of Economics at SOAS, University of London, e-mail: mk17@soas.ac.uk. He has been appointed to serve on the Committee of Experts on Public Administration (CEPA) of the United Nations. His research interests are in the area of governance, institutional economics, industrial policy and property rights reforms in developing countries, with a special emphasis on South and South-East Asia. He studied Philosophy, Politics and Economics as an undergraduate at the University of Oxford, and did his PhD in Economics at the University of Cambridge where he also taught for a number of years. He has many publications in these areas and many of these are accessible on his web-site: <http://mercury.soas.ac.uk/users/mk17>.

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1. Introduction

Viet Nam's rapid growth over the last two decades has taken it from a war-ravaged country facing runaway inflation to the threshold of middle-income status. Like East Asian countries before it, its growth was not initially based on good governance but rather on a number of very specific governance capabilities appropriate for its economic strategies. At the juncture it now finds itself in, there are critical questions about the direction of governance reforms to sustain its growth. Is it now time for Viet Nam to concentrate on good governance reforms such as transparency and accountability to reduce general levels of corruption, improvements in rule of law and property right stabilization? Or are there more specific governance capabilities that it should focus on to strengthen its capabilities for sustaining growth?

The importance of governance capabilities for sustaining growth is widely supported by economists. There are, however, disagreements about the types of governance reforms that should be prioritized, the evidence supporting different positions, and the feasibility of particular reforms in particular countries. The starting point is that existing markets are not able to solve many welfare and growth problems. These lost opportunities represent 'market failures'. Contemporary governance approaches hope to address these market failures by *general* governance reforms that aim to make all markets in a country more efficient. These reforms are generally referred to as '*good governance*' and include strengthening state capabilities for enforcing property rights, enforcing a rule of law and limiting corruption primarily through improving accountability. These goals are desirable in any case, but in addition may in theory reduce market transaction costs thereby reducing overall levels of market failures. We therefore describe this as the *market-enhancing governance agenda*. The problem is that in practice there may be limits to the extent to which these policies can actually be implemented in developing countries, and so it may not be possible to improve market efficiency significantly through these reforms.

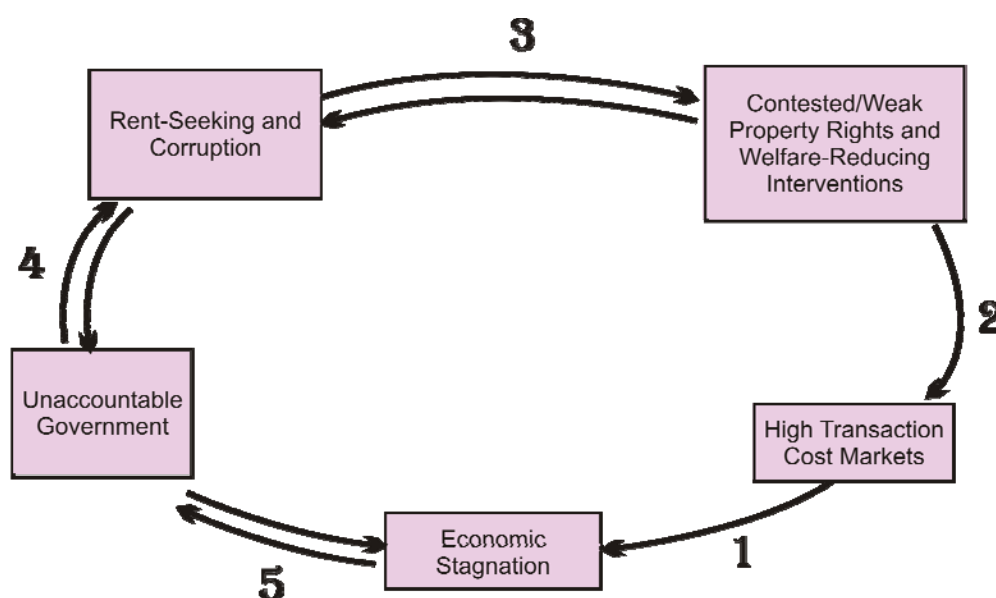
It is not surprising that we do not find evidence of developing countries making significant improvements in their 'good governance' capabilities at early stages of development. The historical evidence suggests that the achievement of good governance is a very gradual process and successful poor and middle income countries focused on *specific* governance capabilities for addressing *particular* market failures that were most important for them. This may require certain types of corruption to be limited, but East Asian countries did not have low levels of corruption overall when their per capita incomes were comparable to Viet Nam. The focus of governance capabilities in East Asia was on governance capabilities that enabled these states to overcome specific market failures. This alternative approach to governance identifies somewhat different priorities compared to the good governance approach. We describe this as the *growth-enhancing governance agenda*.

The successful East Asian countries did not have a good rule of law, stable property rights across the board or low corruption at an early stage of development, but they did have the capability to protect *critical* property rights, to assist domestic firms to acquire and adopt new technologies and limit the detrimental effects of the damaging types of corruption. At the same time, Vietnamese experience suggests that Viet Nam relied on a number of informal mechanisms to overcome specific market failures. The two parts of the analysis are used to identify the types of economic challenges and governance reforms that are likely to be most relevant for contemporary Viet Nam.

2. Good Governance Reforms

The institutional capabilities described in the good governance agenda are all desirable as ends or *goals*. It is surely better to live in a society with low levels of corruption, a good rule of law and an accountable and democratic political system. Many of these conditions can in theory also improve the efficiency of a market economy and good governance reforms are therefore 'market-enhancing governance' reforms. While these are clearly some important *goals* of development the question is whether they are also *preconditions of development*. Even if in theory these conditions can assist development by making markets efficient, they may not be immediately *achievable* in poor countries to an extent that would make a significant impact on economic performance. Indeed, the historical evidence is that the core capabilities of good governance (stable property rights, rule of law, low corruption, democratic accountability) are difficult to improve in the short to medium term.

Figure 1 Theoretical linkages underpinning the good governance agenda

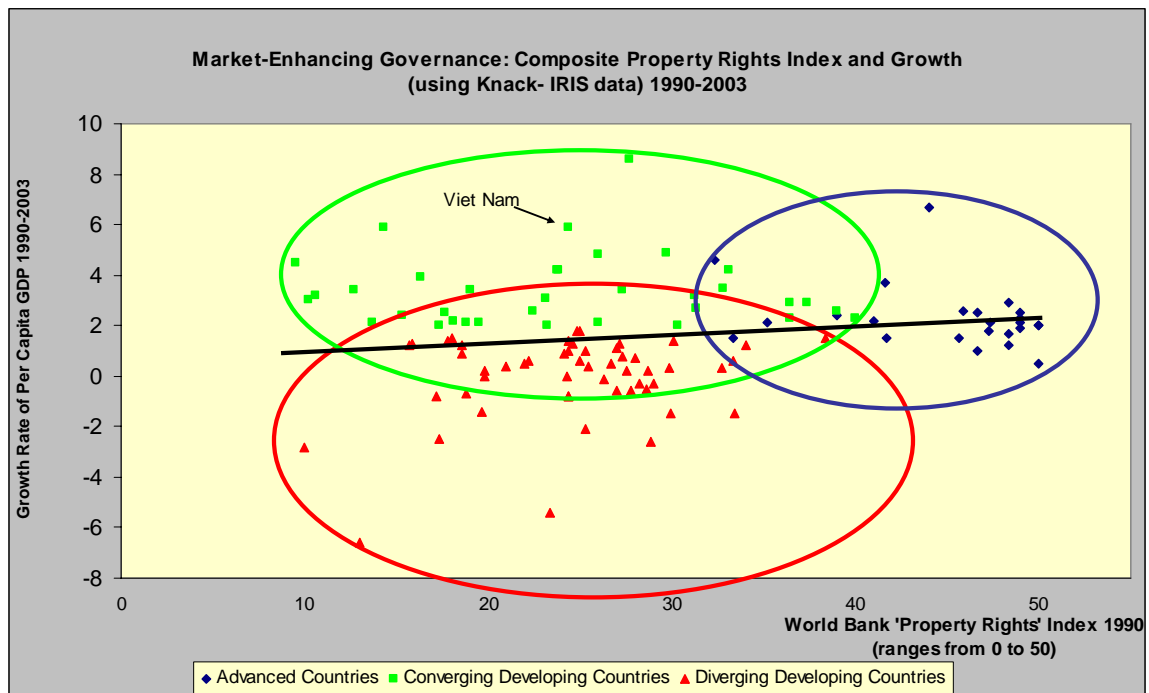


Some of the important theoretical links between the achievement of good governance (or market-enhancing governance) capabilities and development are summarized in Figure 1. Efficient markets require that private parties can contract at low transaction costs. Transaction costs are the costs of making and enforcing contracts. Low transaction costs are necessary to allow gains from trade and from productive cooperation. Transaction costs will be high if property rights are not protected, so that parties do not know if contracts can be enforced, and if the state can make arbitrary interventions that change terms of contracts *ex post*. In turn, property right instability is explained by attempts to capture assets or extort incomes through rent seeking and corruption. So these too have to be reduced to achieve stable property rights. And finally, the persistence of corruption in turn is explained by the absence of democratic accountability. Corruption is possible because small groups of people have purchased or captured public power, so democratic accountability should in theory make corruption and rent seeking more difficult. Clearly, the links in the good governance argument are

potentially plausible and many of these reforms are supported by civil society as ends in themselves.

But what is the evidence that economic success in developing countries was based on an improvement of market-enhancing governance capabilities? An extensive academic literature has attempted to establish that this was the case (Knack and Keefer 1995; Mauro 1995; Barro 1996; Clague, et al. 1997; Knack and Keefer 1997; Johnson, et al. 1998; Hall and Jones 1999; Kauffman, et al. 1999; Kaufmann and Kraay 2002; Lambsdorff 2005). This literature typically finds a positive relationship between market-enhancing governance conditions and growth. The limitations of this data and these types of interpretations have been extensively discussed (Arndt and Oman 2006; Khan 2007a, 2008; Meisel and Aoudia 2008). The problem for the standard analysis is visually summarized in Figure 2. This uses a simple aggregation of the governance indicators available for 1996 (the earliest year for which World Bank data are available) and plots this against growth rates of per capita incomes over the period 1990 to 2003.

Figure 2 Market-enhancing governance and growth 1990-2003



Note: The property right index is an aggregate of the corruption, rule of law, bureaucratic quality indices together with the index of repudiation of government contracts and expropriation risk.

Sources: World Bank (2005b), World Bank (2005a).

