CIEM Central Institute for Economic Management

United Nations Development Programme

HISTORY OR POLICY:

Why don't northern provinces grow faster

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for Economic Management

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WHY DON'T NORTHERN PROVINCES GROW FASTER?

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Preface

In line with earlier successful initiatives in providing alternative policy perspectives and economic analysis to further inform Viet Nam's policy and institutional reform, the United Nations Development Programme (UNDP) and the Central Institute for Economic Management (CIEM) are pleased to present *History or Policy: Why Don't Northern Provinces Grow Faster?* This report is the product of a team of distinguished researchers led by Professor David Dapice, Economist of the Viet Nam Program in the Kennedy School of Government at Harvard University. The team included Mr. Nguyen Dinh Cung, Director of the Department of Macroeconomic Policy at CIEM, Mr. Pham Anh Tuan, Principal of the Center for Rural Progress and Mr. Bui Van, Lecturer of Practice at the Fulbright School in Ho Chi Minh City.

During 2003, the partnership between the CIEM and the UNDP has produced a series of policy studies that have analysed the comparative performance of provinces across the country in attracting business investment. The studies reported wide variation in the provincial level implementation of several laws that regulate economic development. Against this background and building upon previous findings, this paper aims to explore further the nature of differences in economic performance and investment attraction between southern and northern provinces. In addition it suggests various policy initiatives that can be taken to boost economic development and improve the provincial business environments.

The contrast of the relatively weaker economic performance of provinces around the Ha Noi–Hai Phong axis to the provinces around Ho Chi Minh City serves as the basis of an analysis of investment conditions and factor markets from which all provinces across Viet Nam may well benefit. The paper highlights the striking differences in economic performance observed between these northern and southern provinces as per major economic indicators, despite comparable levels of infrastructure development, human capital and proximity to major cities and ports. The authors argue that the historical factors commonly cited for the underperformace of northern provinces are fast disappearing, and that it is indeed the mix of policies as well as the extent and efficiency of their implementation that mostly accounts for the observable economic divergence.

Fostering growth throughout all Viet Nam, including in the north, is critical to building wider national constituencies for the implementation of successive reforms. The transition experiences of many countries have shown the need to spread the benefits of economic growth in order to avoid the formation of coalitions blocking future reforms beneficial to the population at large. In its analysis of the economic performance of Hai Duong, Vinh Phuc, Bac Ninh, and Bac Giang, the paper raises concerns about the fact that much of the business activity in these provinces appears to be state-linked and still enjoys protection and subsidies that will render them unviable in the fast-approaching integrated economy.

Distorted land prices and discretionary treatment of businesses by local officials are underlined as the major constraints to the development of domestic private sector. Increasing the collaboration between the lower levels of officials and the provincial leadership is suggested as the critical element in the efficient implementation of economic policies, and especially important when dealing with prospective investors. The paper also recommends re-classification of farmland and the reduction of land prices outside industrial zones. In line with previous CIEM and UNDP initiatives, such as establishment of Domestic Business Forum, the authors underline the need to further improve the performance of business associations at provincial and regional level, and to promote cross-provincial lesson sharing on best and worst practices. Underpinning provincial efforts, national leadership is considered critical to reward provinces that promote competitive businesses, job creation and efficient growth, providing the appropriate incentives for the development of local private sectors.

This study aims to spark debate among policy makers, researchers and development professionals across Viet Nam. If it leads to a better understanding of the constraints to private sector development at the provincial level and more vigorous discussion about viable policy initiatives critical to further improve provincial business environments, it will have indeed served its purpose.

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A Puzzle

The fast growth of provinces around HCMC is an old story and one that is often explained by their superior location and/or their more recent experience with markets before *Doi Moi*. The fact that some provinces also near to the economic center of Viet Nam do a lot better than others with a similar location is seldom remarked upon, as that would suggest a more complex story. There is a related puzzle. If *any* other region in Viet Nam *should* do well, it must be the provinces close to Ha Noi and Hai Phong.[1] They have good infrastructure, are close to major ports and markets, and have access to well-trained workers.[2] Yet their recent population growth is among the slowest in the country, while several provinces near HCMC are among the fastest. Why should many provinces touching Ha Noi and Hai Phong grow more slowly in population than the Northeast, North or South Central Coast or Mekong Delta?

One might object to using population growth as a measure of success. Yet most provinces report very fast output growth, and the provincial GDP data are rightly regarded with some skepticism. If a province cannot generate decent jobs, people will leave. It is migration rather than birth and death rates that explain most population growth differences.[3] The low population growth suggests that people are leaving these northern provinces. Interviews also suggest it is the young and educated that are most likely to leave, and are leaving. The 1999 Census showed less than 1.5% of the seven northern provinces' population had migrated from another province; while over 5% had done so in the four southern provinces. Even the Mekong Delta and South Central Coast had more migrants as a share of their population.

The gap between the four southern and seven northern provinces is truly breathtaking, considering both are close to major cities and ports. (See table on following page.) If job growth in enterprise jobs from 2000 to 2002 is taken as a measure, the four southern provinces with only *half* of the northern seven's population created 209 thousand jobs – nearly *triple* the northern group, which created only 70 thousand. Even Danang alone created 30 thousand jobs with only 7% of the northern province's population. There is a similar story with exports. The four southern provinces in 2003 exported nearly $4 billion (*excluding* oil and gas), while the northern seven had under $0.5 billion, *including* coal. The Mekong Delta, excluding Long An, exported $1.7 billion.[4] Not surprisingly, FDI follows the pattern: from 2001 to 2003, the four southern provinces had $2.9 billion of implemented FDI while the northern seven had only $0.6 billion. Even per capita Enterprise Law investment from 2000 to 2003 was 20% lower in the North. By any reasonable measure, the northern provinces

[1] The provinces are Quang Ninh, Hai Duong, Hung Yen, Ha Tay, Bac Ninh, Bac Giang and Vinh Phuc. In 2002 they had nearly 10 million people, only 2.6% more than in 1999. By contrast, four southern provinces near HCMC – Dong Nai, Binh Duong, Long An and Ba Ria –Vung Tau had 5.1 million in 2002, an increase of 5.4% over 1999. (Nearby Tay Ninh grew only 2.7%.) All of Viet Nam had a 4% population growth in those years.

[2] The 1999 Census showed the Red River Delta having 11% of those over 13 years having some level of qualification while the national average was only 8%. No other region was higher. Educational levels are similarly high in the Red River Delta region, which can supply labor to these provinces.

[3] In the 1999 Census, the proportion of children under 5 years to total population was typically in the 8-10% range except for the Northwest and Central Highlands, which are lightly populated highland areas. The proportion of children under 5 is a good indicator of birth rates. Death rates are lower in the Ha Noi area provinces. They averaged only 8.3% expecting to die before 40 in 1999, while the national average was 9.7%. This means that the natural rate of increase (births minus deaths) varies little over most regions.

[4] General Department of Customs, "Import-Export Turnover of Provinces in 2003" in *Viet Nam Economic Times*, February 2004. The exports may be from the province with the head office, not the production.

are not doing nearly so well as might be expected. Again – it is not just that they lag the fast-growing South, but in important respects they lag other regions with many fewer advantages of location, infrastructure, and access to skills and markets.

One reason to be concerned is that lagging regions tend to resist economic reform while successful regions tend to embrace it. If only part of the South is successful, it will be difficult to achieve a national consensus about moving ahead quickly with WTO, public administration reform, financial reforms, and other important issues. If the provinces in the Red River Delta remain sluggish in several dimensions with so many advantages, it is likely that the overall pace of economic reform will suffer. There is some urgency in helping these most promising provinces to better reach their potential.

