

## **CORRUPTION AND THE OUTSIDER: MULTINATIONAL ENTERPRISES IN THE TRANSITIONAL ECONOMY OF VIETNAM**

ELIZABETH MAITLAND

*University of Melbourne*

Transitional Vietnam exhibits key characteristics that economists argue are conducive to corrupt practices and, by knock-on effects, to slower economic growth. The process of liberalisation has shifted the status quo in Vietnam, permitting entry by a wider pool of bribe-takers and bribe-givers. Standard economic definitions of corruption focus on the abuse of public office for private gain, whereby corrupt practices are modelled as distortions in the distribution of government provided goods and services. This paper modifies existing models, specifying corruption as a distortion to the definition, allocation and/or enforcement of property rights. The model incorporates an explicit role for the incentive set that shapes behaviour by government officials, private individuals and firms. Abuse of public office is modelled as a distortion to property rights, including the re-assignment of private rights as the result of lobbying or rent-seeking activities. Local norms may sanction corruption against certain groups. The MNE is one case in point; others include different ethnic, religious and socio-economic groups. As outsiders in an environment historically hostile to “outsiders”, MNEs represent “easy” corruption targets.

### **1. Introduction**

“Corruption is taking place every day and every hour,  
at all places, all the time.”

Vietnamese President Tran Duc Luong<sup>1</sup>

While corruption pervades all societies, irrespective of their level of economic development, a perceived explosion of corruption in transitional economies has spurred recent interest in modelling the economics of corruption. The former Soviet bloc countries provide a contemporary laboratory of ‘exogenous’ shocks to systems characterised by high, but allegedly stable patterns of corruption, Vietnam is one such country. Early optimism that the

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*Address for Correspondence:* Elizabeth Maitland, Australian Centre for International Business, Faculty of Economics & Commerce, University of Melbourne, Victoria 3010, Australia, E-mail: e.maitland@unimelb.edu.au.

<sup>1</sup>As quoted in *Far Eastern Economic Review*, January 11, 2001, p. 70.

mid-1980s introduction of economic reforms would create a new Asian tiger were soon tempered by disquiet at the slow pace of reforms and escalating problems of corruption (*The Economist* 2000, 1999, 1995; World Bank *et al.*, 2000; Edwards, 1999; Stier, 1999; Cleary, 1995; Diaz, 1995; Vatikiotis, 1994). Both within and without, corruption is viewed as a key constraint, holding back economic growth, particularly through its negative impact on foreign investment.

Prescribing cures for countries afflicted by high-levels of resource distortion requires knowledge of the conditions that produce and enable such behaviour to become entrenched. Yet, cross-country studies that empirically test such conditions are rare. Obtaining rigorous and testable evidence of corruption has proved a major stumbling block. Equally neglected has been the analysis of why corruption emerges, compounded by confusion surrounding the different types of corruption and their impact on economic performance.

Drawing a direct causal link between evidence of corruption and falling foreign investment levels is too simplistic. This paper argues that the impact of corruption on an economy (and society) occurs through corrupt activity weakening the transparency and predictability of the property rights systems, thereby undermining investment *incentives*. This paper draws on New Institutional Economics to incorporate an explicit role for the institutional context, or incentive set, that shapes behaviour by government officials, private individuals and firms. The second half of the paper presents a preliminary application of the theoretical arguments to Vietnam, exploring the complex sets of institutions shaping and, potentially, constraining multinational investment. For evidence of corruption, this paper draws on media reporting in various secondary sources, including the English-language Vietnamese press and business news journals.

## 2. “Modelling” Corruption

Within the economics literature, much attention has focused on determining the effect of corrupt practices on the pace and level of economic development, the impact on wealth distribution, and the conditions that produce and sustain greater or lesser levels of corruption.<sup>2</sup> Prevailing economic theories narrowly define corruption as the abuse of public office for private gain, which is typically modelled as a classic, but two-stage agency problem. At one layer of analysis, corruption is specified as a bargaining process, whereby a

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<sup>2</sup>Very extensive reviews of the economics literature on corruption can be found in Rose-Ackerman (1999) and Bardhan (1997). The overlap between rent-seeking activity and corruption is discussed in Khan and Jomo (2000).

public official (the principal) and an individual or firm (the agent) negotiate a payment for the illicit sale of a public resource (a license or permit). The second agency relation casts the public official as the agent of the top level of government, focusing attention on the conditions that foster corrupt behaviour.