Developing countries are divided into two groups in Figure 2. Rapidly growing developing countries are ‘converging’ if their growth rates are higher than the median advanced country growth rate and ‘diverging’ if growth is lower. Interestingly, the two groups of developing countries do *not* have significantly different scores on market-enhancing governance indicators. Advanced countries do have higher scores, but we would expect that because greater fiscal resources allow good governance capabilities to be effectively implemented. Looking at all countries together it is true that there is a weak positive relationship between high scores on market-enhancing governance and higher rates of growth, but this relationship is a misleading one. If we look at countries at similar

levels of development, it is hard to discriminate between high growth and low growth states by looking at their 'good governance' indicators. While we have only presented data here for an aggregation of indicators and for one period, this basic story is repeated when we look at any set of good governance indicators and any of the periods for which data is available (Khan 2004, 2007a).

For this period, Viet Nam's weak good-governance score makes it a typical converging country, with characteristics that are about average for this group. Governance indicators do not exist for the 1960s when East Asian countries were at an equivalent stage of development, but case study evidence suggests that scores on good governance characteristics like rule of law, democratic accountability, or the overall protection of property rights in South Korea or Taiwan at that time would be comparable to contemporary converging developing countries. Indeed, even as late as the mid-1980s when the first governance indicators became available from Knack and Keefer (1995), South Korea's score was comparable to African countries like the Ivory Coast (Rodrik 1997).

It is not surprising why developing countries do not manage to achieve high scores on good governance indicators. Protecting property rights for all assets and enforcing an effective rule of law in a society is very expensive and can only be sustained if most assets are very productive and are paying significant taxes to pay for their protection. By definition, in a developing country many assets are not productive enough to pay significant amounts for their protection. This makes the attempt to achieve a rule of law across the board in poor countries financially infeasible (Khan 2004, 2005b).

Similarly, a reduction of corruption across the board requires fiscal resources to pay bureaucrats and politicians at rates that are close to the private sector they are supposed to be regulating. And the control of political corruption requires sufficient fiscal resources for social democratic electoral strategies to be viable (Khan 2006a, 2006b, 2006c).

Finally, achieving high scores on democratic accountability requires a democratic system that can deliver to constituents. In most developing countries fiscal resources are not sufficient to satisfy the political demands of powerful constituencies. Thus patron-client politics and the use of political power to gain access to economic resources outside the budget are features of political stabilization in virtually all developing countries (Khan 2005a). For all these reasons, developing countries have relatively poor scores in good governance.

Nevertheless, there are high growth and low growth developing countries, and the high growth ones clearly have *some* governance capabilities that are enabling them to sustain growth. These governance capabilities may however have little to do with the good governance capabilities identified by the good governance theories. The answer may be that growth requires the solution of significant market failures and high growth countries had governance capabilities appropriate for addressing some of the most significant market failures.

3. Growth-enhancing governance: an alternative framework

History as well as economic theory tells us that markets may not be of much use for a developing country if there are significant structural factors that prevent markets from working effectively. In these cases, the development of markets and good governance capabilities may not solve the problems of development because very limited improvements in markets may be feasible and significant market failures may remain.

Any intervention, including those that address market failures inevitably creates new income flows as a result. These are '*rents*', defined as policy-induced income flows that would not exist in the absence of that policy. Rents are benefits that some people get as a result of specific state policies. Government can create rents for some people by

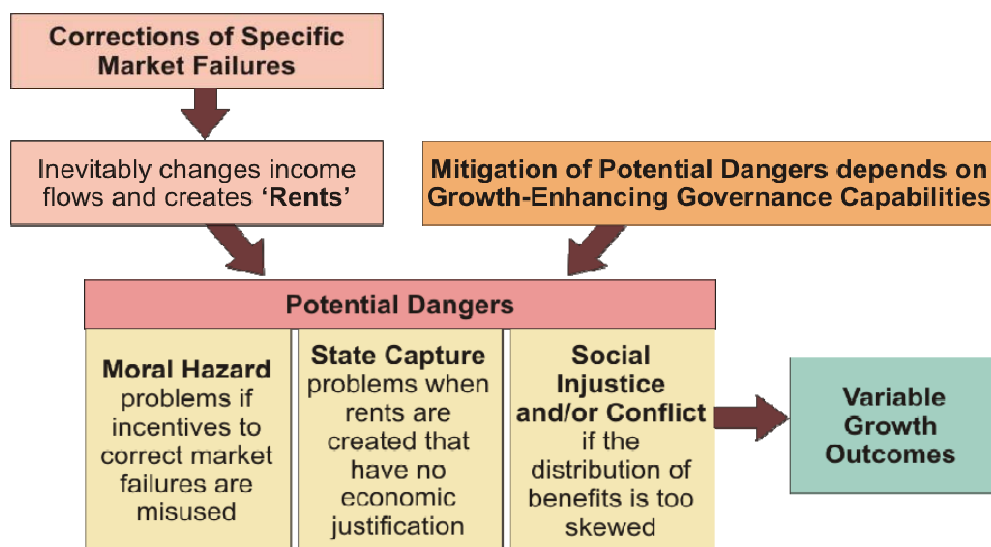
creating a monopoly, restricting imports, taxing and subsidizing and in other ways. Whether the policy is socially damaging or socially beneficial is a different matter. A policy (and therefore the rents associated with it) can be socially beneficial if the policy enhances net welfare. Some rents like monopoly rents are clearly socially damaging because the monopoly reduces social welfare even though the recipients of the monopoly rent are better off. Other rents like subsidies to control pollution or enhance technological progress may be socially beneficial *and* the rents may be beneficial for the direct beneficiaries (Khan 2000a, 2007b). Whether an intervention results in an improvement in growth or welfare depends not only on the type of intervention but also on the capabilities of the state to manage potentially socially beneficial interventions and rents.

The management of rents is important because wherever income flows are created, individuals and groups will organize and compete to capture or protect these rents. These expenditures are described as rent seeking. Rent seeking can be legal, and can take the form of lobbying, legal political contributions, the employment of think tanks and journalists and other legal mechanisms to influence government policy. But rent seeking can also be illegal, when the expenditures to buy influence are illegal. These include not just corruption in the simple sense of bribery, but also political corruption where individuals and groups can spend resources to acquire political power that in turn allows them to capture rents, or to spend resources to acquire coercive power to extract or steal from others, thereby directly extracting rents from society. Even potentially beneficial policies creating potentially beneficial rents like subsidies for learning can become socially damaging if the rent seeking is very extensive or if it succeeds in distorting policies too much, for instance by enabling inefficient firms to capture or retain rents that were intended to assist them in acquiring technology (Khan 2000b). The important point from the perspective of governance reform is that while the creation of some rents (like monopoly rents) triggers new market failures and lowers social welfare, other rents (like some government expenditures) may be a response to existing market failures and if properly managed can raise social welfare. *Growth-enhancing governance capabilities can be understood as governance capabilities that enable states to manage vital corrections to market failures by managing potentially beneficial rents in appropriate ways in the face of inevitable rent seeking activities.*

The major challenges are summarized in Figure 3. The failure of policies to support growth in many developing countries can be explained in terms of their weak governance capabilities to manage the rents that growth policies inevitably create. In contrast, the success of East Asian countries was to a large extent due to governance capabilities to 'manage' rents so that potentially growth-enhancing rents had the desired effects. The policy challenge for developing countries today is to learn the lessons from East Asia in a nuanced way. Since their initial political and institutional conditions as well as international conditions are very different today, a straightforward imitation of East Asian policies is not likely to work. Instead, the challenge is to develop appropriate growth-enhancing governance capabilities to correct important market failures in an effective way. To succeed, policies to correct market failures have to overcome a number of problems that could otherwise make them fail.

First, there has to be mechanisms to reduce the problem of moral hazard. Policies to correct market failures often depend on providing incentives to individuals to behave in particular ways. A common problem (often described as moral hazard) is when individuals appropriate the incentives but do not change their behaviour. For instance, subsidies to assist training or making credit lines available to new startup companies to overcome market failures may simply be wasted without achieving the desired result. For this not to happen, governance capabilities of oversight and policy change are required so that the rents created to change incentives are not permanent and may be withdrawn if results are not achieved. The more narrowly defined the policy is, the more plausible it may be to develop the governance capability to administer the policy reasonably effectively.

Figure 3 Strategies for Addressing Specific Market Failures



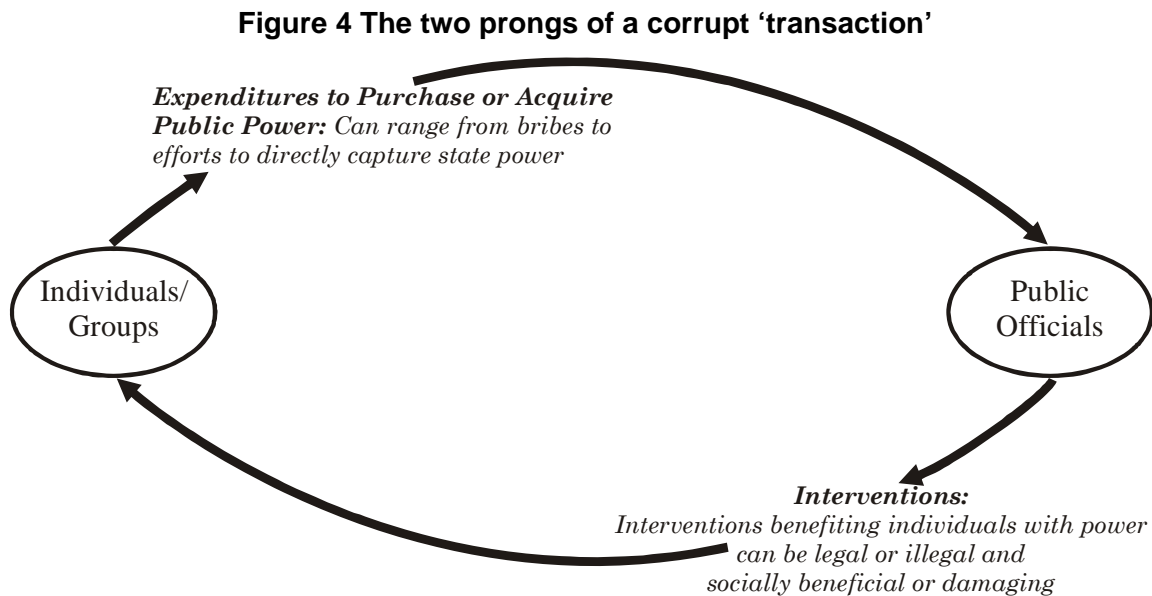
A second problem is the policy-making agencies of government may get captured by rent seekers who may engineer 'solutions' to market failures that do not really exist, simply to benefit from the rents created as a result. For instance, subsidies may be created for 'technology adoption' by industries that do not need these subsidies. Finally, policy responses to market failures may be politically controversial because the solutions may benefit particular constituencies or groups and hurt others and this can result in political conflicts that can overturn the implementation of the policy. Success requires governance capabilities to devise interventions that are the least conflictual and to manage conflicts in politically acceptable ways.