Northern Seven and Southern Four Provinces: Economic Comparisons

	Northern 7	Southern 4
Population (millions)	10	5
Exports per capita	$50	$785
Implemented FDI pc	$60	$570
Enterprise Law Inv't pc	$84	$103
New Jobs per 1000 (2000-02)	7	41
(2003)	3	12

Notes: Exports are for 2003, based on Customs data. FDI per capita is that *implemented* from 2001 through 2003. The Enterprise Law investment per capita is *licensed* from 2000 through 2003. New enterprise jobs are end-2000 to 2002 based on a special survey of enterprises of all ownership types. The 2003 formal sector jobs data are from the Ministry of Labour.

Dueling Hypotheses

One reason often given for this striking underperformance of peripheral northern provinces is history. This northern area has a long experience with old style central planning. It lacks the relatively recent memory of a market economy and so has trouble dealing so well with foreign and even domestic private investors. In this view, the lack of bureaucratic understanding, social structures, and habits of thought limit the upside growth in the North. Officials wait for things to happen, think in terms of state planning, and expect larger firms to be state led. Indeed, some are suspicious if private firms get too large. Investment promotion means going to Ha Noi to see old friends and asking for projects. Even the people expect this, so they do not try to create larger private firms. Of course, it has been over 15 years since *Doi Moi* started and a disproportionate number of overseas educational opportunities go to people living in or near Ha Noi, so one might have expected by now that some of these problems would be diminishing. Some might argue that there is no recent tradition of entrepreneurship in the North, but this would not explain why many from this region come down to the South to do business, or why there have been similar numbers of enterprise law startups per 1000 population in Bac Ninh and Dong Nai. History has some weight, but it should be diminishing over time.

For example, the excuse of better southern infrastructure can no longer reasonably be a primary reason. Years of high investment have added important port facilities, highways, and better power and water supplies to this northern region.[5] Industrial zones are now plentiful. Similarly, the cost of labor is higher in the South

[5] Indeed, the roads north of Ha Noi to China and Cai Lan Port are now better than those south out of HCMC to Can Tho. Average driving speeds according to drivers are about double in the North vs. in the South to Can Tho. Cai Lan port can take very large ships as well compared to Saigon. Industrial Zones in the North have much lower occupancy rates than in the South, so good quality land is not a constraint.

Leaving Out the Big Cities, and Differences Between Them

The discussion about provinces surrounding major cities leaves out the major cities themselves. This might seem odd to many readers. Yet, the nature of successful growth is that it spreads. If good conditions are created for competitive firms, they will grow and use ever more land and labor. High costs in major cities will push some firms into outlying areas where these costs should be lower. Just as astronomers blot out the sun or use an eclipse to study the solar atmosphere, an economist studying growth will often leave out the major city – which anyway tends to attract a lot of service and real estate investment – and look instead at the growth outside of that "bright" area.

If we compare these two urban areas (taking Ha Noi and Hai Phong as one), we see the South with a 20% larger population: 5.5 million in HCMC vs. 4.6 million in the North. Job creation from the end of 2000 to 2003 was 479,000 vs. 264,000. Exports were $10 billion from HCMC (of which $3.8 billion is oil) and $2.4 billion from the two cities. Implemented FDI per capita in 2001 through 2003 was $1036 vs. $913. Enterprise law registered investment p.c. was $373 vs. $316. While the South has much higher exports and recent job growth, the overall conclusion must be that big cities are growing. The northern provinces have dynamic neighboring cities.

Having said this, there is no doubt that the larger number of jobs and exports near HCMC means that conditions for pushing outward to nearby provinces are better. A recent visit to a Hai Phong foreign-owned exporter of handbags showed why. His salaries for established workers were under $40 a month, compared to $60-$80 in HCMC for similar jobs. Conditions were also not as good, as the smell of solvent-based glue was heavy in the air, and work of six days a week was intense. Yet turnover was very low (under 4% a year) because alternatives for women workers were much worse in the Hai Phong area. Farm jobs, when available, paid less than $1 a day and domestic private or state wages were only $25 to $30 a month. The investor said he would not leave Hai Phong because the wages were low and other conditions were favorable. Only if many more labor-intensive (probably export) jobs originate in the North will the same economic pressures create more demand for land and labor in the northern provinces. This cannot be forced by licensing or administrative pressure but must come from investors finding the North a preferred location.This requires more effort on the part of many parts of the government including tax, customs, and other officials.

than the North, so that should be a northern advantage. The "cluster" explanation has some merit – under this argument, there is a critical minimum mass of activity that then acts on its own to attract still more. This critical level has presumably been reached in the South but not yet in the North. Yet ten years ago, these levels were much closer. Why has the South pulled so much ahead?

One line of inquiry is to look at growth patterns and strategies in different northern provinces and observe differences. The differences may shed light on what the critical elements attracting or repelling investments are. Of course, there is still the question of how the northern provinces could begin to resemble the southern ones. This too should be part of any reasonable inquiry. One key point is that often the formal rules are not the ones that are effectively implemented. That is, for example, it makes sense to look at patterns of who *actually* gets space in an industrial zone, not simply who is *eligible* for it. If private businesses tend to go to one northern province but not another, it is likely that various signals are sent and received about the *de facto* treatment of private investors.

In practice, the ability to set up and run successfully a business can be likened to a race with many hurdles. There is a hurdle for getting land, for access to capital, for permission or freedom from intrusive inspections, for knowledge of markets, for technical know-how, and so on. Domestic or foreign firms need not only to compete with others in Viet Nam but increasingly with others in the region or the world. If some of these hurdles are too high, the firm will be slowed down or altogether discouraged. The inquiry in this paper will look to see what the hurdles are and if they are of different heights in various provinces. Note that this line of inquiry is able to incorporate the “cluster” hypothesis. When many similar firms are together, often specialized services begin to be available, lowering the costs of items such as marketing, product design, repair, quality control, production techniques and so on. On the other hand, sometimes there are some unique elements that are impossible to replicate. No other province has Ha Long Bay or the industrial villages of Bac Ninh.

The Four Northern Provinces

Four provinces near Ha Noi and Hai Phong were selected for this more intensive study out of the seven previously mentioned. The four are: Vinh Phuc, Bac Ninh, Bac Giang, and Quang Ninh. The first three are next to Ha Noi and the last touches Hai Phong and has a major port and tourist area in Ha Long Bay and also a major connection to China at Mong Cai. The table below shows how these provinces differ in terms of several measures previously discussed. Additional data on industrial output can be found in Appendix B.

Four Northern Provinces: Selected Data

	2001-2003 Population ‘000/ growth	2001-2003 FDI pc ($)	2000-03 Private I pc ($)	12/2000-02 jobs created per 1000	2003 Exports $ million	20002 Industrial Output per capita
Bac Ninh	971/ 3.0%	nil	$114	7.5	0-250*	2581
Bac Giang	1535/ 2.6%	nil	$24	4.8	nil	446
Vinh Phuc	1128/ 3.1%	$120	$34	8.8	61	4320
Quang Ninh	1040/ 3.3%	$89	$339	11.8	244	4753
Subtotal	*4674/ 3.0%*	*$49*	*$115*	*7.9*	*305-555*	*2786*
All Viet Nam	79727/ 4.0%	$88	$105	14.1	20,000	3265

Notes: Population growth is total from 1999-2002. Implemented foreign and licensed private [Enterprise Law] investment per capita is cumulative for the 2001-03 and 2000-2003 periods. Jobs created refer to jobs in enterprises of any type per 1000 of provincial population. The source is *The Real Situation of Enterprises Through the Results of Surveys Conducted in 2001, 2002, 2003*. (GSO, Statistics Publishing House, Ha Noi, 2004) Exports are from General Department of Customs.

* Bac Ninh claims exports of handicrafts of over $250 million in 2003, but these may be credited to Ha Noi by Customs.

There is a remarkable diversity of outcomes in these provinces.