Many economists have viewed corruption benignly (see for example, [Leff, 1964](#); [Huntington, 1968](#); [Beck and Maher, 1986](#); [Lien, 1986](#)). Corruption is promoted as an efficiency enhancing practice, when government policy produces second-best outcomes in resource allocation, particularly through over-regulation of economic activity. The ability of officials to price discriminate between bidders for government permits or licenses imitates a competitive process, such that the permit is allocated to the highest value-user. Similarly, bribe-taking may function as a *de facto* tax, surmounting weaknesses in government expenditure. Bribes equate to a wage premium for public-sector employees, supplementing inadequate official incomes and incentivising appropriate effort in the provision of government services. Accelerated approval time through bribery also lowers the costs of over-rigid bureaucracies, “greasing the squeaky wheel” ([Bardhan, 1997](#): 1332).

‘Efficient’ corruption arguably exists only in highly stylised models, which overlook the costs of efforts to avoid detection and punishment for corrupt activity. Drawing on models of industrial organisation to analyse ‘markets’ for corruption, influential work by [Shleifer and Vishny \(1993\)](#) and [Rose-Ackerman \(1999\)](#) argued such costs critically affect the distortionary impact of corruption. Context matters, as discovery costs are a function of competition between political groups and the scale of entry barriers to corruption markets.

[Shleifer and Vishny](#) demonstrated their arguments using a basic model of a public official able to restrict the quantity of a government good “sold” to private agents. The official can charge a bribe on top of the government price for the good (labelled corruption without theft) or “hide” the sale, such that the buyer price is equal only to the bribe (corruption with theft). By introducing various complicating variables, such as the need to obtain multiple government goods to operate a business, entry barriers to the pool of bribe-takers were shown to affect the level and type of corrupt activity. Where public officials can freely enter the corruption market (that is, there are no restrictions on the ability of officials to extort bribes from private individuals to obtain government goods), the bribe burden on private individuals theoretically stretches to infinity, such that sales of government goods and bribe revenues fall to zero ([Shleifer and Vishny, 1993](#): 606). A strong state able to erect entry barriers to corruption markets produces fewer distortions in resource allocation than a weak state unable to restrain the proliferation of

independent bribe-takers intent on maximising their individual rent stream. In the latter case, collusion between public officials or agencies imposing bribes on private agents is less *inefficient* than conditions of perfect competition in corruption markets. In all scenarios, the need to minimise the risk of exposure renders corruption more deleterious than taxation as payment for government produced goods.

### **2.1. *Empirical studies of corruption***

Resolving the debates on the costs and benefits of corruption is impeded by the difficulties of assembling comprehensive and rigorous data-sets. Data on corrupt practices has proved particularly elusive, forcing reliance on published indices of perceptions of, rather than actual, corruption. Utilising subjective perceptions data for a cross-section of countries, [Mauro \(1995\)](#) analysed the impact on economic growth of corruption and a series of institutional variables, such as the level of red-tape, judicial integrity, political stability and the degree of social homogeneity. Mauro's empirical estimates found perceptions of corruption were strongly, negatively associated with the investment rate. The negative association held irrespective of the level of red tape, providing little support for benign views of corruption overcoming the inefficiencies of lumbering bureaucracies. The strong association between corruption and investment rates appeared to operate through a broad-brush impact on total investment, rather than corruption inducing inefficient investment choices. Discerning the factors fostering high levels of corruption uncovered an association between greater ethnolinguistic diversity within a country and heightened perceptions of corruption. Mauro speculated this was linked to bureaucrats favouring members of their own social group, such that more homogenous societies were able to achieve Shleifer and Vishny's (1993) notion of joint-bribe maximisation, with its less-deleterious impact on economic performance.