4. The Appropriate Design of Anti-Corruption Strategies

Anti-corruption has become a major part of governance reforms in developing countries for a number of reasons. First, in the market-enhancing or good governance policy agenda, anti-corruption plays a vital role in ensuring market efficiency as shown in Figure 1. Secondly, aid donors have found it politically very difficult to justify giving aid to countries that cannot ensure that aid is not misappropriated. In extreme cases, the evidence of significant corruption in their aid programmes can force donors to suspend aid given the accountability of aid agencies to their domestic taxpayers. Examples include the PCI scandal that resulted in the suspension of Japanese aid in November 2008 and other instances of corruption have affected World Bank and ADB loans. But from the perspective of growth-enhancing governance targeting specific types of corruption is important because some types of corruption can disrupt the ability of a state to address market failures. However, each of these perspectives can direct our attention to very different anti-corruption strategies. The choice of anti-corruption priorities is therefore implicitly determined by what we think can be feasibly achieved and the priorities that anti-corruption needs to address.

Corruption is usually defined as the illegal use of public authority and power by bureaucrats, politicians and others in positions of public responsibility for their private benefit. This definition can cover a vast range of phenomena, ranging from relatively innocuous tips and gifts to petty officials to vast sums appropriated by senior officials and even expropriation by warlords with guns with possibly very serious consequences for the economy and society. To classify the different types of corruption it is useful to first

break down every corrupt 'transaction' into two parts shown by the two arrows in Figure 4.



The top arrow shows 'rent seeking' expenditures, which are expenditures by individuals to either influence public officials or to capture power directly, thereby becoming 'public officials' themselves. Corruption typically involves illegal rent seeking activities. The simplest types of corruption involve the use of bribes to 'purchase' influence. The expenditures in this part of the transaction are generally illegal (but not all of these expenditures need be illegal). In most cases the use of resources to attempt to purchase political power or influence also represent at least in part a waste of social resources. The waste can be less than the total amount of the bribe because bribes are partly simply transfers of resources between individuals. So for instance, bribes can sometimes involve transfers from richer people to poorer public servants and can in theory be welfare enhancing, but in general we can assume that the rent seeking part the transaction is usually socially wasteful.

The bottom arrow is much more important and shows the types of rents or benefits that the public power is then used to 'purchase'. Much more significant damage can be caused by corruption if it supports the creation of damaging rents. Here there is considerably more variation than is recognized in the simple theory supporting the policy advice for anti-corruption efforts in developing countries. The interventions and rents that are supported or altered by rent-seeking activities can in turn be legal or illegal, and the effects of these rents and interventions can be socially beneficial or damaging. Note that here we are talking about the social welfare associated with particular rents, because all rents are privately beneficial for those who receive them. As long as laws were broken in either of the prongs shown in Figure 4, the involvement of public officials in these activities is corruption. The law is most likely to have been broken along the top arrow, and often along the bottom arrow as well. The varieties of interventions that can be involved along the bottom arrow are shown in Figure 5. It shows that the rents/interventions associated with the corruption (the bottom arrow in Figure 4) can be legal or illegal, beneficial or otherwise and it is important to understand these differences when designing anti-corruption strategies.

Figure 5 Types of Corruption and Appropriate Policy Responses

	Legal Interventions	Illegal Interventions
Potentially Beneficial Interventions	<p>ii) State-Constraining Corruption. Can be associated with growth if policy benefits outweigh cost of corruption. Response should be to legalize rent seeking and strengthen state capabilities to prevent subversion.</p>	<p>iii) Political Corruption and Primitive Accumulation. Net effect depends on stability achieved and whether productive economy can grow. Long-term policy should seek to increase fiscal capacity for legal political stabilization and legal property right protection.</p>
Damaging Interventions	<p>i) Market-Restricting Corruption. Net effect of corruption always negative. Anti-corruption policy should remove these damaging state 'functions' through liberalization and privatization.</p>	<p>iv) Predation/Theft. Net effect always negative: Possible descent into warlordism in some countries. 'Anti-corruption policy' has to strengthen centralized coercive power of the state.</p>

Source: Adapted from Khan (2006b: Table 2).

4.1. Market-Restricting Corruption

The anti-corruption policy coming from the good governance position assumes corruption is primarily of this type: the interventions that create the rents in this case are legal but they are not socially beneficial. Public officials create legal but market-restricting interventions either by mistake or deliberately to create obstacles for investors that they have to bribe to get around. In this case the rent seeking by investors (paying bribes) provides them with benefits, but the benefit is simply to avoid an unnecessary hurdle. The rent in this case is therefore not socially beneficial and it would be better to simply get rid of the hurdles directly. Examples would be unnecessary red tape and regulations, large numbers of useless forms that need to be filled in, unnecessary inspections of factories and so on. These provide opportunities to harass and slow down business, to avoid which business may be willing to pay speed money of different types. The bribes in the top arrow of Figure 4 in this case are to influence public officials so that they overlook private investors sidestepping unnecessary and restrictive regulations. Even if the bribes themselves are mainly transfers to underpaid bureaucrats and therefore not necessarily directly very damaging in every case, the overall effect of the corruption is likely to be damaging. This is because along the bottom arrow the 'rents' that are captured are not socially beneficial at all and at best allow society to operate closer to the 'market' outcome that may have been achieved in the absence of corruption. Bribes in this case allow private investors to navigate round unnecessary restrictions, for instance unnecessary and extensive paperwork but at the cost of lost time and resources involved in the bribing.

Market-constraining corruption is always associated with damaging outcomes because both the rents created by the intervention (avoiding hurdles) and the rent seeking (bribes to overcome the hurdles) are damaging. The policy package coming from the mainstream good governance approach would be applicable in this case. Liberalization would help reduce unnecessary state activities that perform no useful function. Paying bureaucrats and politicians competitive salaries and developing a good system of detection and punishment would raise the opportunity cost of corruption and thereby deter corruption. Rule of law reforms, transparency reforms and accountability reforms would increase the probability of punishment and therefore reduce the incentives for bureaucrats and politicians to be corrupt. These well-known suggestions are plausible but the problem is that this type of corruption is likely to be a small part of the overall

spectrum of corruption in a developing country. Moreover, the package of reforms that are required to reduce this type of corruption are quite demanding for most developing countries, in particular the requirement that it is not sufficient to pay bureaucrats and politicians more, but also to have credible detection and punishment systems.

4.2. State-constraining corruption

There are many state activities that are essential for growth and development, and many of these activities are legal. The corruption associated with these types of interventions raises a different set of challenges. While all economists agree that there are essential public goods that states have to provide, the analysis of market failures in developing countries suggests a more extensive set of beneficial interventions to accelerate growth and development. When states engage in these interventions (along the bottom arrow in Figure 4) they create potentially beneficial rents. But these rents imply in turn rent seeking activities (competition to capture rents) to influence the type or allocation of these rents. Rent seeking can be illegal, involving bribes or kickbacks to influence public officials, but it can also be legal involving lobbying or legal contributions to political parties, and both are expenditures along the top arrow of Figure 4.

The net outcome of state-constraining corruption (and rent seeking in general) can be positive or negative. We can identify two polar extremes with most cases lying somewhere in between. At one end would be a state that was 'autonomous' such that it could determine and change policies (and therefore the allocation of benefits) according to its own criteria. Corruption and rent seeking in this case would provide kickbacks to public officials but would not necessarily determine the allocation or management of the rent because public officials would have an incentive to allocate and manage rents to maximize their kickbacks or taxes over time. They would have no incentive to provide rents to inefficient firms because efficient firms would be able to provide them with bigger bribes or taxes over time. *In this case state-constraining corruption could be associated with moderately good growth outcomes.* South Korea or Taiwan in the 1960s would come close to this polar extreme, where policies were not subverted by rent seeking but where there was plenty of evidence of corruption whereby public officials received kickbacks from firms benefiting from incentives. However, if the firms did not perform, kickbacks would not help these firms and they would lose their benefits to other firms or sectors (Khan 1996, 1998, 2000b).

At the other extreme would be a politically weak state where rent seeking expenditures by actual and potential beneficiaries determined policy and blocked changes in policy. *In this variant, state-constraining corruption would be associated with poor performance because inefficient groups would be able to use corruption or legal forms of rent seeking to block policy changes or rents that harmed them.* The problem here is not the corruption but the power of the inefficient to buy influence to block changes that harmed them. Indeed, even without any corruption, legal rent seeking by powerful firms could result in exactly the same effect. Most developing countries are somewhere in between these two extremes, but the closer they are to the second pole, the weaker their growth-enhancing governance capabilities are likely to be. The subversion of potentially beneficial state policies through corruption and rent seeking is therefore a manifestation of weak growth-enhancing governance capabilities.

State-constraining corruption can therefore be associated with either growth or stagnation. This is exactly what is demonstrated by the available empirical evidence such as in Figure 2. While it would be very desirable if there were no corruption or rent seeking at all when the state creates potentially beneficial rents, it is unrealistic to expect there to be no rent seeking when policy interventions inevitably create rents. If the rent seeking is inevitable, the objective is to limit the damaging effects of the rent seeking rather than to get rid of the potentially beneficial intervention and rents. In the longer run,

the objective is to convert most of the rent seeking into legal rent seeking in this case, so the process of rent seeking can be transparent and regulated. Clearly, the policy response here cannot be to liberalize to get rid of the rents because in this case the interventions are potentially beneficial. Paying bureaucrats more may help, but only if it was linked to the creation of appropriate bureaucratic capabilities for managing the necessary interventions.

The most effective immediate policy response here would be to make sure that the bargaining over rents does not subvert the policy of correcting market failures. The aim must be to identify critical growth-enhancing policies and to strengthen the capabilities of states to respond to rent seeking in ways that maintain growth. Transparency and accountability may sometimes help if both the rents and the rent seeking can be potentially legalized. In these cases, the rent seeking can then be regulated by developing appropriate governance capabilities so that growth is sustained. For instance, if industrial policy is based on the legal provision of assistance to high technology industries, then the lobbying of different industries who want to be classified as high-technology industries can also be made legal. However, if there are legal limits to some types of rent creation (for instance WTO rules can make it difficult for developing countries to assist technology acquisition), then it may be difficult to make all of the rent seeking legal too. These are structural problems that many developing countries face, and they require pragmatic solutions.

4.3. Political Corruption

A major problem for developing countries is that there are many types of rent allocations that are potentially beneficial but which cannot be immediately legalized for various reasons. Political corruption takes place when public officials are involved in rent-creating activities that cannot be legalized but which are politically or economically necessary. This would be the case where politics creates rents for powerful constituencies whose satisfaction is necessary if social conflict is to be avoided. *Although political corruption is politically undesirable in the long-run, the immediate net economic effect of political corruption can be positive if stopping this rent creation had damaging effects of political stability.* Clearly political stability has significant economic benefits and in developing countries this typically involves allowing significant rents to be created for powerful constituencies through off-budget transfers and accumulation opportunities for powerful constituencies (Khan 2005a). Here the significant difference with advanced countries is that in the latter, the budget is big enough to allow competing parties to offer credible spending plans to voters that can potentially win one of them a majority. But in developing countries fiscal resources are insufficient to satisfy the redistributive demands coming from powerful organized groups. Patron-client politics often involving rent-creation for powerful constituencies are processes through which political stability maintained. In one-party states, the internal political distributions that maintain political stability are even more difficult to observe or make transparent.