Bac Giang: Bac Giang, in spite of touching Ha Noi and being on a major road to China, has private domestic investment only ¼ of the national average and quite modest recent FDI and exports. It created the fewest jobs per capita, and has the slowest population growth rate. It got started late in attracting private investment and has many hard-to-develop mountainous areas. The recent industrial zone and more favorable terms for investors are just starting to have an impact. Poor and agricultural, it still seems to put more emphasis on government-led and protected industry than private and competitive alternatives. Its recent large vehicle assembly factory will be state-owned and use Korean technology. However, it will be hard for costs to be brought down far enough to compete with imports if tariffs continue to fall.

Bac Ninh: Bac Ninh, which was recently part of the same province with Bac Giang, has better location and has “private” investment (really Enterprise Law investment) equal to the national average and a history of craft villages and entrepreneurship. While formal job growth is low, the industrial villages have added over 50,000 jobs in recent years, but in very small firms. Still they account for most exports. Recent FDI is quite low. Its very good roads to China, major ports, and Ha Noi (including Noi Bai airport) give it an excellent location. However, perhaps because of these advantages, officials are selective in the kinds of businesses they want to come to the province. Larger firms tend to be government linked. The industrial zones are not filing up with active and operating investors.

Vinh Phuc: Vinh Phuc has much poorer roads but better enterprise job creation than Bac Ninh. FDI is above the national average, though mainly in protected industries. Private investment has been rather low but is growing quickly. Domestic private firms regard the province as especially helpful and friendly in solving problems. Like Bac Giang, it recently was created from the breaking up of a larger province in 1997, and was poor and agricultural. However, the leadership decided early to be business friendly and over time, this is beginning to show up in more private sector activity, though from a very low initial base.

Quang Ninh: Quang Ninh has FDI equal to the national average, and the highest exports (mainly coal), jobs created, population growth and Enterprise Law investment of the group. Exports, new jobs and population growth are below the national average in spite of that. The province benefits from a major connection to China, an improved port, and a popular tourist area. However, most larger companies are state-linked except in the tourist sector.

The significant differences among these four provinces should not hide their similarities. All of the provincial leaderships are trying to promote industrial and economic activity. All have introduced investment promotion policies and invested in infrastructure such as industrial zones. Administration is being streamlined. More investment is coming in, though at very different rates. There is a general feeling of improvement. However, none is doing as well as successful southern provinces, for various reasons. The major problem is that the attitude towards larger private firms has been better in the South, and that is still the reputation. Many people in the northern provincial governments, not always the leaders, are more comfortable with state-linked firms and try to make sure they predominate. They often do, but at the cost of less dynamism and competitiveness. This shows up in lower FDI, fewer exports in labor-intensive industries, and less overall job creation.[6] To the extent that state enterprises or state-linked firms rely on cheap land, subsidized credit, access to favorable contracts or other crutches, they will not be able to compete over time. Issues of land and business associations are also critical in limiting the growth of even competitive enterprises. Overall, it is hard to understand why well situated Quang Ninh gained fewer enterprise jobs from 2000 to 2003 than Long An – an agricultural province in the Mekong Delta. Unless there is more success in the North, it will be hard for all of Viet Nam to sustain rapid growth based on exports and global economic integration.

What is a Private Investment?

The Enterprise Law made it much easier to get a license to operate a business and has given rise to over 70,000 newly registered firms since it went into effect in 2000. Many of the new firms set up under the Enterprise Law are private, but some are fully or partially state owned. Many foreign investments, which set up under a different law, are also partially state owned through joint ventures. Then there are firms that are legally private but set up with support from important organizations or people. These firms often have an easier time getting loans, land, or access to other important inputs or contracts than firms without such connections. There is nothing unique to Viet Nam about this situation, but it does create a more nuanced reality than a simple public/private dichotomy that is often used in analysis.

It was found that some provinces tended in practice to favor firms that were state linked or otherwise connected to influential groups, while "real" private firms often had less favorable treatment. To the extent that "real" private firms seek favorable treatment by shopping for "good" provinces, there might be distinct differences in the investment activity in various provinces. It is often difficult to distinguish among the different types of firms from published provincial data. In addition, sometimes there is more investment because of a uniquely favorable situation such as a tourist spot or border crossing, rather than because of policy. However, it is useful to distinguish among these firms if it is possible. Fully private firms may well turn out to have more flexibility and growth potential than those that require some degree of subsidy or other support to function.

[6] It has been argued elsewhere that in order to find jobs for new labor force entrants and those likely to leave low-paying rural jobs, it is crucial to develop more urban jobs. Without such job creation, there will be growing urban – rural inequalities and undesirable urban crowding, crime, and other social evils.

Land

One constant theme in provincial visits was that the cost of non-farm land outside of industrial zones was a problem. It is expensive in and around Ha Noi including in the northern provinces. Recent estimates were that the price per square meter in Ha Noi or even places in nearby provinces was similar to that in Japan – even though per capita income is less than 2% of crowded Japan's. This is an incredible distortion that makes rational industrial growth and urbanization much more difficult. While farmland is plentiful, produces little revenue, and has a low value for its use-rights in farming, it cannot easily be privately sold and converted to higher-priced commercial, industrial and residential uses. This creates many problems. Farmers are reluctant to part with their land if the compensation is perceived to be based on the "old" value based on agricultural use – generally well under $1 per square meter - rather than one based on non-agricultural use. These *provincial* prices can easily exceed $100 per square meter, and sometimes $1000! (See table below for typical land values; the first three categories are for factories.) Difficulties in compensation have led to numerous delays and disputes in provinces close to Ha Noi, so these issues can result in less investment and growth.

Typical Land Values

No	Category	Price per sqm.	Remarks
1	Land in industrial parks, with infrastructure	$28-$35	For 50 years
2	Land in industrial parks, without infrastructure (often not available)	$0.5-$1	For 50 years, possible waiver for 5-10 first years
3	Land next to the industrial parks, without infrastructure(Major problems with land acquisition)	$0.5-$1	For 50 years, possible waiver for 5-10 first years
4	Non agriculture land in industrial village (market price)	$150-300	With Land Use Certificate for 50 years
5	Land for housing in new urban areas in provinces	$500-2000	For unlimited time frame
6	Agriculture land (estimated value, not price)	$0.5	Based on the income from rice production

One provincial response has been to make various extra payments to farmers for relocation, resettlement, job training, or living stabilization in addition to land payments. These amounts vary from one to several hundred dollars per family, or 1 square meter worth of land at the new price, if it were sold privately. This support is not always adequate.

There is another issue that slows the conversion of agricultural land. Some argue that Viet Nam must guard its agricultural land, especially its rice land, against other uses. A related argument is that farmers who lose their land, even with compensation, are often unable to earn a living any other way and fall into poverty, becoming a social problem.

These arguments have flaws, even if there are a few examples to support them. As a rice exporter, Viet Nam could afford to give up land near cities for higher value uses. Land *outside* of Ha Noi is often priced at several hundred dollars per square meter, while 10,000 square meters (1 hectare) can seldom provide as much as $1000 a year in net farmer income growing two rice crops and perhaps a third vegetable crop. Even at $100 a square meter, the value of a non-farm hectare would be $1,000,000! If even a small fraction of that value were invested in 8% government bonds, the income flow would far exceed that from farming. By restricting conversion, the opportunities and incomes of poor farmers are held down, while the costs of housing and new firms are

Why Are Land Prices So High – and Why Does It Matter?

The price of land in Bac Ninh province in the new residential zone, 30 km from Ha Noi on a good road, is as high as $2000 per square meter, while even poor and rural Bac Giang has land prices of $300 near to the provincial center, about one hour or over 60 km from central Ha Noi. These prices are high relative to Ho Chi Minh City. There, recent land prices in desirable District 7 (only 4 km from the city center) are only about $500 per square meter while prices in adjacent Dong Nai for residential land are only about $10 per square meter. This land is less than 50 km from the center of HCMC. Note that HCMC is larger than Ha Noi and incomes in Dong Nai are far higher than in Bac Giang. Yet land prices in Bac Giang are many times those in Dong Nai. Those in HCMC are less than in Bac Ninh. Why these huge disparities, even within Viet Nam?