Following Mauro's lead, Treisman (2000) utilised perceptions data to explore potential sources of corruption. A series of regression models tested explanatory variables from political stability, democratic governance, state-market intervention and legal system (common, civil, religious) to ethno-linguistic homogeneity, religious affiliation, colonial heritage, level of development, openness to trade, and raw material endowments. The strongest influence belonged to the "dead hand of the past": countries that had been democracies since 1950 and, more particularly, former British colonies (and Britain) were perceived to be significantly less corrupt, even when controlling for economic development and openness to trade. Political instability was not a significant determinant of high levels of perceived corruption, nor was the country's current status as a democracy.

Building on findings from La Porta *et al.* (1999) that countries with French or socialist legal systems exhibit inferior government performance, Treisman hypothesised British colonial heritage and prolonged experience of democratic rule proxied complex traditions placing the rights of the individual alongside, rather than subordinated to, the interests of the state (Treisman, 2000: 438–39). Legal culture was pivotal. Countries with common law systems, but no history of British rule, had higher perceived corruption, while countries with just British heritage were still associated with lower perceived corruption (Treisman, 2000: 422–24). As La Porta *et al.* (1999: 232) argued:

A civil legal tradition . . . can be taken as a proxy for an intent to build institutions to further the power of the state . . . [t]he English common law tradition is entirely different in that its development starting in the 17<sup>th</sup> century has been shaped by Parliament and the aristocracy at the expense of the Crown, and hence it has reflected to a much greater extent the intent to limit the power of the sovereign (David and Brierly, 1978: 303; Finer, 1997: 1347–1348). As a result of this influence, the judges who made common law “put their emphasis on the private rights of individuals and especially on their property rights” (Finer, 1997: 1348). There is also more emphasis on restraining the government and on protecting the individual against the government.

Context clearly matters. Corruption, whether in response to large-scale government inefficiency or individual greed, feeds on the incentive set shaping decisions. It is not a simple bargaining process, in which the bribe-taker and bribe-giver negotiate an ‘efficient’ outcome, disembodied from the surrounding political, economic and social environment. Individual public officials face a series of decisions, balancing the costs of discovery, which may occur in the distant future, against largely immediate benefits. The task for economists is to incorporate the setting, or “rules of the game”, into theoretical models, as well as empirical tests.

The following section leverages the emphasis placed by various authors on the importance of context through a New Institutional Economics (NIE) model of corruption that explicitly specifies property rights systems and the incentive set for corruption. Viewing corruption through a property rights lens casts light not only on differing levels of corruption across countries, but also, through a more refined definition of corruption, conditions that promote different types of corruption.

### **3. A New Institutional Economics Model of Corruption**

Uncertainty of ownership is a powerful disincentive to acquiring knowledge and skills. Where corruption undermines incentives to invest in new capabilities, development will slow or retreat. Defining ownership requires

measurement and delineation of assets, while enforcement rests on the presence of a credible threat discouraging violation of rights. Historically, economies of scale in the use of violence have favoured the emergence of a single agent, the state, with formal powers to define and enforce property rights systems. The state defines, allocates and enforces property rights through a hierarchy of rules, from constitutions, legislation, common law decisions, bylaws and contracts (North, 1990: 47). These rights encompass the right to earn income from assets and to contract over the terms of asset use with other parties, the right to permanently transfer the asset to another party, as well as user rights, such as the right to physically alter or destroy an asset (Eggertsson, 1990).

Specifying corruption as a re-assignment of property rights through the aegis of state sovereignty reveals two types of corruption: ‘greasing the wheel’, including bribes to speed or gain a government permit; and corruption where bribes are paid to re-assign rights to select interests. In contrast to existing models, bribes are not paid to obtain access to government goods supplied by public officials. Rather, bribes are paid to affect some aspect of the definition, allocation and/or enforcement of property rights to assets — tasks that are controlled by public officials.

In Type I corruption (‘greasing the wheel’), the individual or organisation paying the bribe ‘agrees’ to a partial rights transfer to the public official. The bribe represents the transfer of part of the income stream (rent) on the asset or assets the individual seeks to exploit. The transfer occurs when a public official is able to manipulate property rights that have already been defined and allocated by the state to the individual in question. The *Times of India* (1998) provides a representative illustration of a police officer arrested for demanding and accepting a bribe when called to a break-in at a photo studio. The break-in had been committed by the owner of the adjoining premise, who had attempted to gain possession of the studio by breaking down the wall between the two shops. The bribe was demanded as payment for removing the neighbour and allowing the studio owner to rebuild the damaged wall, thereby enforcing rights that already existed in law.