The mechanisms through which political corruption works can take many forms and vary across countries. In terms of Figure 4, the top arrow in this case refers to a variety of expenditures by powerful factions and political entrepreneurs to organize followers and achieve political power. Payoffs along the bottom arrow are privileges and rents created for powerful constituencies. If one or both of these arrows involves illegal activities, corruption is involved. But for structural reasons, the corruption in this case cannot be either stopped or easily legalized and made transparent. This is because political stability has to be achieved somehow, but fiscal constraints mean credible promises to all those who are powerful cannot be made through the budget. This structural problem affects all developing countries and makes the political process structurally subject to significant amounts of political corruption.

In societies like Viet Nam where politics is organized through a one-party structure, the internal distribution of benefits to party members is the mechanism through which political stability and order is maintained. Some of these internal rent allocations can be legal; others may have the character of political corruption. Targeting all types of political corruption in developing countries before these countries have an adequate fiscal base for maintaining political stability through social democratic policies is not realistic. However, to the extent that some instances of political corruption can overlap with the state-constraining corruption discussed above, the development of growth-enhancing governance capabilities may involve reducing or targeting specific instances of political corruption.

Political corruption and state-constraining corruption are often closely overlapping. For instance, in some cases where successful firms get vital state assistance that helps them to improve their technology and viability, political corruption can be an overlapping profit sharing arrangement between political players and private firms. Here rents for firms achieve technological progress and some of these rents are transferred to powerful political players to achieve political stability. In these cases while the corruption is still undesirable, the economic damage can be limited. But in other cases political corruption can result in the construction of poor infrastructure, the protection of inefficient enterprises, and in extreme cases predatory behaviour of the type that we will discuss as the fourth type of corruption. In these cases, the rents to failing firms are socially damaging, and the sharing of some of these rents with powerful political players through political corruption makes it more difficult to discipline or remove these rents. Growth-enhancing policies require these types of corruption to be significantly reduced.

Like state-constraining corruption, political corruption is not always the result of limited transparency and accountability. Indeed, sometimes this type of corruption can be directly driven by the responsiveness of the political leadership to powerful groups in society. In these cases political corruption will not be reduced by democratic accountability, and indeed this is the evidence of democratization in many developing countries. Nor is it necessarily going to be reduced by higher salaries for public officials or strategies of increasing the opportunity costs of corruption since in this case bureaucrats engage in corruption in close cooperation with their political masters. The importance of this type of corruption in developing countries explains why standard anti-corruption strategies often have negligible effects on aggregate measures of corruption.

4.4. Predation and theft

The most damaging type of corruption occurs when 'public officials' engage in activities that create rents which are both damaging and illegal. Corruption in this case takes the form of predatory activities and theft. *Predatory corruption and theft are always damaging*. Here the upper arrow in Figure 4 represents expenditures that sustain the political and military power that is then used in the lower arrow to transfer income and wealth in predatory ways to themselves (the damaging 'rents' in this case). Thus, warlords seek rents by spending resources on maintaining their armies (their rent seeking expenditures) and then capture resources from society (their rents). Here the economic consequences can be seriously negative and can rapidly impoverish the economy. Any state that is stable enough to think beyond the present can be expected to curb these types of corruption in its own self-interest. So while some instances of predation and theft can be found in all states, sometimes overlapping with types of political corruption, this type of corruption only becomes significant in states which have already begun to fall apart.

As a result, when societies begin to exhibit this type of corruption, standard anti-corruption strategies are once more inappropriate. Here the relevant policy has to be to

strengthen the centralized power of the state, sometimes to build it from scratch. Fortunately, Viet Nam is not one of these countries. Nevertheless, there are likely to be instances of theft and predation in all countries and this is a type of corruption for which zero tolerance is politically feasible and entirely warranted.

4.5. Anti-corruption policy challenges

Anti-corruption policy is most likely to succeed if it is targeted very carefully against specific types of corruption that are constraining economic performance rather than if it broadly targeted all types of corruption. It is easier to focus genuine political effort against very damaging types of corruption. While all corruption is undesirable, progress towards that goal has to be steady and pragmatic, and the perspective of growth-enhancing governance can allow the design of pragmatic policies that identify a small number of specific areas that need immediate attention.

The priorities of anti-corruption policy in a country depend on the types of corruption that are most important. This in turn depends on the types of rents that are dominant in the economy. For instance, if monopoly rents and rents created by restrictions on economic activity dominate, most of the corruption in that society would be market-restricting types of corruption. In this case, the good governance anti-corruption strategy may indeed be the appropriate response. If on the other hand many potentially beneficial interventions and rents are evident, then state-constraining corruption may be an important problem. In this case, strengthening state capabilities to solve these market failures more effectively would be the priority. Some areas of corruption may need to be targeted as a priority, but accountability and the threat of prosecution may not be sufficient for the reasons discussed earlier. While zero corruption may not be achievable in the presence of a significant extent of necessary rents, anti-corruption policy here should focus on building institutions and capabilities that ensured that corruption did not protect moral hazard or enable the capture of policy benefits by inefficient producers.

Political corruption is likely to be widespread in all developing countries and we would expect to see rents created for politically powerful organizers and factions. It may be very difficult to make a significant impact on political corruption in the short term but improving fiscal capacity would be a starting point. It may also be important to address some types of political corruption when these overlap with damaging state-constraining corruption. Any finally, if there is a significant amount of predatory corruption, strengthening the central policing capabilities of the state would be the priority. This is very important in countries facing state collapse but likely to be less significant in relatively strong states like Viet Nam.

Since corruption is politically sensitive because of its links with political processes, a step-by-step and narrowly defined anti-corruption strategy that targets specific areas of corruption may be the only feasible way of addressing growth-reducing corruption. A head-on attack on all types of corruption may get superficial political support from a country's political elites but the experience from many developing countries suggests that such broadly based policies have little chance of success.

5. Vietnam: The Role of Rents and Anti-Corruption Policy

To identify the types of corruption that may have dominated in Viet Nam, we need to look at the types of rents that may have been driving or constraining growth over the last two decades. The evidence suggests that the transition to growth in Viet Nam cannot be explained in a simple way by liberalization doing away with unnecessary state restrictions (and implicit monopoly rents). Rather, the story appears to be more complex. Viet Nam in the 1980s benefited from a range of implicit interventions that in a deliberate or accidental way created solutions for significant market failures. These solutions had rents associated with them and we should therefore not be surprised that some of these rents resulted in efforts to capture or influence the allocation of these rents. In a developing country some of this influencing activity is often hidden and not regulated by law, and therefore by definition can be classified as corruption. If this type of corruption was important in Viet Nam, policy-relevant research would aim to identify the extent to which state-constraining corruption affected the achievement of growth. The priority for this type of corruption would be to improve the capability of the economy to sustain or even accelerate growth. If on the other hand, more damaging types of rents predominated in Viet Nam, other responses including liberalization may be appropriate anti-corruption strategies.

Viet Nam's growth experience dates from the late 1980s with the process of *pha rao* or the 'breaking of fences' that gave public enterprises greater freedom to market their products, leading eventually to the formal announcement of *doi moi* in 1986. This was the beginning of a growing formal recognition and encouragement of the private sector and towards enterprise autonomy for the SOE sector (Tran 1999: 43-7; Rama 2008: 13-23). The outcome of reform efforts was a significant change in the policy framework that enabled growth to accelerate around 1990 and remain high for almost two decades before the effects of the global downturn of 2008 began to be felt.

Table 1 shows Viet Nam's growth relative to other countries. For the period 1985-2005, Viet Nam's growth was second only to China. However, China has a per capita income almost three times higher than Viet Nam, and Thailand and Malaysia are even further ahead. Viet Nam's current per capita income is closer to that of India.

Table 1 Viet Nam's Recent Economic Performance in Comparative Perspective

	Viet Nam	China	Thailand	Malaysia	East Asia	All Developing	India	Advanced Countries
GDP Per Capita 2006 Current Dollars	700	2000	3050	5620	1856	1997	820	38190
Population 2006 millions	84.1	1311.8	63.4	26.1	1898.9	5507.4	1109.8	944.4
GDP Per Capita Growth								
1985-1990	2.5	6.4	8.9	4.1	5.9	1.3	3.9	3.1
1990-1995	6.0	10.8	7.1	6.5	8.7	1.5	3.2	1.3
1995-2000	5.2	7.2	-1.8	1.1	4.8	2.5	4.0	2.3
2000-2005	5.8	8.5	4.5	2.7	7.2	3.9	5.2	1.4
1985-2005	5.3	8.1	4.3	4.0	6.6	2.1	3.8	1.9

Source: World Bank (2008)

Opening up, allowing greater enterprise autonomy and creating rewards for risk taking were all important contributors to Viet Nam's growth. A common interpretation of this experience is to suggest that market reforms were responsible for Viet Nam's growth by allowing the country to produce according to its comparative advantage. The

implication is that even greater exposure to the market through liberalization and improvements in market-enhancing governance will sustain growth and take it forward. A closer look at the context in which growth took place in Viet Nam throughout this period shows that liberalization and efficient markets alone cannot explain the sustained growth acceleration in the country. In particular, growth was driven by FDI looking for rent opportunities within Viet Nam. In addition, accidental rents like those created by the MFA solved critical market failures and allowed Viet Nam to develop labour-intensive industries. Finally, Viet Nam did not conform to the 'good governance' conditions theoretically necessary for efficient market growth.

Table 2 shows how Viet Nam fared in terms of good governance indicators in 1996, around the time when its growth acceleration began. This is the first year for which a broad data base of comparative governance data is available from the Worldwide Governance Indicators (WGI) data set of the World Bank. Viet Nam's relative ranking against a number of high-growth countries over the period 1985-2005 is also shown graphically in Figure 6 through to Figure 11.