The answer is supply and demand. The demand for land in the North at these very high prices is driven by speculation. A speculator buys something because he believes the price will rise and he hopes to make a profit by buying low and selling high. In interviews, it was said that many local and central officials bought land. If their incomes were irregular, they are easier to hide in land holdings than in bank accounts or bonds and stocks. Additionally, land gains are not taxed relative to labor income. The proximity of these northern provinces to Ha Noi makes it easier for central officials to buy land there. Of course, local officials and anyone with money also buys land, given the “fever.”

So far as supply is concerned, there is a clear tendency in northern provinces not to convert very much agricultural land into non-farm uses, even when these are very much more productive. This might be due to a desire to keep agricultural land from being lost, or strict adherence to a regulation limiting conversions without a master plan. (These have been in preparation for over a decade! Knowing what land will be able to convert is valuable knowledge, since rights can be bought cheaply from an unaware owner and then sold at much higher prices.) A desire by officials who own land and want high land prices maintained cannot be ruled out as a possible cause for sluggish land conversion in the North. The huge differences in land prices between the North and South might be both a cause and a result of the South being friendlier to private activity. If local officials see their success in a thriving economy, they will find ways to make plentiful farmland more available for conversion to other uses. This will hold down the land price and make it easier for both businesses and new residents to find places to operate and live. If local officials fear the wrath of land speculators, or are among them, they may limit conversions.

The result of very high land prices is distinctly negative for development. Funds that might go into industry and create jobs are diverted into sterile assets like land, with the sellers often consuming much of their newfound gains. Big profits from buying and selling land, often with money of uncertain legality, tend to emphasize the “casino” element of wealth and discourage those who would prefer to earn profits through normal competitive activity. This hurts the standing of anyone with wealth and makes sudden policy reversals seem more probable. Finally, of course, anyone who wants to live in a high priced area or find room for a firm is faced with a particularly high barrier. The land tends to discourage growth, offsetting advantages from cheap and skilled labor.

At the very least, a quarterly listing of land prices by province would be helpful in showing what differences exist within Viet Nam. This would be easy to assemble. Taxing land each year, at perhaps ½ of 1% to 1% of its market value, (as in most other countries) would generate local revenue and discourage speculation. This is more effective than a transfer tax, which is collected only when land is sold and is easily evaded. If it were felt that poor farmers or home owners should not pay, various deductions could be allowed. It is hard to see why labor – which is a source of value and clearly discouraged by taxes – should pay a tax rate of up to 40%, while land, which is not much influenced by taxation except for improvements, should pay nothing at all. There have been recent attempts to create a healthy property market (see May 19th, 2004 resolution of the Prime Minister) but much needs to be done to reduce the imbalances that hurt growth, equity, and healthy social conditions.

increased. In addition, the rapid increase in land prices threatens to create vast inequalities in wealth that are largely unearned and untaxed, with very damaging effects on local development. These distortions are much less around Ho Chi Minh City. (See box, following)

In one northern province, the Chairman is using a 70/30 plan. In that case, a plot of agricultural land is taken for use as commercial-industrial or residential land, but the farmer is allowed to keep 30% of the original plot but rezoned for non-agricultural use.[7] (In some cases, the same amount of rezoned land is given in a nearby plot if the farmer's entire parcel is needed – this is not yet clearly allowed, though it is agreeable to all parties.) If farmers are glad to retain just 30% of their original holdings with rezoning, it is likely that the real economic value of land is ***very much*** higher in nonfarm uses. That is, it helps the national economy as well as the farmer to convert this land. One hectare with a factory might provide hundreds of jobs and much higher production than rice land. Since only a very few percent of land used for farming in most provinces would need to be converted, the impact on production could easily be offset by investing in yield-enhancing technology. But even if that did not happen, the nation would have more output and more jobs – if slightly less rice to export – if it allowed limited conversion of farmland. The main issues should be to ensure that the farmers are fairly treated and are aware of the need to use the proceeds to create a new income stream.[8] In some cases, training for non-farm jobs could be included in any package of land sales.

Another approach to making land available is to create industrial zones and allow investors to gain long-term use rights to land at a low or even subsidized price, with land compensation issues handled by the state.[9] In addition, licensing of small to medium sized investments can be done locally and red tape can be reduced by the IZ authority. This is often done, yet even so sometimes this option is not attractive to investors. There seem to be several reasons. One is that investors often hope that land use rights OUTSIDE of industrial zones will be converted into ownership at some point in the future. Thus, renting inside a zone removes a potential gain. It is sometimes easier to borrow against "owned" land than rented IZ land as well. Two, the movement of goods in and out of an industrial zone are much easier to monitor, making tax evasion more difficult. Three, sometimes the local authorities show a clear preference for larger or state linked investors in these zones. They may, for example, have a minimum lot size of one hectare – more than a smaller (usually private) investor needs. While a small investor can find another private investor and share the lot, it increases transaction costs and uncertainty. Four, sometimes the zones are not close to homes or labor supplies of smaller local investors. This can be a drawback if cheap local or even family labor is a source of competitive advantage. Finally, in some cases the costs of land in the zone may be higher than an initial family owned plot. While expansion from the family plot might be more expensive outside of the zone, the result might be to start on family land and to stay small. For all of these reasons, the IZ's are welcome and helpful but not a complete answer to the problem of expensive land in these provinces, especially for residential use or by smaller private firms. On the other hand, there have been reports of some "investors" (really land speculators with no real project) leasing IZ land cheaply with the hope of re-renting to another investor at a higher price. While there are provisions against such practices, they are not always tightly enforced.

It is possible to build many industrial zones in one province and to make them easier to use by private investors. This is the approach used in Binh Duong in the South. By having small plot sizes to rent out, flexible rental terms, multiple locations not far from most potential local investors, and a supportive environment, it is possible to reduce the height of the land hurdle even for smaller private investors. Vinh Phuc, with nine planned

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[7] In southern provinces this is also done but with a lower share (about 10%) given to the farmer.

[8] There are anecdotal accounts in news stories about some who sell land and cannot find a new role, reportedly wasting their newfound wealth. Doubtless this happens, but in many other cases the farmers buy farmland some distance away (and often much more land) or set up petty businesses for higher incomes and a much easier life. Land policy should not assume that farmers are children, though they may need help.

[9] A typical deal is to exempt IZ lease payments on land for 5 to 10 years and to reduce it by 50% for another five years. Use rights are available for up to fifty years and annual or long-term payments are possible. The compensation issues can be complex and drawn out, so it is much easier to have the government handle these negotiations than to have one investor deal with many smallholders. When rent is paid, it is often a one-time payment of $28 to $35 per square meter for IZ land use rights for 45-50 years, with infrastructure costs extra.

industrial zones covering 1062 hectares at full development, seems to be following this approach. (Note even nine fully developed IZ's are less than 1% of the province's total area.) Because it is a surplus revenue province due to some FDI projects, it is able to buy land at a legal price from farmers but add generous village infrastructure and make it available at low cost to private firms.

Another southern innovation recently adopted in Dong Nai province is to have an industrial zone developer build housing and other amenities along with factory buildings. This is being done in the Tam An residential-industrial complex just 23 km from HCMC. Land is leased at about $20 a square meter for 49 years. Traffic congestion is reduced and workers have housing close to work. The developer can sell or rent the housing and recover capital quickly.[10]

An alternative is the "industrial village" approach of Bac Ninh in which certain villages are allowed to develop historic crafts into industry and convert land to industrial uses. While this does create a kind of cluster and builds on traditional craft skills, there are still problems of crowding, pollution and mixing industrial and residential uses. These villages facilitate traditional craft activities but it remains to be seen if they form a basis for rapid and sustainable growth on a large enough scale to be important. The amount of land per firm is small and expanding can be expensive, so this approach appears to be only a partial solution, even though it is positive and could be developed further.