Type II corruption is distinguished by the payment of bribes to achieve the transfer of full or partial rights from the initial owner *without* their consent. This form of rights re-assignment falls into three sub-categories:

- (a) the transfer of private property rights to new private owner(s);
- (b) the transfer of property rights from public to private ownership; and
- (c) the transfer of rights from private to ‘public’ ownership.

Correspondingly, the manifestations of Type II corruption are many and often difficult to discern. A firm paying a bribe to obtain a permit to utilise toxic-fume emitting technologies represents one such case. Under government

environmental policy, use of the technologies in question may be fully legal and the bribe is a straightforward example of 'greasing the wheel' to speed permit clearance.<sup>3</sup> Alternatively, the bribe may form Type II(b) corruption, whereby the rights of the public to a clean environment are transferred to the private firm, through the issue of a 'false' permit.

At any point in time, the property rights system is a function of the distribution of power within a society. The politically advantaged benefit from a redistribution of property rights, providing an incentive for interest groups, including public officials, to engage in predatory rent-seeking behaviour (Eggertsson, 1990; Libecap, 1989, 1993; Krueger, 1974, 1996). As Coase (1960) demonstrated, the initial assignment of property rights affects economic outcomes. Valuable rights will not always find their highest value use, as transaction costs (the costs of search, negotiation and enforcement of agreements) may be so high as to prevent voluntary re-allocation.<sup>4</sup> Hence, in the earlier example of Type IIb corruption, the inability of homeowners to form an effective pressure group results in a transfer of rights to the 'air' above their homes to the firm.

Modelling property rights systems requires an understanding of the institutional web or rules of the game that structure interaction in a particular setting. Political, economic and social groups emerge in response to the opportunities created by institutions and, in turn, mould changes in the rules of the game in a complex process of institutional evolution (North, 1990).<sup>5</sup> Change may be in the form of new legislation or gradual shifts in social attitudes towards, for example, racism or slavery. The effectiveness of each new institution is heavily dependent on its enforceability within the society. Numerous empirical studies have shown that societies do not always produce institutions that support sustained economic growth (Greif, 1989, 1992, 1993; Greif, Milgrom and Weingast, 1994; Landa, 1994).

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<sup>3</sup>This does not presume that the technology is safe, merely that it meets government standards, which may be low or reflect the prevailing state of scientific knowledge.

<sup>4</sup>The classic example of the Coase theorem is of a polluting factory affecting the air quality of adjacent housing. Cooperation and coordination among home owners are likely to be affected by 'freeriders' seeking to benefit from clean air without having to incur the 'costs' of engaging in negotiations with the factory. When transaction costs are zero, negotiations between the factory and residents will determine the allocation of the rights to 'air', depending on the relative valuations of air as a resource by residents and the factory. Irrespective of the initial position of whether residents have the right to clean air in their neighbourhood or the factory has the right to pollute, the problem of social cost, as defined by economists, disappears where there are assumed to be no costs of transacting.

<sup>5</sup>Organisations range from political bodies (such as the organs of government, regulatory agencies and political parties), through economic groups (including firms and trade unions), to social bodies (such as churches and educational groups).

Functioning either as formal or informal constraints, institutions limit the choice set of individuals to induce co-operation and co-ordination (or limit non-cooperative behaviour) between members of a society. Formal institutions encompass political, judicial and economic rules, such as legislation, common law decisions, and government competition and welfare policies, while informal constraints are the conventions or codes of behaviour in a society (North, 1981; 1990; 1991). Within a society, all forms of interaction, whether social, political or economic, are governed by formal and informal rules. For example, marriage is a social relation governed by legal statutes that specify the division of wealth if a marriage fails, as well as social norms influencing the nurture of children of the relationship.