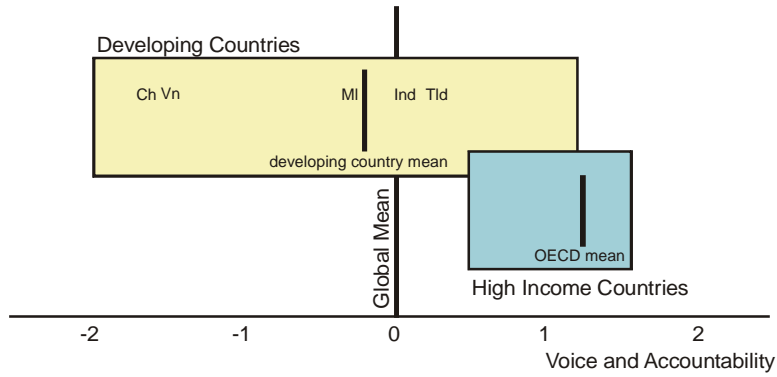
Table 2 Viet Nam's Relative Performance in Conventional Governance Indicators 1996

	Governance Scores 1996						Growth of Per Capita Income 1985-2005
	Voice and Accountability	Political Stability	Government Effectiveness	Regulatory Quality	Rule of Law	Control of Corruption	
	(standard errors in brackets)						
Viet Nam	-1.50 (0.23)	0.31 (0.29)	-0.23 (0.24)	-0.32 (0.29)	-0.65 (0.2)	-0.54 (0.19)	5.3
Malaysia	-0.31 (0.23)	0.64 (0.29)	0.88 (0.23)	0.68 (0.23)	0.73 (0.19)	0.49 (0.17)	4.0
Thailand	0.29 (0.23)	0.05 (0.29)	0.46 (0.23)	0.45 (0.23)	0.58 (0.19)	-0.31 (0.17)	4.3
China	-1.66 (0.23)	-0.26 (0.29)	0.14 (0.23)	0.15 (0.23)	-0.25 (0.19)	-0.15 (0.17)	8.1
India	0.12 (0.23)	-1.12 (0.29)	-0.20 (0.23)	-0.01 (0.23)	0.29 (0.19)	-0.36 (0.17)	3.8
East Asia	-0.01	0.07	0.10	0.08	-0.08	-0.05	6.6
Developing Countries	-0.22	-0.30	-0.23	-0.05	-0.31	-0.28	2.1
Range	-2.01 to 1.21	-2.90 to 1.05	-1.77 to 0.96	-3.13 to 1.29	-2.27 to 1.22	-2.09 to 1.29	
High Income OECD Countries	1.22	0.96	1.76	1.00	1.59	1.68	1.9
Range	0.50 to 1.59	0.15 to 1.37	0.81 to 2.43	0.35 to 1.58	0.70 to 2.08	0.58 to 2.30	

Source: World Bank (2005b; 2008)

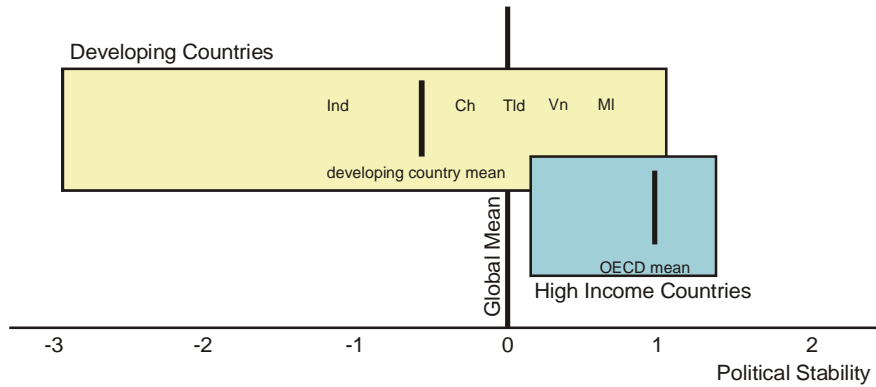
The WGI indicators measure performance in terms of market-enhancing governance. The data demonstrate a number of interesting features. First, developing countries score significantly lower on *all* market-enhancing governance indicators compared to advanced countries (also shown in Figure 2). Secondly, the scores given to the same country by different studies vary greatly, and this is reflected in large standard errors for each indicator in the WGI data base. In many cases, the standard errors are so big that we are not able to say if differences between developing countries are statistically significant (Table 1). The only exceptions are Voice and Accountability and Rule of law, where Viet Nam and China score lower than the other countries, and political stability where they score higher. The scores of Viet Nam and China could reflect the fact that they are the only one-party states in our sample.

Figure 6 Viet Nam's Governance Performance 1996: Voice and Accountability



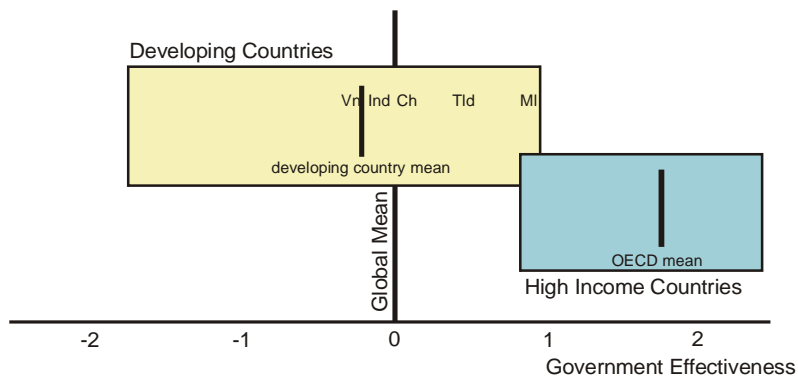
Note: Vn = Viet Nam, Ch = China, Tld = Thailand, MI = Malaysia and Ind = India. Scaled only along horizontal axis.

Figure 7 Viet Nam's Governance Performance 1996: Political Stability



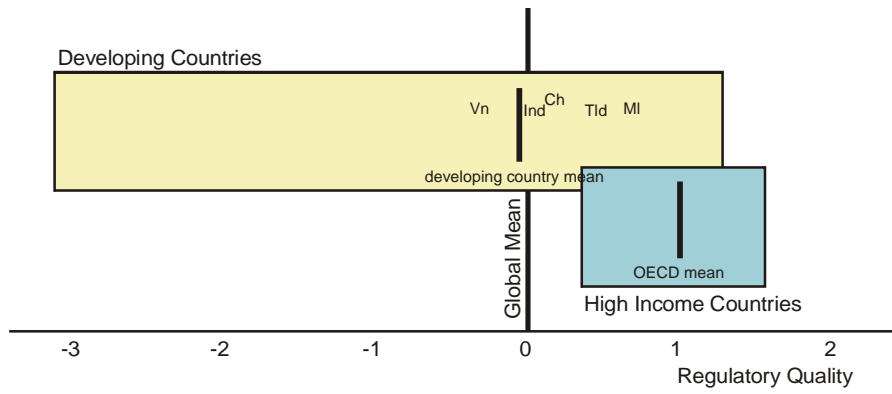
Note: Vn = Viet Nam, Ch = China, Tld = Thailand, MI = Malaysia and Ind = India. Scaled only along horizontal axis.

Figure 8 Viet Nam's Governance Performance 1996: Government Effectiveness



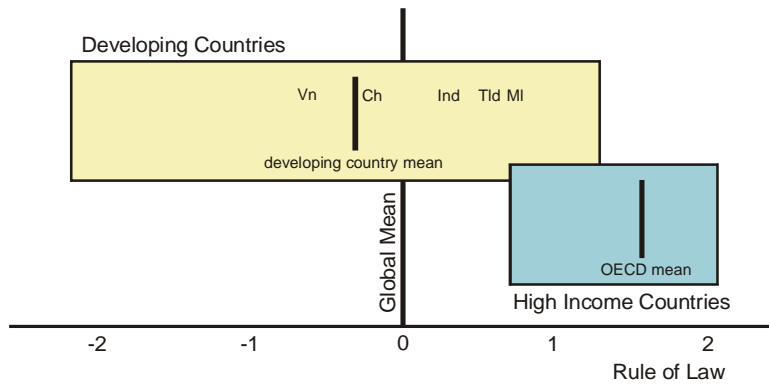
Note: Vn = Viet Nam, Ch = China, Tld = Thailand, MI = Malaysia and Ind = India. Scaled only along horizontal axis.

Figure 9 Viet Nam's Governance Performance 1996: Regulatory Quality



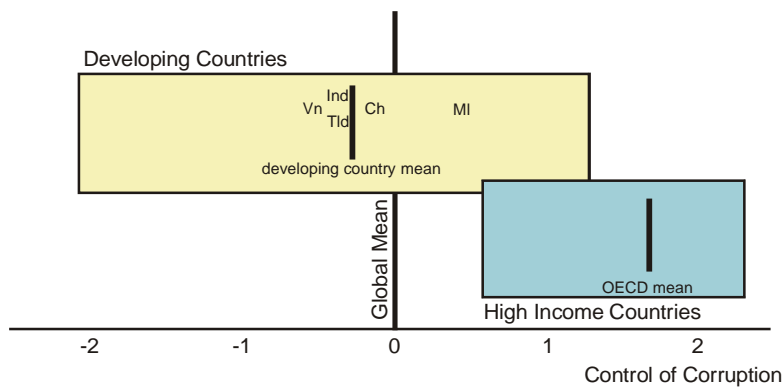
Note: Vn = Viet Nam, Ch = China, Tld = Thailand, MI = Malaysia and Ind = India. Scaled only along horizontal axis.

Figure 10 Viet Nam's Governance Performance 1996: Rule of Law



Note: Vn = Viet Nam, Ch = China, Tld = Thailand, MI = Malaysia and Ind = India. Scaled only along horizontal axis.

Figure 11 Viet Nam's Governance Performance 1996: Control of Corruption



Note: Vn = Viet Nam, Ch = China, Tld = Thailand, MI = Malaysia and Ind = India. Scaled only along horizontal axis.

David Dollar's (2002) argument that Viet Nam's growth slowed down in the 1990s because of its lower scores on good governance relative to India, China and Thailand is

questionable given these large standard errors. For most indicators Viet Nam did not score significantly worse than its comparators in the 1990s and these high-growth developing countries did not in turn have significantly better scores compared to the developing country *average*. Thus, neither Viet Nam's growth takeoff nor the slowdown later on can be explained by its performance in good governance.

The importance of market failures are underlined for instance in the Investment Climate Surveys for 2006 where most businesses identify access to finance, land, infrastructure and skilled personnel as important constraints to doing business (Joint Donors 2007: 73-4). When rents are associated with responses to market failure, the rents may be growth-promoting. Other rents may signal inefficiency. A number of features of Viet Nam's growth since 1990 point to the types of rents that may have contributed to growth or slowed it down. First, Viet Nam's growth since 1990 was primarily driven by relatively small firms using labour-intensive technologies (Belser 2000; Harvard Vietnam Program 2008: 34). This is often interpreted as proof that growth was driven by rent-free competitive markets. In fact, market-driven growth only works when technological capabilities can be developed by overcoming critical market failures constraining technology acquisition.

Secondly, an important mechanism through which this happened was the MFA. This created important fortuitous rents for the garment industry when Viet Nam was granted reduced-duty access to Europe and the USA and quota free access to the USA (Nadvi, et al. 2004a; Nadvi, et al. 2004b). The implicit rents attracted investment and allowed learning in the garment sector. It is therefore wrong to represent the growth of the garment industry as being entirely driven by free markets and comparative advantage. Yet, success in labour-intensive industries has been used to support WTO accession and other bilateral free-trade agreements (Flatters 1997; Joint Donors 2007: 49-58). In fact Viet Nam's experience shows the importance of temporary rents to attract investment and technology even in labour-intensive sectors.