It appears that the amended land law of 2003 is not very much more liberal than the previous one, so any solutions to the land problem will initially have to be partial and locally specific. It might be helpful to allow all provinces to convert up to 3% of total land to new industrial or residential zones, with perhaps the 70/30 approach being used in the more rural provinces to allow farmers to benefit from the higher land prices their rezoned land would fetch.[11] This would keep acquisition costs of the province low – indeed, they could sell the acquired land and improve local infrastructure. They could also pass on the savings with low rents in industrial zones or develop higher-density but low cost housing if that were in demand. Continued local flexibility with villages making crafts or with smaller scale manufacturing is also appropriate, so long as authorities and the people affected agree on the steps taken, and zoning of polluting activities takes public health into account. It may be necessary to decide that if a large majority (for example, 75% by affected households *and* by area of land to be taken) approve of a move, then the others would have to follow under similar terms. In other words, it should not be possible for a few holdouts to prevent a desirable change that has overwhelming official and local support. Increasing the transparency of any steps and making sure they are widely publicized should reduce the possibility of abuse. Certainly if the transition to an economy with less of an agricultural share and more of an industrial-service share is to be realized, these sorts of changes are already overdue.

Capital

One surprising finding during company visits was that the capital constraint had eased for many larger firms. They reported being able to find short-term loans from banks or suppliers for moderate amounts consistent with the current scale of their businesses. They admitted that if they wanted to expand and move from (for example) raising a few hundreds of thousands of dollars to a one to many millions, then there would be a difficulty. However, there did seem to be easier access to finance for these firms for incremental expansion and working capital than many previous surveys had found. It was not clear if actual or anticipated profitability was required by banks, or if the loans were more based on collateral availability. Certainly, these larger firms

[10] This is reported in the *Saigon Times Weekly*, May 29, 2004, pp. 20-21

[11] If anywhere near 3% were actually converted, the scarcity of non-agricultural land would decline and so would the prices paid for it. Land prices would fall considerably outside of cities if they were priced in some reasonable relationship to people's incomes. For example, low-rise flats (apartments) in Kuala Lumpur recently were listed for under $500 per square meter of *living* space, while similar flats in secondary Malaysian cities (Johore) went for $220 per square meter. Construction costs in Vietnam run from $90 to $140 per square meter for apartments and good quality houses. Malaysia, with higher wage costs, probably has higher construction costs. It is not unusual to find, on a square meter basis, raw *land* prices in Viet Nam's provinces as high as Malaysian *apartment* prices!

indicated that finding markets, getting (garment) quota, or knowing the right kind of technology seemed to them to be bigger problems than finding someone to extend credit.

This is an interesting finding, and it likely does not apply to smaller private firms. A recent survey in 2002[12] found that smaller firms with relatively few employees did suffer badly from a lack of access to capital. One suggestion was that the joint stock banks were more aggressive in looking for viable but established borrowers compared to the state-owned banks.[13] Also, many of the firms we talked to had many dozens of workers and either a foreign or state linkage. They almost certainly had access to credit more readily than purely private firms.

There have been a number of special government credit programs for exports or industry and these could also be part of the explanation.[14] Finally, many of the entrepreneurs we talked with were not from within the province but from other provinces, often in the South or Ha Noi. They often had land in their home city, and thus had collateral. It may also be that collateral-rich and larger firms that are expanding in the North are sufficiently successful that bankers have more confidence in lending to them. While the capital constraint may have eased for these types of businesses, it is likely that many others continue to face difficulties in getting loans at normal rates of interest and have to turn to the curb market instead. Moreover, the ratio of bank credit to GDP is still below 50% in Viet Nam compared to over 100% in China and several ASEAN economies. This would suggest that improvements would need to be sustained for some time.Then there is the question of how well banks assess credit risk, and if those who get loans are those most likely to repay.[15]

Who Are the Entrepreneurs?

One reason to argue for a more "level playing field" is to be able to tap the energy and genius of all Vietnamese citizens. In a competitive world, relying on just a narrow segment of potential manager-owners is apt to cost jobs and output, relegating Viet Nam to a lower level on the value added chain than it could otherwise achieve. Thus, it is of interest to ask if a "typical" person with no special advantages can start a firm above household or family size, or if larger firms are the product of special access.

In the provinces studied, most of the larger firms did have some advantages. Most of the larger firms had owners and managers from outside of the factory's province, often with some connection to state enterprises in the past or present. This in itself is not bad if the connection is used to *get started* rather than to sustain the firm. If special advantages are needed to continue operations, then the growth potential of the firm is limited. Subsidies cannot be extended indefinitely, even if trade agreements allowed it. In particular, the joint ventures where about 30% of the firm is given to a state enterprise partner for some land and regulatory help is a model that works *only* in a protected or difficult operating environment. (The land was seldom worth anywhere near 30% of the JV company.) If lower tariffs allow imports at world prices and regulatory reforms create firms where all profits are directed to those who put up the risk capital, then the joint ventures under the old rules will not do well. No firm can compete for long in a low tariff world if a partner has to put up 100% of any new capital for 70% of the profits, unless it has a very high debt ratio or other subsidies.

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[12] "The Internationalization of Vietnamese SME's" by Ari Kokko and Fredrik Sjoholm, draft, April 2004. The paper reports on a 2002 survey of 1600 small and medium enterprises, mainly at the household level. The provinces include Ha Noi, Hai Phong, and Ha Tay. Median workers were 6 per firm and assets were $20,000.

[13] The IMF reported in their December 2003 Statistical Appendix for Viet Nam that credit to "Other" [non-state] sectors increased by 30% from March 2002 to March 2003, compared to 13% for state enterprises. However, joint-ventures of SOE's with foreign firms or joint-stock companies with SOE shares do not count as state enterprise borrowing, so the data might not show quite so much of a change as they appear to.

[14] Many of the larger firms visited were state-linked and the Development Assistance Fund provides over $1 billion a year (in both 2003 and 2002) for loans to ship building, garments, steel, cement, etc. plus various infrastructure projects. The Fund is providing much more credit to SOE's than the banking system.

[15] The ratio of credit to GDP includes only bank credit, not credit from the Development Assistance Fund. This Fund is supposed to lend at low rates to both public and private companies, but the companies we talked to typically said that its procedures were "very complicated" unless they were state linked.

The most promising larger fully private domestic firms tended to be in Vinh Phuc. In those cases, ex-state enterprise experts and managers were found to have invested in businesses in which they had expertise. These were “real” private firms, getting no more access to land or credit (so far as we could tell) than others. They were run for a profit and would go broke if they incurred too many losses. For glazed tile, garments and milk products, these firms all had competent management in competitive industries. All commented on the positive and supportive “problem solving” attitude of the provincial government and all had benefited from low land costs in industrial zones – which were generally available.

Smaller “real” private firms from within the province were starting in the industrial villages of Bac Ninh. This province, with a long history of crafts and entrepreneurship, is encouraging somewhat smaller and less sophisticated firms to grow. There are varying degrees of success, but some products, such as furniture, are doing well and growing fairly rapidly. However, these firms lack advanced technology, sophisticated marketing, and were simply managed. They will have to improve in several dimensions to become internationally competitive firms. Even so, they are one reason why Bac Ninh has high enterprise law investments and could become a nucleus of more significant growth if hurdles of size, market knowledge and technology can be lowered.