While rules of ownership are typically defined, allocated to different groups and enforced by the state, informal norms are also important. Such norms may affect the willingness of the state to assign ownership to genetic material or to allocate and enforce intellectual property rights to brand names, trademarks, copyrights and patents. Local norms may also support corruption against certain groups, particularly when in favour of others. The multinational enterprise (MNE) is just one case in point. Others include different ethnic, religious and socio-economic groups. Hence, Shleifer and Vishny's (1993: 610) argument that "[c]ountries with more political competition have stronger public pressure against corruption" holds only with an implicit assumption that "the public" does not discriminate on the basis of who (or what) is the victim of corruption.

For MNEs, key players in the property rights system will include, *ceteris paribus*, host country organisations such as domestic firms, labour unions, welfare agencies and environmental groups. Distortions to the property rights regime emanating from the state will also be strong where the development of the institutional framework lags the sophistication of the capital stock and where the state is a key holder of ownership rights. In the former case, which typically characterises transitional economies, discontinuities between the evolution of the economic system and the legal regime, with respect to institutions such as bankruptcy and intellectual property, entail that the system of property rights is not adequately supported by legislation and state enforcement (Rapaczynski, 1996). In these cases, much of the definition, allocation and enforcement of entitlements within the country are left to administrative and, frequently *ad hoc*, decision-making. The scope for administrative discretion, which fosters corruption, is also significant where the state is a key holder of ownership rights. As Rapaczynski (1996: 93) noted a "state that conducts much of its policy through the exercise of its ownership rights (which leave a lot of discretion to the decision-maker) tends to neglect the development of its regulatory capacities (where a certain degree of transparency and procedural regularity is required) and thus increases the degree of arbitrariness in the pursuit of its economic policies."



In Vietnam, the process of liberalisation has shifted the *status quo*: existing barriers to markets for corruption have been dismantled, permitting freedom of entry for a wider pool of bribe-takers. The radical shift in rules (the incentive set) has wrought responses from organisations and individuals. A key question is whether the shift in the supply curve for corrupt practices will have an ultimately negative effect on Vietnam's economic development. The following section applies the notions of Type I and Type II corruption to Vietnam. As the World Bank (2000: 61) noted in its recent handbook on fighting corruption in Vietnam, "there is scant quantitative evidence on the extent and main sources of the problem."

The following analysis is preliminary: it first identifies examples of the different types of corruption in Vietnam targeted at MNEs. The final sections of the paper explore the institutional context of economic change to identify factors shaping weaknesses in the property rights system that potentially erode incentives for foreign firms to enter and expand their operations in Vietnam. These factors include significant gaps in the legislative framework with respect to a market-based economic system and on-going hostility within state organisations towards private enterprise. The hostility is part ideological, historical and a reaction to the loss of power suffered by government ministries and state-owned enterprises in the shift from central planning.

## 4. Vietnam, Corruption and *Doi Moi*

### 4.1. *Evidence of corruption*

*Doi moi*, or the reform programme of economic renovation, was formally adopted by the Sixth National Party Congress of the Communist Party of Vietnam (CPV) in 1986. The programme was explicitly aimed at overhauling the "bureaucratic centralised state subsidy system" in favour of a multi-sectoral economy (Vo Nhan Tri and Booth, 1992; [Plummer, 1995](#)). In December 1987, the first *doi moi* law pertaining to foreign investment was passed, effectively re-opening the country to Western companies. Despite early promise, Vietnam's embrace of economic liberalisation has been clouded by myriad structural legacies of poverty, uneven regional and industrial development, and mismatched political and economic systems.

As the 1990s progressed, corruption was an increasingly visible 'side-effect' of *doi moi*. Mid-decade, the Political and Economic Risk Consultancy described Vietnam as "in contention for the Imelda Marcos golden shoe award for outstanding achievement in the category of corrupt activities" (as quoted in Schwarz, 1996b: 18). The need to combat corruption emerged as a recurring theme in official pronouncements and policy platforms. At the Eighth Plenum of the Central Committee of the CPV, in January 1995, General Secretary Do Muoi bemoaned the rising corruption and deteriorating morality of state

officials. In a blunt report to the National Assembly, the Prime Minister observed:

The state of corruption plus incapacities, red tape and domineering behavior, and lack of a sense of discipline among numerous officials in various state machines at all levels and branches ... have ... jeopardized the renovation process and brought discredit to the Party's leadership and State management (Goodman, 1995: 95–96; omissions in original).