Thirdly, Viet Nam enjoyed significant foreign inflows in the form of FDI and aid. FDI reached 10.2 billion dollars in 2006, and was bigger as a share of GDP than FDI in China (Joint Donors 2001: 6, 2007: 72). Viet Nam has also been one of the biggest recipients of aid in absolute terms. Aid through budget support was an important source of rents that financed pro-poor policies which in turn helped the state to sustain pro-growth strategies (Joint Donors 2007: 29-33). The FDI often came in search of fortuitous rents as in the garments sector or rents in protected domestic markets.

Fourthly, almost all large domestic firms were in the SOE sector. Many had access to significant rents because of their market power and implicit subsidies. Yet the SOE sector also took the lead in driving reform. Some SOEs used rents available to them to upgrade technology and move up the value chain. They performed less well than private companies, but collectively registered growth unlike many other developing countries (Harvard Vietnam Program 2008: Table 5). The majority of SOEs were also profitable (Joint Donors 2007: 62). But in many cases damaging rents also emerged, based on monopoly pricing or speculative forays into real estate and stock markets. The reorganization of SOEs into a number of giant conglomerates in 2006 is unlikely to make them more productive or efficient (Harvard Vietnam Program 2008: 30-1).

Finally, Viet Nam remains an effective and legitimate one-party state, where the political system has been successful in remaining legitimate by delivering high rates of growth. The internal distribution of power and resources within the party has maintained political stability, though some privileges captured by politically powerful individuals are rents, and some of the processes through which rents were allocated or captured may be judged to have been corrupt (Harvard Vietnam Program 2008).

Figure 12 Governance and Growth in Viet Nam: Patterns and Vulnerabilities

Policies/Rents	Governance	Outcomes/Vulnerabilities
<p>Rent allocation to state owned enterprises for technology acquisition and industrialization 1976-</p> <p>Monopoly of state sector in economy 1976-86.</p> <p>1986- After <i>doi moi</i> reforms state sector had access to a variety of rents: cross-subsidies, protection, access to bank loans, market power, asset and land speculation.</p>	<p>Governance of SOE sector linked to the governance of rent allocation within the Communist Party</p> <p>SOEs grouped under sectoral (but increasingly diversified) General Corporations which are evolving into holding companies.</p> <p>'Equitization' particularly from 2003 introduced profit-seeking and competitive behaviour.</p>	<p>Contribution of SOEs to growth but lower than that of private sector</p> <p>But Vietnamese SOEs are largely profitable and growing and there are instances of technology upgrading, innovation and cooperation in learning (eg in shipbuilding and garments).</p> <p>However, concerns about inefficient use of capital and exercise of monopoly powers.</p>
<p>Fortuitous learning rents particularly for garments sector under MFA 1990-</p> <p>Preferential garment quotas for EU 1992.</p> <p>Bilateral trade agreement with USA in 2000 (USBTA).</p> <p>In some sectors, large firms have used speculation rents to finance learning.</p>	<p>Credible protection of private sector after <i>doi moi</i> but weak framework ensuring that learning rents are effective</p> <p>Trade preferences for competitive export sectors worked because they provided time bound rents.</p> <p>Rents created by speculation in larger firms have more ambiguous effects on technology upgrading.</p>	<p>Dramatic growth acceleration in low technology export-oriented industries</p> <p>Some evidence of gradual technological upgrading in labour-intensive industries but not as dramatic as in East Asian countries.</p> <p>Concerns about the focus on land and asset speculation in larger firms.</p>
<p>Significant foreign capital inflows 1990-</p> <p>Rapid growth of FDI particularly in export-oriented labour-intensive industries (initially attracted by fortuitous rents and state capacity to address failures in land and other markets).</p> <p>One of the largest recipients of total aid, with significant budget support.</p>	<p>High level of political stability and relatively disciplined political process</p> <p>Political stability and informal relationships assure protection for foreign investors and encourage investment in sectors with quick returns.</p> <p>Relatively strong governance capabilities for targeting aid to anti-poverty sectors attracts donors.</p>	<p>FDI supported growth and aid supported stability through anti-poverty spending</p> <p>Foreign investors appear reluctant to make high technology investments with longer learning periods.</p> <p>Difficult to meet anti-corruption and governance requirements of donors: eg Japan temporarily suspended aid December 2008.</p>

Growth in Viet Nam was therefore driven by complex factors and not just liberalization. There is evidence that a range of rents played a critical role in driving growth, though there were also rents that damaged growth. The important rents and the governance structures that determined how they were 'managed' are summarized in Figure 12. While growth was high, labour productivity and its rate of growth was very low.

Between 1993 and 1997 value-added per worker increased by a total of 54 per cent (Belser 2000: Table 4) but this figure reflected the absorption of under-employed agricultural labour into manufacturing. Value-added per worker in manufacturing decreased from 57 per cent of the Chinese level in 1990 to 40 per cent in 2000 (Jenkins 2004: Table 6). Given that Viet Nam is a poorer economy with lower initial productivity in manufacturing, the slow growth of manufacturing productivity is a problem. Between 1990 to 2000, total factor productivity for the economy as a whole grew at only 1.1 per cent per annum (Joint Donors 2001: Table 1.3). We now look at some of the significant sources of rents to see how they can explain some of these economic features of Viet Nam's growth and the constraints it faces.

5.1. SOE Responses to Market Failures: Growth with Constraints

Viet Nam's reform effort was initiated by its SOEs with the tacit support of pragmatic party officials (Rama 2008). This fact explains much about the relative dynamism and pragmatism of the Vietnamese SOEs compared to SOEs in many other developing countries. Having broken free of the Soviet type planning system, many SOEs used their growing autonomy to search and develop new opportunities for making money. In this they faced the expected raft of market failures in the context in which they found themselves, but their access to substantial rents and pre-existing organizational structures allowed some to find ways of upgrading technologies, making new investments and enhancing output. But many SOEs were less dynamic, relying on rents to protect jobs and inefficiency and failing to create opportunities to raise themselves into more viable and dynamic economic trajectories.

The rents available to SOEs came from a variety of sources. First, SOEs typically enjoyed market power because they were selling products that were protected in domestic markets. Second, the implicit government guarantee of SOE debt as well as their access to state owned banks meant that SOEs had access to easier and cheaper credit, giving them implicit rents. Thirdly, SOEs possessed critical assets like land and access to natural resources that gave them a significant advantage over potential entrants from the private sector or foreign firms particularly in some critical sectors. Finally, SOEs were organized within 'Enterprise Unions' in their line ministries, which were the precursors of the General Corporations. The financial cross-subsidization of firms within Unions and the sharing of expertise and learning experiences provided implicit rents that were sometimes used to acquire technology.

Cheshier and Penrose provide examples of how successful garment factories were encouraged to effectively cross-subsidize and assist lagging ones into new higher value adding lines like suits, merge with poorly performing enterprises, and offer management assistance (2007: 14-15, 27-28). One of the remarkable examples of using internal rents to achieve learning was Vinashin, the General Corporation responsible for shipbuilding. It decided in the 1990s that it would move Viet Nam's fledgling shipbuilding industry with its focus on river boats into a global player making ships. To do this, the Corporation had to spend substantial internal resources to explore technologies, market Viet Nam as a potential shipbuilding country and even construct a sample ship that sailed round the world picking up potential customers (Cheshier and Penrose 2007: 14, 30). In other sectors, mergers were used to mop up poorly performing enterprises that had no chance of achieving profitability. Thus while the objective of most Vietnamese General Corporations and SOEs was often simply to protect jobs and maintain profitability, the effect was in many cases to upgrade technologies and finance learning in a context where market failures precluded other ways of doing this. However, while some SOEs like Vinashin was initially quite successful in technology acquisition, the recent performance of Vinashin and its levels of indebtedness has raised serious questions as to whether rents continue to be well-used by this SOE. This raises the

importance of having a better understanding of the uses of rents within the SOEs so that the Vietnamese state can have a better understanding of whether society is getting a good return from the rents that it makes available to particular SOEs.

However, the SOE sector clearly also suffered from problems because unregulated rents can create adverse incentives and these have been frequently identified in the literature on this sector in Viet Nam. A growing source of rents from the late 1990s was from speculation in nascent stock markets and property bubbles. Access to land is a major constraint on growth in developing countries and land rights are difficult to define efficiently in all developing countries (Khan 2009). Viet Nam as a socialist country has specific issues in defining land rights adequately to achieve high growth while maintaining social stability. These speculative investments allowed inflated balance sheets to be used to finance risky credit-based expansion (Cheshier and Penrose 2007: 17-22). Given the privileged position that SOEs have in getting access to valuable land, this is a major source of rents that SOEs can capture in Viet Nam. These may be useful rents if they allowed rapid changes in land use in the direction of greater productivity, but only if Vietnamese policy-makers have the governance capabilities to track land use and ensure that recipients of land do not engage in speculative land accumulation (which results in the creation of damaging rents). The protection of domestic markets of SOEs through a variety of measures also meant that rents were created in protected domestic markets. This could be potentially growth-enhancing if domestic market rents allowed learning to commence and was combined with pressures for technology acquisition. But protection could also imply damaging rent creation if Vietnamese SOEs remained excessively inward-oriented in which case the rent creation through protection would turn out to be damaging (Belser 2000: 27). More serious is the possibility that close connections between SOEs and political power could be used to appropriate public assets in ways that are difficult to observe and *possibly* with negative implications for productivity growth (Harvard Vietnam Program 2008: 3).

The overall assessment of Viet Nam's SOE sector therefore has to be nuanced. On the one hand the sector as a whole is profitable. A survey of 44 major SOEs in Ho Chi Minh City in the mid-2000s showed an average profit rate of almost 7 per cent (Joint Donors 2007: 62). We have also referred to examples of technology upgrading, aggressive searching for new markets and the achievement of export and sales growth. Of the top 200 firms in Viet Nam in 2007, 122 were SOEs, 56 were foreign owned and only 22 were domestic private firms. Most of the latter were banks (Cheshier and Penrose 2007: 6). On the other hand, the availability of some types of damaging rents and the absence of any overt regulation even of the potentially beneficial rents could have resulted in hidden internal corruption in the relationship between politically powerful individuals and groups and SOEs that could be state-constraining or even predatory. Given the overall performance of the sector, our hunch is that the predatory variant of corruption is not dominant but the state-constraining corruption may be damaging in some cases because of weak institutions and productive incentives. The growth of total factor productivity is a crude and imperfect measure, but to the extent that it reveals the pace of upgrading, TFP growth has been low in Viet Nam, being just above 1 per cent for the economy as a whole over the period 1990 to 2000 (Joint Donors 2001: Table 1.3).