In most other cases, there were more often special factors behind the firms that were visited. When there was a foreign partner, they normally provided most of the funds (land aside) and management. The local partner, almost always a state enterprise, was passive and got a share of the total firm for providing land and presumably easing regulatory problems. This would apply to the startup of the cooking oil firm and a Taiwan tourist company in Quang Ninh, for example. The Honda and Toyota operations in Vinh Phuc would also follow this model, as would the float glass plant in Bac Ninh. These three were more or less directed by the central government to these provinces. However, the floating glass factory (a joint venture with a Japanese firm) had to stop production in 2003 because imported Chinese glass was undercutting prices and causing huge stockpiles. Toyota vehicles cost about twice as much as in the US. Honda motorcycle prices were double those of the identical model in Thailand until Chinese competition forced lower prices.

These examples illustrate the difficulty of using the “old” joint venture structure in a world of low tariffs. The only hope for such firms is to (a) argue for more protection or subsidies (e.g., high-cost government contracts) so their inefficiency can remain or (b) change the structure of the firm so that the 30% partner puts in 30% of the incremental capital, possibly from the profit stream. Alternatively, the foreign or domestic firm might buy out the other, making it wholly owned by one owner. This assumes that the scale of operations can become large enough to function efficiently. In some products Viet Nam is a small market and may not be an efficient producer, even if there are only one or a few firms, unless there are also exports. In motorcycles however, local demand is sufficient to support efficient production.

The Taiwanese tourist company JV is able to function partly because of contacts with potential foreign tourists and partly because they got access to waterfront property on favorable terms which they are developing. This is a good example of a company with sufficient advantages to stay in business, but with limited prospects for expansion without similar implicit subsidies. It does bring additional skills and contacts to the firm, but might not be able to expand rapidly with “normal” land costs.

Another type of investor is a state enterprise, joint stock company with SOE ownership, or a private firm with strong connections to influential groups. These investors will typically be able to get land in an industrial zone, or even get land directly on favorable terms. Interestingly, these investors seldom come from within the province they operate in, but instead come from Ha Noi, HCMC, or perhaps Hai Phong. Again, the question for the province and the country is if these firms simply use their past connections to get started or if they need continuing advantages to stay in business, much less to expand.

An approximate observation is that most of these firms continue to rely on some sort of special access to markets or implicit subsidy (cheap land, labor or favorable credit terms) or market restriction to function. That is, it is hard to see them forming the basis of an industrial sector that could compete with firms in ASEAN or with China in a world with low trade barriers and fair bidding on contracts. That does not mean that some might not transform their operations and become as efficient as best-practice firms – only that their ability to do so remains uncertain. Examples would include a shoe firm in Bac Ninh that wanted to avoid places with higher labor costs. They feared that their experienced workers would be bid away by other firms more than they saw any benefit from "clustering." They produced simple, low-margin shoes and did not envision moving up to more complicated machinery, designs, or workmanship. This traps them in the low end of a market, and reduces the utility of higher value-added services that come from clustering such as design, technical expertise, marketing, or other specialized services. Another example was the precast concrete factory in Quang Ninh. It had locational advantages by being near Cai Lan port – precast pipes are expensive to transport – and also had a good relationship with provincial procurement, making them a primary supplier for many of the infrastructure projects. When asked about new technology acquisition, after a puzzled silence, the manager said he supposed he would talk to experts – but saw little need for it.

A third example of a state enterprise with limited growth capability is the new vehicle assembly plant in Bac Giang province. The 100% Vietnamese firm under the Ministry of Transport got 38 hectares from the province, with all land clearance costs paid for by the province. The firm will assemble sedans and light vans, initially with imported parts. Unless it quickly moves towards getting low priced components, it will find it hard to compete with similar vehicles from other countries – unless trade barriers stay high. The level of vehicle demand in Viet Nam is rather low – especially when an efficient engine or transmission plant has to produce at least several hundred thousand units a year to reach an efficient scale. Without a multinational to help develop local suppliers or to tie together other suppliers in ASEAN with that factory, it will be hard to reduce the cost of production.

The low amount of northern province exports, aside from coal and handicrafts, is some indication that most of the firms are hard-pressed to compete in open markets. (The entire Red River Delta area and Quang Ninh has only about 15% of national exports, even including Ha Noi and Hai Phong.) While efficient import-substitution is a necessary and valuable part of national industrial growth, it is likely that many of the state-linked firms will have to work very hard to improve their competitiveness as tariffs and other trade barriers fall. To do that, they will have to use their low-cost land, labor and capital to buy time to become more efficient, rather than as a durable source of competitive advantage. Because firms in China and other ASEAN economies are rapidly improving productivity and quality while lowering costs, simply relying on cheap inputs is a losing strategy. Thus, a dynamic and innovative management will be needed to move these firms forward faster than they appear to be going at present. The alternative is to resist trade liberalization, as in slowing WTO accession. This would have the effect of creating barriers for efficient industries and subsidizing those with the worst long-term prospects and little employment generating ability or potential. It would create slower and more unequal growth.

Business Associations

Well-run business associations are found in several Asian economies, but are perhaps most notable in Taiwan with its many small and medium firms. These Taiwanese firms seldom have the scale to develop fully capable technical or marketing departments. Their regional (e.g. the Taipei region) business association acts collectively on their behalf, engaging in market studies or surveys of technology so that they have access to critically important information in a timely way. These associations, or other collective groups, will often train certain types of labor that are not produced by the normal educational process. By collectively providing inputs that smaller firms find difficult to provide alone, they are a key ingredient to boosting Taiwanese manufactured exports, which were $650 per capita in the last year compared to $125 per capita for Viet Nam. (FDI sourced exports in Taiwan are small as well, compared to Viet Nam where they account for over half of total and also of manufactured exports. That is, good business associations increase indigenous capacity.)

Most firms in Viet Nam, especially but not only private firms, are small in size and weak in terms of their knowledge of markets.[16] Garment makers often sell through other Asian companies and do not know their final customers well. Shoe making is often dominated by multinational companies or their subsidiary suppliers, few of whom are Vietnamese. Even in fragmented markets with no dominant firms, such as wooden furniture or

[16] Kokko and Sjoholm in their previously cited paper found nearly half of firms said "too much competition" was a problem and one-quarter said "limited demand" was a problem.

handicrafts, few companies systematically gather information and are able to plan new products with any certainty of their acceptability. There are also troubling questions of quality control – sometimes a few “bad apples” will create a poor reputation for an entire industry and depress prices for all Vietnamese producers. This leads to losses and reduced output. The annual surveys in the *World Economic Forum* rate Viet Nam among the least advanced nations in their survey in terms of marketing.

Business associations in Viet Nam tend to be more government oriented and government run for a number of reasons. There is still some official uneasiness about having truly independent associations, so there is often government pressure to put a government official as head of a local association. Until recently, it was a requirement. If this happens, the association tends to be more bureaucratic, since the next position of the association head will be in another government bureau or state enterprise rather than in private business or consulting. In addition, many business associations started with only state enterprise membership, and they thought in terms of government support. The result is that the association is then used primarily to request the government’s help for special favors such as tax reductions, access to land or credit, etc. rather than to solve problems of information or training. For example, the steel association asked for no reduction in tariffs on steel imports, even though a global steel shortage had sent prices up by 30% in early 2004. This pressure for government leadership often comes even from the private businesses. They feel safer if a government person heads the association, and are unfamiliar with the “business consultancy” type of services that a well-run private association can provide. The result is that they frequently lack vital information on markets or technology that would raise their competitiveness.

One private furniture exporter in Bac Ninh employed 100 workers with very simple machinery and was planning to go to a trade show in the US to explore sales. Yet he had not used the Internet to explore potential contacts, look at possible competitors, nor present his own firm – or even for e-mail. No group or person had suggested this to him, even though the Bac Ninh government was providing free web hosting of companies. The availability of VOIP (voice over Internet Protocol) telephone calls at low prices, of higher bandwidth connections at reasonable prices, and of auxiliary website services that would help create a connection to buyers through the Internet would all have helped him.[17] With these, he might get a sharper knowledge of what other designs might sell better than the traditional variety, for which there was a good local market but a narrow international market. Without such information, it will be hard to compete against China’s furniture exporters whose exports to the US last year were nearly **fifty times** that of Viet Nam’s. A good industry association would help identify furniture designers, buyers, and technical experts who could help with specialized machinery and quality control. No single private firm could afford such people, but an association could act on behalf of many dozens or hundreds of producers.