A complaints hotline, established by the Prime Minister in 1998, received roughly 50,000 calls alleging corruption and government inefficiency in its first year (World Bank, 2000: 61). Combating corruption was a major theme of the 1998 and 1999 Party Plenums, producing a number of ordinances and decrees to tackle the problem, and an official anti-corruption campaign was launched in mid-2000.

Many of the corruption cases reported for Vietnam involve the transfer of public rights to private ownership, which is unsurprising given the nature of the transition from central planning to a market-economy. The cases range from the illegal sale of 4,000 tonnes of steel intended for a cross-country power-line, bribes to customs officials to overlook rice smuggling to China equivalent to 20–30 percent of official rice exports to the country, and the diversion of poverty relief funds to build new homes for local officials (*Vietnam Investment Review*, 1993; Reuters, 1995; *Bangkok Post*, 1995; Watkin, 1999).

Examples of Type I corruption affecting MNEs abound, with customs officials displaying a particular predilection for extracting bribes from foreign investors to allow imported goods through airports and ports (BBC Monitoring Service, 1996). Quoting anonymous foreign business executives, the *Vietnam Investment Review* provided tentative evidence that the far-reaching inspection powers of various state bodies were also enabling corrupt activity: “We are frequently forced to receive inspection delegations from various authorities. They often unnecessarily interfere with our business operations, sometimes threatening us and demanding bribes”, said a textile company official in Hanoi.” (Duc Hung, 1998)<sup>6</sup>

Evidence of Type II corruption has also appeared in media reports on the experiences of foreign firms in Vietnam. In articles published four years apart, *The Economist* has twice reported the availability of “neatly-bound” photocopies of foreign firms’ business proposals, first in a sole bookshop in Hanoi and, later, throughout Vietnam (*The Economist*, 1995; 1999: 48). In such cases, the transfer of rights from the MNE is two-fold: first, having paid a corrupt official(s) to leak copies of the proposals, the bookseller profits from the sale of the MNEs’ intellectual and, possibly, technological property

<sup>6</sup>Quote from on-line edition: [www.vir-vietnam.com](http://www.vir-vietnam.com).

embodied in the proposals; second, buyers of the proposals can potentially erode the rent stream on the MNE's exploitation of its distinctive resources and capabilities, by establishing competing activities, based on the 'revealed' know-how.<sup>7</sup>

Press reports also indicate a complex form of Type II corruption involving an Australian mining company, Westralian Sands. The company became embroiled in a bitter dispute with its joint venture (JV) partner, a state-owned enterprise of the Ha Tinh province people's committee, and government officials. The Vietnamese partner reportedly sought to take control of the JV's revenues and, ultimately, the enterprise itself, by co-operating with officials to harass the Australian parent and its staff. Australian expatriates were arrested by the local people's committee for failing to have properly obtained visas and the firm was accused of attempting to import equipment without notifying customs and the local partner. Westralian Sands counter-argued the source of the dispute lay with its discovery that the government appointed general-director was covertly selling the mine's ilmenite output to a Japanese buyer in direct breach of the JV agreement (Baker, 1995; Cleary, 1995; Diaz, 1995; Schwarz, 1995; O'Flahertie, 1996).

Delineating the difference between Type II corruption and the activities of a government pursuing economic and social policies is difficult. In formulating legislation and policy, central governments must carry on a multiple level bargaining process not only with pressure groups but also with lower levels of government, foreign governments and multilateral agencies. It is a 'game' complicated by incomplete and imperfect information as to the costs and benefits for the country, let alone the motivations of those involved. Distortions to the property rights of the foreign firm may be based on ideological grounds, resulting in a form of transfer of the private rights of the MNE to public ownership. In Vietnam, foreign companies are charged a premium relative to domestic firms for basic utility services, such as water, electricity and telecommunications, as well as for housing, advertising and wages for local labour.<sup>8</sup> Commenting on the US firm, 3M, *The Economist* (2000: 65) reported the "paper that 3M imports to make Post-It Notes faces an arbitrarily high tariff as 'office' products (40% duty) rather than 'adhesive-backed paper' (10%). This makes it more expensive than the same Post-It Notes which smugglers bring in from Thailand."

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<sup>7</sup>The word "paid" is employed in its most general sense, such that the bribe may have taken forms other than monetary payment.