The SOE experience shows how some firms, perhaps because of good leadership at the level of the firm or the General Corporation overseeing the firm used available rents to assist technology upgrading in a context of serious market failures. The only regulators of these rents were the General Corporations themselves and the implicit internal competition and negotiation within the Communist Party. But the General Corporations were primarily interested in the welfare of the firms under them and not necessarily in the national economy. It seems to have been a matter of luck and leadership quality of particular corporations that determined the aggressive use of rents for seeking out new markets, products and technologies. The internal processes within

the Communist Party could perhaps also have played a role in regulating rent creation strategies across sectors but little is known of the negotiation structure within the party in the published literature. Given the complex internal structure of the Party, a recommendation of greater transparency may not be immediately implementable, but a greater understanding of the ways in which rents can be beneficially used and the uses that are damaging may help the party to internally regulate and limit the damaging variants of state-constraining corruption in the short to medium term.

5.2. Fortuitous Learning Rents: Trade Agreements and Low Technology Exports

Viet Nam made spectacular progress in the 1990s in a number of low technology export sectors, in particular garments, but also in footwear, electronics assembly and some agro-industries like catfish and coffee. The spur to this takeoff came from a number of preferential agreements on trade that benefited Viet Nam during this period. These included the preferential garments quotas that Viet Nam was offered by the European Union in 1992 and in particular the bilateral trade agreement that Viet Nam signed with the USA (USBTA) in 2000. These types of trade agreements that give some developing countries generous quotas or quota-free access or lower tariffs when relatively more advanced developing countries face restrictions obviously create significant rents for export-oriented industries in the preferred countries.

These 'fortuitous' trade related rents can be very important for overcoming some specific market failures in learning that can preclude setting up even low technology industries. Market failures in capital markets and in markets for knowledge may preclude investments in these industries if low labour productivity implies high unit costs of production despite low wages. These costs of production and quality improvements can only come about through a process of learning-by-doing. But this requires either loss-making investments by risk-loving investors who can take a long view or the emergence of accidental rents of the type that preferential trade agreements can give to developing countries *when other developing countries suffer restricted access*. Preferential trade rents can allow producers in these countries to begin to produce at a competitive price for foreign markets enabling learning-by-doing so that eventually the sector can survive without rents.

Clearly, free trade agreements have to be discriminatory if they are to create effective learning rents for newcomers. This important point is often not well understood. Developing countries which enjoy high growth rates with a free trade agreement that is discriminatory in their favour can make the mistake of believing that their growth was driven by free markets. They may even believe that a comprehensive set of free trade agreements will deepen their export-oriented success. This may not follow at all if other developing countries are also signing free trade agreements at the same time. The importance given to trade agreements in many countries is based on a misunderstanding in international policy circles that free trade will help developing countries to achieve industrialization using labour-intensive technologies.

The initial effects of preferential free trade agreements were dramatic for Viet Nam when these agreements gave Viet Nam implicit rents. After Viet Nam signed the free trade agreement with the USA in 2000, exports to the USA increased by 28 per cent in 2001 and then by 128 per cent in 2002 (Pincus and Thang 2004: 15). This experience, together with other international evidence such as Bangladesh's entry into the garments industry in the 1980s suggests that even in the case of relatively simple labour intensive technologies, the entry of poor countries very often depends on temporary rent opportunities that allow them to initiate learning-by-doing processes.

One aspect of Viet Nam's entry into low technology export-oriented sectors is the relatively significant presence of foreign investors even in these sectors. For instance, in 2001, 28.2 per cent of garment and textile output in Viet Nam was in foreign-owned

firms, 48.5 per cent in state owned enterprises and only 23.3 per cent in domestic private firms (Nadvi, et al. 2004a: Table 1). From 2000 to 2005 the share of the private sector (domestic and foreign) in manufacturing increased from 57 per cent to 65 per cent, and though the domestic private sector was described as 'buoyant', the foreign owned component of the private sector clearly remains the dominant partner in terms of technology and productivity (Joint Donors 2007: 72).

The presence of foreign investors even in low technology sectors is noteworthy and different from some other developing countries at early stages of development. For instance, the garment and textile sector is almost entirely domestically owned in Bangladesh, which means that many more domestic entrepreneurs are learning about international business, quality control, financial management and so on, and many of them will acquire skills to move on from this sector when the next tier of garment producers emerge in another country. In contrast, foreign investors still dominate in low technology sectors in Viet Nam, not just in garments and textiles but also in other sectors like footwear (Cheshier and Penrose 2007: 7).

The presence of foreign investors can be an advantage because there could be significant technology transfer to domestic firms through partnerships and joint ventures. It is not surprising that when Vietnamese private firms show evidence of moving up the value chain they have usually been assisted by foreign firms as partners or as suppliers of superior inputs. For instance, in the garment industry some Vietnamese firms have been able to move up the value chain because of investments by South Korean and Taiwanese investors in textiles, which lowered the domestic price of higher quality fabrics (Nadvi, et al. 2004b: 117-18).

Based on its initial positive experience with trade liberalization domestic support could be mobilized in Viet Nam for further free trade agreements such as with ASEAN (the ASEAN Free Trade Agreement of AFTA) and for WTO accession in 2007. AFTA was aimed at allowing regional specialization within ASEAN, and in particular to allow multinationals to produce components for complex products like automobiles in different ASEAN countries. These strategies require easy and cheap cross-border transshipment of components. But AFTA did not create any new learning rents and so did not create strong incentives for multinationals to locate higher technology production sites in Viet Nam.

By the time Viet Nam joined the WTO there were no significant learning rents to be captured through preferential trade agreements because most significant competitors were also signing up to free trade agreements with advanced countries. The benefit for Viet Nam were largely limited to the possibility of responding to false anti-dumping claims made by some importing countries like the USA and even that was limited by Viet Nam's status as a non-market economy that is likely to last till 2018 (Joint Donors 2007: 49-58). The effect of these free trade agreements in promoting labour-intensive sectors has therefore been more muted exactly as we would expect.

While trade-related rents are now rarely available to induce learning, the market failures in learning and technology acquisition remain. This is widely recognized and many policy advisors recommend that Viet Nam should spend more resources on public education programmes to ensure that workers are better educated. For instance, the proportion of university educated workers in the workforce was only 2 per cent in Viet Nam compared to 5 per cent in China and 8 per cent in India (Harvard Vietnam Program 2008: 27). However, we know that formal education is no guarantee of higher productivity in the workplace, which only comes from learning-by-doing. The fact that formal education is not sufficient for industrial performance is shown by India's relative performance in manufacturing compared to China, or indeed the relatively poor performance of the Philippines in East Asia (ADB 2007: 317-38).

Thus, an important challenge for developing countries like Viet Nam is how to continue to finance learning-by-doing when preferential trade rents have disappeared. It is very likely that new low technology industries will continue to get informal rents to enable them to set up. These could be through land or credit allocations or in other forms. Without such implicit rents new startups may be difficult, but the competition to capture these rents may induce forms of state-constraining rent seeking and corruption. Again, a better understanding of the challenges may assist governments to mitigate possible negative effects by developing institutional capabilities to allocate these rents in growth-enhancing ways.

5.3. FDI-driven growth but constrained technology acquisition

Viet Nam has benefited from being in a high-growth region where multinationals, particularly Japanese ones, have been interested in looking for new countries to diversify production. As foreign investors began to arrive during the 1980s, Viet Nam acquired a reputation for its hard-working workforce. Preferential trade agreements dramatically increased the incentives for foreign investors to move into Viet Nam in the late 1990s and beyond and created a spurt of new investments in areas like garments, footwear and electronic assembly. Japanese multinationals have been significant investors looking at Viet Nam as part of their regional plans. At the same time, there are persistent observations that foreign investors in Viet Nam are constrained by the absence of a clear policy framework that would create strong incentives for them to invest in upgrading technologies (Ohno 2006).

Although investments by foreign investors have primarily been in export-oriented labour intensive industries, it is important to recognize that a number of rents were at play here too. Temporary trade-related rents created by fortuitous preferential trade agreements were clearly important for attracting foreign investment in some export-oriented sectors. In addition, foreign investors were able access land and other critical resources relatively rapidly, compared to procedures in many other developing countries. As they were not buying land in well-working land markets, the ability of the state, particularly of local level state authorities to make land allocation decisions quickly and to make other necessary assets and resources available was clearly an important attraction for investors seeking new low cost investment sites.

Implicitly, the availability of land at a total cost (including the transaction cost) that was significantly lower than in the actual and highly imperfect market was a source of rents that foreign investors could access, possibly through local partners with contacts (Belser 2000: 7-8). Finally, some foreign investors were also attracted by protected domestic markets to invest in capital-intensive production processes serving domestic markets with rents. In the late 1990s, 70 per cent of foreign investment was producing for domestic sectors where the effective rate of protection was higher than 50 per cent (Belser 2000: 27). All of these rents clearly helped in both attracting new foreign investment and also in inducing some technology transfers. Viet Nam's success in attracting FDI is reflected in the fact that in the 1990s, FDI amounted to 5.4 per cent of Viet Nam's GDP, compared to 1.1 per cent in China, which received the biggest FDI in aggregate (Joint Donors 2001: Table 1.1). In 2006 Viet Nam received a staggering 10.2 billion dollars in FDI, about half as much as the total for India, a country thirteen times bigger in terms of population. The impact of these foreign investments was very positive for the local economies. Multinational investments have been found in some studies to be a stronger predictor of provincial per capita income growth even more than export performance (Ngoc and Ramstetter 2006). The question for Viet Nam is how to sustain these processes and move further up the value chain. Once again, understanding the role of temporary rents and the importance of managing these implicit and often hidden rents is likely to play a key role in sustaining growth in countries like Viet Nam.

As Ohno (2006) has pointed out, at the very least, Viet Nam must have a consistent structure of dialogue with foreign investors to find out what types of policy changes are needed to make some types of longer-term investments more likely. In addition, it is important for Viet Nam to develop a strategy of developing local enterprises and capabilities. It may be difficult today to use local content requirements, but it is possible to achieve similar results by having an integrated strategy where incentives are created for domestic firms to enter as subcontractors or component suppliers. The incentives and opportunities created in turn have to be managed to ensure that moral hazard and damaging rent seeking including value reducing 'state-constraining' corruption do not derail these specific strategies. It is in such a context that carefully designed strategies and complementary governance capabilities and anti-corruption strategies need to be developed to achieve the desired results.

Viet Nam has also been a fortunate recipient of significant amounts of foreign aid. Donors have responded to the capacity of the Vietnamese state to target aid for pro-poor spending by granting significant amounts of aid in the form of budget support. This 'rent' for the Vietnamese economy has allowed Viet Nam to use aid for welfare improving pro-poor spending and this is likely to have assisted its political stability. This source of rents has therefore also been a contributor to Viet Nam's growth story in an indirect sense, by allowing a greater part of domestic tax revenue and savings to be used for financing growth.