The solution would be to encourage more of a “business service” orientation with the associations, perhaps even using government funds to *co-finance* critical services. However, this is likely to work only if the private companies have a sense of ownership and see some benefits from association membership. While a government representative might be kept as an observer, it would be better to have someone whose future career would benefit if the association were dynamic and provided needed services actually running it. This does not prevent the association from going to the provincial authorities with certain problems that the authority can reasonably solve. For example, there was a business group in Vinh Phuc that met regularly with the provincial authorities to solve problems. Businesses praised the group and the authority as a good way to resolve issues. For example, the major road is only a widened and improved country road, clearly inadequate for the mix of factory trucks, local farmers, shoppers on bicycles and motorbikes, and through traffic in cars and buses. Accelerating improved roads was a priority and one that the provincial authority understood and was trying to bring about. In contrast, the roads in Bac Ninh were much better, but had been more of a top-down directive. This does not make them a bad idea, but the notion was that roads would provide growth in that case. There was not a bottom-up demand or immediate need for the roads, and there is not an association in that province that works as well as the one in Vinh Phuc. This is even truer in the other provinces.

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[17] The website of the Viet Nam Chamber of Commerce has links to hundreds of thousands of global companies and basic information on them. A good association would show businesses how to tap this resource, which might be hard to use for those not skilled in using electronic resources.

In Quang Ninh, Ha Long Bay is a major tourist destination and a major reason for the high level of enterprise law investment. Yet a number of polluting and unsightly heavy industry projects are slated for that immediate area. There is no hotel or tourist association there to talk with the local government, which does not seem to see much difficulty in combining a world heritage tourist site and huge industrial plants and a major port. One hotel owner, who was selling a medium-quality hotel and planning to build a better one across the Bay, said: "I have nothing to say to them [the local government]. They know how much investment there is and would not put us out of business." In other words, he expected the government to do the right thing without any input, comment, or argument from those most affected by the intended heavy industry investments. Given the competing interests at national and local levels, the helter-skelter development of hotels without adequate sewerage[18], and the large bridge and port expansion that will compete with and perhaps compromise the tourist views, this faith is touching but perhaps not well placed. As there is a *national* plan to put a 1200-megawatt coal fired electric plant[19] within a few kilometers of Ha Long Bay, some local input is badly needed.

In Bac Giang, the province – which only split off from Bac Ninh in 1997 – was historically poor, agricultural and conservative. It is only very recently (2001) that they have decided to try to attract industry by providing a business-friendly environment. They now will provide subsidies for land clearance of up to 100%, provide land rent for up to 15 years, tax breaks, and up to 50% of training costs. There is a one-door policy for getting licensed and a one-week turnaround time on applications. Like Bac Ninh, they are focused on providing an IZ and developing industrial villages. They have also limited intrusion from inspections, police and tax visits, etc. All of these steps are beginning to help, but as of end-2003, there had been only $16 million licensed FDI since 1988 and only $12 million implemented. In terms of implementation, this was 8% of Bac Ninh, 6% of Quang Ninh and 4% of Vinh Phuc. Even in terms of licensed FDI in 2003, when the friendly policy might have been expected to gain some traction, they got only $2.2 million – the same as Bac Ninh, which also has very low FDI. But Quang Ninh ($67 million) and Vinh Phuc ($45 million) had much higher FDI. For Enterprise Law investments, Bac Giang's licensed amount in 2003 was one-third of Bac Ninh and one-ninth of Quang Ninh. Bac Giang's investment came to $11 per capita, up from $7 per capita in 2002, but still only about half of the national average. In short, if even a well-located province starts late, it takes time to build up a reputation and attract capital. The flip side of clustering is that the places that ignore investors tend to get punished – not for reasons of vengeance, but simply because it is easier and safer doing business when there are many other similar businesses nearby. Obviously, if there are few businesses and little private investment, there will be limited pressure to create "bottom up" business associations to service those few firms.

One weakness in any idea aimed at improving the business associations is that they do not function well now. According to one veteran observer, they often ask for large government grants and then do not perform well. In order to change this, competitive firms would have to take effective control and put their own money into providing needed services through their association, perhaps with some government matching of contributions. In addition, it might be necessary to have a regional association covering several provinces but only one industry, such as a "Ha Noi-Hai Phong region furniture association." Getting participation and even supervision by firms over a larger area might be difficult, but is probably necessary. The industry in any one province might not be large enough to merit the kinds of marketing and technology studies needed to compete with China.

This raises a question about the utility of business associations as a way to attract new investment, rather than simply provide services to existing firms. As Bui Van has suggested, there are (at least) three styles of provincial governance. One is the old fashioned one of heavy intervention. In this case, the emphasis is on planning, regulation, detailed licensing and inspection procedures, and a tilt towards state enterprises. A second is a "hands off" attitude. In such a case, registering a firm is easy, and there may even be a fast and easy way for (at least) a medium-large firm to get into an industrial zone. But beyond that, the attitude is that you are on your own. This is a better attitude than the first for private entrepreneurs, but might fall short if they

[18] A Danish aid agency is reportedly going to offer a larger sewerage plant to prevent the Bay from becoming a dumping ground for the effluent of thousands of tourists. It is not clear if this would have come about without some outside intervention in nearly the same time frame.

[19] A 1200 megawatt plant is huge – eight times as large as the coal-fired generator at Uong Bi nearby. Its tall smokestack and the smoke will be visible from many kilometers, unless smog blots out the view.

are weak. The third stance, now observed more in progressive southern provinces, is more proactive and supportive. The provincial authorities let it be known that they have an interest in the firm's success. If there is a problem that the province can help with, it is easy to meet and discuss it – and sometimes to get some action. In Binh Duong, when labor was in short supply, individual firms found that if they trained workers, others might "raid" them. This made most of them reluctant to do training. So, the province sponsored a well-focused training school with contributions from the firms needing the skills taught. This let the firms focus on production while getting access to a supply of skilled workers. The beginnings of this attitude are found in Vinh Phuc where there is a business association that meets with the provincial government to address problems, although it is not specialized by industry.

From our observations, an effective business association is easiest to establish when there is a constituency for it. But with even a modest beginning, if it is dynamic and responsive, it can add to the reputation of the province and/or region and help the existing firms expand much more rapidly. As there is more and more visible activity, it becomes easier to attract new investors. Probably Bac Ninh and Quang Ninh are the best candidates for encouraging service-oriented business associations to form, but even Bac Giang might find that setting up a structure would prove fruitful as their other reforms begin to be appreciated and attract more interest from private investors. Of course, business associations can still play the role of representing business concerns to the local government. This is especially important if village or commune officials tend to be more intrusive and less helpful than the provincial leaders would like. Indeed, creating a mechanism to reduce abuses must be viewed as one of the highest priority steps for any province. Nothing scares away investment more than the thought that some corrupt or abusive local official can make life miserable, raise costs, and even destroy one's business with impunity. A good reputation is a good place to start for any province – and it requires more than the top leadership to create a favorable impression. It requires a united approach by the entire government, with methods of finding out those who are misbehaving and disciplining them. At present, this is not easy to do.