Donor concerns with the misuse of aid reflect fiduciary responsibilities to their taxpayers at home who have very limited tolerance of tax-financed aid being misappropriated. Donor agencies have therefore adopted good governance priorities not only because they promise to improve market efficiency but also because the anti-corruption and accountability parts of the programme promise to reduce the risk of aid misappropriation. To the extent that developing countries like Viet Nam wish to continue to receive significant inflows of aid, some progress in limiting the expropriation and misuse of aid is both necessary and desirable. The suspension of Japanese aid to Viet Nam in November 2008 after a Japanese contractor admitted it had paid a substantial bribe to a Vietnamese official is a case in point. Greater transparency in the allocation of contracts funded by aid and in the targeting of aid-funded services will help to assure taxpayers in donor countries. But here donors too must be realistic in assisting developing countries to achieve governance capabilities that are relevant. It is potentially feasible for developing countries to *improve* the governance of aid programmes to make predatory types of corruption less likely here. But donors should not necessarily expect these policies to achieve a significant reduction of corruption *across the board* in the short to medium term.

6. Conclusions

Viet Nam has enjoyed a period of labour-intensive growth that was the product not just of market opportunities created by opening up, but also of a range of deliberate and fortuitous 'responses' to market failures that allowed the development of new capabilities to take advantage of these opportunities. These responses to market failures can be viewed through the lens of different types of rents that emerged through conscious policies but also often as a result of fortuitous rent creation and institutional adaptation. In some cases the rents created incentives and opportunities for investment, learning and the adoption and adaptation of new technology. In other cases the rents signalled waste and lost opportunities. As rents are always associated with forms of rent seeking, the analysis of different types of corruption provides a lens through which to understand some of the growth-enhancing governance challenges facing Viet Nam. The reform task is to learn from these responses about the types of and responses to market failures in Viet Nam, and to improve and extend the scope of learning processes to move further up the value chain.

This approach can help to indirectly address the problem of prioritizing different types of anti-corruption policies. Our analysis and all the available evidence suggest that the overall reduction of corruption is a long-term process in developing countries. However, there are many types of corruption that are particularly damaging for sustaining the growth process. A governance reform process that focuses on the development of growth-enhancing governance capabilities will necessarily have to attack damaging types of state-constraining corruption and predatory corruption. A growth-enhancing anti-corruption strategy can be successful in accelerating growth if it targets these types of corruption even if there is no observable effect on aggregate corruption. This indirect approach to corruption is also likely to have greater political resonance in poor countries where anti-corruption has become a sensitive political issue that is often used to criticize governments without offering meaningful strategies which even well-meaning governments can feasibly implement.

Governance capability development is more likely to attract the attention of policy-makers if the priorities identified make sense in terms of the experiences of the country. This is one reason why beginning with a better understanding of the market failures that actually affected Viet Nam, and the different types of responses that have partially mitigated some of these market failures is a good place to start the policy discussion. This paper has drawn on the available literature but there are clearly still many gaps in our understanding of how some of the critical market failures were 'worked around' during Viet Nam's first stage of growth. A better understanding of how and to what extent capital, land, labour and technology market failures were actually addressed would be a very useful background for engaging policy-makers to think about the most pressing market failures and therefore the governance capabilities that need to be developed to address these market failures. In turn, this will require attention to ensure that damaging variants of state-constraining become less likely by focusing on appropriate institutional and governance capabilities, and creating a broader understanding of these issues within the political leadership and broader society.

Viet Nam scores worse than some of its comparator countries in terms of rule of law and corruption, to the extent that subjective indicators provide any indication of relative governance performance (Figure 10 on page 21 and Figure 11 on page 21). But paradoxically, Investment Climate Assessments for 2006 report that the overall cost of bribes is only around 0.4 per cent of sales and most businesses report that corruption is a 'manageable' problem (Joint Donors 2007: 163-4). The Provincial Competitiveness Index (PCI) which estimates the *actual* time spent on red tape in Viet Nam finds this to be relatively low compared to the World Bank's Doing Business Surveys which estimates notional time wasted as estimated from the number of procedures that have to be completed (Joint Donors 2007: 23-5). This observation suggests that private sector businesses in Viet Nam are mainly exposed to relatively benign forms of market-restricting corruption (the first type of corruption in Figure 5).

In contrast, state-constraining corruption is likely to be very important in Viet Nam given the wide range of rents that have driven growth in the recent past. Some of this state-constraining corruption is likely to be profit-sharing between public officials and businesses when valuable rents are allocated. Where these rents play a productive role the overall effect of the corruption may be relatively small. If this type of corruption is to be addressed legal and regulated methods of solving market failures (and therefore for creating and managing rents) have to be devised. However, some of the state-constraining corruption is damaging because in these cases corruption adversely affects the allocation or monitoring of the rents, resulting in poor outcomes or the creation of growth-reducing rents. In these cases the development of regulatory capabilities to limit these adverse outcomes is even more of a priority.

In developing countries, economic and political powers are often closely connected. As a result, the processes of political bargaining and redistribution that involve elements of political corruption are likely to overlap with the allocation of potentially beneficial economic rents that are involved in state-constraining corruption. Compared to other developing countries where political competition is more likely to be between political parties and factions and therefore more transparent, in Viet Nam these factions are within a single party, the Communist Party and more difficult for outsiders to observe. Nevertheless, the allocation of rents and privileges in response to political bargaining within the party is likely to involve rents that also have broader economic consequences. For instance, the internal bargaining within the Communist Party between individuals, regions and groups could determine the type and allocation of rents to different SOEs or private sector firms. Therefore some analysis of these internal political bargains may be necessary to understand the types of state-constraining corruption, and the extent to which they allow or prevent the allocation of necessary economic rents in efficient ways.

Viet Nam's system of relatively closed internal policy formulation may not be easy to change in the near future, but it may not be necessary either from the perspective of sustaining growth in the medium term. The good governance claim that open and transparent government is a *necessary* condition for market efficiency is belied by the experience of many countries in recent history, from South Korea and Taiwan in the 1960s to China today. Greater transparency can assist some types of growth-enhancing interventions in some countries, while making other types of interventions more difficult in some contexts. The East Asian experience suggests that the withdrawal of rents from non-performing firms may have been easier in a context where these firms could not lobby extensively and purchase allies in an open political system. It is difficult to say in general whether transparency will always be useful, necessary or sufficient for greater efficiency in the allocation of rents. Nevertheless, the transition to greater political openness may be desirable for other reasons. Given the desirability of transparency in itself, an agenda for achieving greater transparency can in general be supported. From the perspective of growth-enhancing capabilities, it is important that Vietnamese policy-makers themselves understand the nature of the bargaining that is going on so that they can ensure that some of the most vital rent allocation and rent-management decisions are not left to the arbitrary push and pull of internal forces. If some of these critical decisions can be made on growth-enhancing criteria, it may be very feasible for the internal politics of the Communist Party to sustain growth even with gradual improvements in transparency.

Finally, the evidence that is available does not suggest that Viet Nam suffers excessively from the worst type of corruption: predation and theft. Some instances can no doubt be found but there is no evidence that it is widespread, let alone the dominant type of corruption. This does not mean that we should ignore this problem. Some aspects of theft of aid resources demonstrate elements of theft, perhaps closely associated with political power and therefore internal political bargains within the Party. A greater awareness of the processes through which these happen can help to develop governance capabilities that limit the damage caused by these scandals.

The analysis sketched in this paper can provide a framework for further research into how specific types of corruption can constrain growth. In each case, the analysis suggests that different types of governance reforms and capabilities may be appropriate to address that specific type of corruption. The analysis also suggests that a general approach to anti-corruption may not be very useful in developing countries. On the other hand, an approach that identifies a limited number of areas where corruption can potentially play very damaging roles is more likely to achieve results and contribute to growth by improving the management and allocation of necessary rents while limiting the

creation of damaging rents. The main areas of focus for further research could include the following:

i) A major area of concern in developing countries is the issue of land rights and the availability of land for valuable investments in emerging sectors. As land rights are typically poorly defined in developing countries (and Viet Nam faces specific challenges given its transition from a statist development model) non-market transfers of land can create significant rents for those who receive these allocations. Land allocation systems in all developing countries are therefore subject to both state-constraining corruption as well as political corruption. These allocations may be associated with growth-enhancing land allocations or the reverse. A better understanding of how the interface of evolving land rights, political rent seeking and/or corruption and state strategies for allocating this valuable resource to emerging sectors can identify critical areas where growth-enhancing governance needs to be strengthened. It can also identify areas of potentially seriously damaging rent seeking and corruption which need to be addressed if the long run growth trajectory of the country is to be maintained. This approach is likely to be much more helpful than the simplistic governance agenda of strengthening property rights on land. The latter is part of the good governance agenda, but the international evidence shows that it is very difficult to make significant improvements in the protection and definition of property rights in early stage developers. In the meantime, the growth-enhancing strategy is to work with existing rights and strengthen the growth-enhancing governance capabilities of states to ensure that land is allocated to growth-enhancing sectors, that political stability is maintained by achieving fair and adequate compensations to those who are asked to part with their land, and that policy-makers have an adequate metric for comparing the value of alternative uses of land in making land allocation decisions. As growth continues, gradual moves towards better property rights on land can simultaneously be pursued.

ii) The allocation of rents to SOEs can be potentially growth sustaining or growth retarding. A better mapping of how rents are being allocated to major SOEs in Viet Nam and the uses that are made of these rents can assist state policy-makers to allocate these rents more rationally and to hold SOEs to account. The simplistic policy position which says that SOEs should not have access to rents or that SOEs should be privatized is not likely to be helpful in the context of developing countries facing significant market failures. A better approach would be to map the uses and misuses of rents in SOEs and to assist countries like Viet Nam to strengthen their growth-enhancing governance capabilities so that SOEs can be assisted to drive growth over the longer term.

iii) The framework proposed in this paper can also be used to assess the likely social gains of standard anti-corruption and governance strategies. For instance, an undue emphasis on subjective governance indicators that are very volatile and which combine perceptions of many different types of corruption is unlikely to provide useful information for policy-makers. The aggregate corruption index for poor countries is likely to remain unfavorable for some time. The person on the street is unlikely to have an adequate framework for distinguishing between different types of corruption in a reasonable way. Indeed we have seen that high growth and low growth developing countries both suffer from significant *aggregate* corruption. The task of research is to provide detailed case study based evidence of specific types of corruption that are damaging and design policies to address these. The challenge for countries like Viet Nam is that although they have grown reasonably rapidly in the past, if adequate policies are not in place to ensure that growth-reducing types of corruption and rent seeking are addressed, growth can easily collapse over time. But a broad-based approach that seeks to address all types of corruption immediately is also likely to fail.

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