In that sense, a workable business association is one part of a strategy to change the way a province works. Instead of having all major projects "called for" and specified by the government, the government helps the association find out the information the local businesses need to determine the "right" investments from a business point of view. Instead of having a government personnel and credit system provide the management and capital, the government decides to allow competitive labor and capital markets to determine the outcomes. This represents a decision to reduce the role of politics and increase the role of the market in hiring, borrowing, investment and output decisions. *There is nothing inevitable about this approach in the short to medium term.* It is possible for a province to rely on government funding, protection, subsidies, and similar advantages and continue to support state-owned or state-linked enterprises. The difficulty is that these firms have trouble competing, employ few people, and do not export much.They are a weak basis for future growth and stability. The "old" system will not flourish in a low-tariff world of global competition, any more than a firm with 70% ownership will be able to put up 100% of the money and compete fairly with a firm that has 100% ownership and puts up 100% of the money. In that sense, the kind of business association is simply a reflection of a larger strategic choice that a province has to make. It is likely that if the economy becomes more competitive, then provinces with more competitive and flexible firms will tend to perform better than those that continue to rely on state support or intervention.

Summary and Conclusions

It is important to start with the observation that all of the four provinces are moving forward. They have provincial leadership that wants to create economic growth and they have taken significant steps to make the provinces more business friendly. And things are, in fact, getting better. The question is what more can be done to further quicken the pace of growth and to slant it towards activities that will be able to compete and sustain themselves in a world with less protection and fewer subsidies than many firms now enjoy. In effect, this means helping private firms without special connections grow larger and to have state-linked firms learn to function more on the basis of competitiveness and less on the basis of special advantages which will be hard to maintain. If these kinds of competitive industries flourish, they will tend to produce more jobs and reverse the "brain drain" from which many of these provinces apparently suffer.

In Appendix A, a typology developed by Dr. Edmund Malesky in his recent Ph.D. thesis investigating the impact of FDI on provincial level policies is shown. He argues that provinces with a lot of FDI, especially if export-oriented, tend to develop policies that favor over-all development. However, provinces that are poorly located and endowed start with disadvantages that tend to keep them tightly tied to traditional and state-led policies. Provinces with good location and conditions but limited FDI tend to be intermediate cases.It remains to be seen if domestic Enterprise Law investment, if in sufficient amounts, plays a role similar to FDI. It has been argued elsewhere that rewarding poorer provinces that attract FDI and/or private investment might be a good way to encourage more enthusiasm for reforms in less fortunate provinces.[20] Certainly, thought needs to be given to ways that would entice and encourage local leaders to find ways to be more supportive of competitive investments that do not require special support. If they can be persuaded on the direction, then the content of needed steps might include the following:

1. Unify the lower levels of officials with the provincial leadership: District and village officials may not be in agreement with top provincial officials concerning the direction and content of economic policy. A lack of unity can be fatal, as investors are easily scared away by red tape, inspections, and difficult administrative practices. Part of the solution is training, part is instituting better lines of communication between investors and officials, and part is allowing personnel policies sufficient flexibility.

2. Land prices need to come down outside of industrial zones. By allowing farmers to keep some of the gains from land reclassification and allowing a modest per cent of total land to be used for nonfarm purposes, even without a master plan, it should be possible to bring land prices closer to their realistic (i.e. southern) values in residential and commercial uses. Increasing the number of industrial zones and making the terms of leasing more flexible would have a similar impact, even for residential use if this were included in existing zones. (Land around Ha Long Bay is a separate issue, as this is limited by geography and needs separate treatment.)

3. There should be a regional – not just provincial – effort to increase industrial competitiveness by improving the performance of business associations. If these industry-specific groups were able to provide better marketing and technical information, and to facilitate training, they would help both state and private firms become more capable and efficient. Such associations could also help firms communicate legitimate concerns to government officials. However, the governance and efficiency of these associations is an issue. Having firms pay a non-trivial fraction of any costs is one way to ensure that someone is taking the whole problem seriously and not simply spending government funds. In the case of Ha Long Bay, such a group should work with the provincial government to push for better location of several proposed heavy industry projects.

4. Study tours to the successful southern provinces might be useful for local officials, helping them see what can happen when an entire province decides to move from "leaving business alone" to "lending a helping hand." (This assumes that the province has already stopped trying to control and curtail business firms.) Similarly, if provinces shared their own best practices in the North, they might find ways to settle land disputes, create options for displaced farmers, streamline and improve local government, and boost local firms more effectively than just experimenting on their own. Central support for reasonable solutions is also critical.

5. There needs to be national leadership to reward provinces that develop competitive industry, rather than using government and aid funds to keep a high-cost and subsidized system and inefficient firms growing. Growth needs to start radiating from both HCMC and Ha Noi. Rewarding provinces with the right kind of growth might be done in several ways, but the basic idea is not to promote inefficient industry and excessive infrastructure, but to reward the growth of jobs, exports, and efficient industrial growth in the northern region. For example, requiring tolls to provide even partial finance for highways or ports might be one step that would link investment to use, rather than to the skill of the province in arguing for central investment. Linking infrastructure funds to population growth is another idea and a logical one if housing, utilities, roads, etc. are needed as population expands.

[20] See "Viet Nam's Economy: Success Story or Weird Dualism? A SWOT Analysis," May 2003, UNDP, David Dapice.

The basic problem with the northern provinces is not that they are stagnant, but that so much of their potential is not being developed. If they continue to emphasize industry that employs few people, they will continue to lose people. If land conversions are limited, land prices will continue to be ridiculously high. If the leadership and other officials begin to promote efficient and competitive firms, there will be more of them. These firms will provide a much more stable and rapid long-term kind of growth than what is now predominating. Getting from where the provinces are now to where they need to be will not be easy, but neither will it prove so very difficult that it would be foolish to attempt. Many pieces are in place. Solving land, regulatory or business service problems are well within the grasp of the governments and firms. If these problems can be addressed, the overall rate **and** quality **and** sustainability of growth will improve. So will regional balance, urban-rural inequalities, and political stability. These are goals worth reaching for, especially if they are within one's grasp.

Appendix A: Malesky Classification of Types of Provinces

Province Type	Description	Behavior	Examples
1. Reformers	Good initial conditions with low state sector dependence	Fence Breaker/or Sanctioned Experimenter	HCM City, Binh Duong, Dong Nai, Da Nang (in late 1990's)
2. Spillover	Near type 1 provinces. Attract FDI in later 1990's	Late fence breaker/ maybe sanctioned experimenter	Long An, Vinh Phuc, Kien Giang
3. Wafflers	High FDI but in JV's and highly state dependent	Cautious fence breaker likely to reverse course	Hai Phong, Hai Duong, Bac Ninh, Da Nang (in early 1990's)
4. Greenfield Private	Low state sector and low initial conditions	Encourages private but with very little Experimentation	An Giang, Tay Ninh, Lam Dong, perhaps Dak Lak
5. State Captured	Low initial conditions and large state sector (central and/or local)	Depends on formal state transfers or indirect subsidies	Quang Ninh, Phu Tho, Ha Tinh, Nghe An, Nam Dinh
6. Poor & Struggling	Poor initial conditions, high minority, small but important state sector	Little fence breaking as province relies on state transfers	Northwest Viet Nam, Hoa Binh, Son La, Lang Son, Bac Lieu

Note: This table is taken from Table 13 of a Duke University Ph.D. thesis by Dr. Edmund Malesky. The title is "At the Provincial Gates: The Impact of FDI on Economic Transition"

Appendix B: Real Industrial Growth Rates in Northern Provinces, 1999-2002

	1999-2002 Total Growth	% of growth from			2002 Industrial Output per capita			
		State	FDI	Non-State	State	FDI	Non-State	Total
Bac Ninh	227%	28%	32%	40%	1137	701	743	2581
Bac Giang	63%	76%	3%	21%	317	7	122	446
Vinh Phuc	272%	6%	89%	5%	273	3759	288	4320
Quang Ninh	57%	74%	19%	7%	3672	816	265	4753
For comparison								
Binh Duong	229%	2%	66%	32%	837	8689	5294	14819

Notes: From *2002 Statistical Yearbook.* Growth rates are for total period, not annual. Output is thousand 1994 dong per provincial inhabitant. "Non-state" is the residual of total less state less FDI output.

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