<sup>8</sup>The Ministry for Planning and Investment, which oversees foreign investment, reported that electricity charges for foreign firms were 25 percent higher in Vietnam than in regional countries, while postal and telecommunications charges were four to five times higher (Ha Thang, 2000: online).

Equally, ideological opposition may also function as a convenient screen for Type II(a) corruption, whereby the public official(s) accepts a bribe to ensure the transfer of private rights to a select interest group. The dispute between the large consumer-goods multinational Proctor and Gamble (P&G) and its local partner, a subsidiary of the Industry Ministry's Vietnam Chemicals Corporation, is illustrative. The dispute was triggered by P&G's desire to increase its licensed investment, thereby enabling it to stem losses and regain profitability. Hampered by a lack of cash, the local partner could not increase its equity share in the JV but rejected P&G's counter-offer to takeover full ownership. Within a climate of strong attacks on consumer goods MNEs for alleged unfair marketing tactics, the Central Bank of Vietnam ordered a freeze on the JV's loans, forcing P&G to default on its borrowings. One interpretation of the reported events is that P&G fell victim to Type II(a) corruption, where the local partner sought to free-ride on the competitive advantages of P&G and "paid-off" officials in several government agencies to ensure access to P&G's rent stream on its transferred competitive advantages.

Disentangling the source of difficulties for MNEs and determining whether a firm has fallen victim to corruption or a legitimate exercise of state power is obscured by Vietnam's long-run history of animosity to outsiders, the state's ideological commitment to maintaining the economic pre-eminence of the state-owned sector and the sheer scale of transformation being undertaken by Vietnam.

#### **4.2. *Corruption and state policy***

While economic necessity forced the adoption of the *doi moi* reform program, the embrace was an unwilling one resisted by many state organisations. Overlaying Vietnam's re-opening to foreign firms is a political ideology and rhetoric of xenophobia and officially sanctioned differential treatment of foreign firms relative to domestic enterprise. Nationalism and resistance to foreign interests are hallmarks of the Communist Party of Vietnam (CPV), embedded in an historical tradition of hostility to outsiders ([Chapuis, 1995](#); [Keyes, 1995](#); [Pelley, 1995](#); [Jamieson, 1993](#); [Post, 1989](#); [Marr, 1971](#); [Chesneaux, 1954 \(1966\)](#)). Pre-unification, the communist Democratic Republic of Vietnam published a raft of historical Vietnamese language works, which Pelley (1995: 233) argued comprised a "new history" purposively aimed at cultivating among "the Vietnamese an understanding of the national past that revolved around the central thematic of resistance to foreign aggression".<sup>9</sup>

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<sup>9</sup>In 1954, an internationally brokered cease-fire agreement between the French and the communist Viet-Minh revolutionary force, cleaved the former French colonies in Indochina into the communist Democratic Republic of Vietnam to the north and the increasingly US backed State of Viet-Nam to the south.

A language of “resistance to foreign interests” continues to characterise government and CPV statements in the *doi moi* era, epitomised by the official “campaign against foreign evils” launched in December 1995.<sup>10</sup> During the “campaign”, the advertising billboards and brand names of foreign firms were targeted by decrees seeking the elimination of non-Vietnamese language signs and advertising boards.<sup>11</sup> Simultaneously, senior party and government figures fuelled the atmosphere of animosity with inflammatory pronouncements. For example, in a June 1996 speech, a vice-minister of interior and soon to be member of the Politburo, Le Minh Huong, declared: “Hostile forces are trying to carry out peaceful evolution, and make ill use of loopholes in our management and conditions . . . to plant their people deeper into our internal organs” (as quoted in Schwarz, 1996a: 14; omission in original).

The campaign underlines the inherent contradiction within Vietnam’s reform process: the simmering tension between a nation seeking foreign aid and technology, while clinging to a rhetoric of independence, self-reliance and freedom from foreign firms. Reporting on the most recent attempts to pass foreign investment legislation amendments through the National Assembly, Ha Thang (2000:1) noted “unclear perceptions of the role of foreign investment in the economy by many delegates”, while the Minister for Planning and Investment conceded some “foreign-invested companies have purposefully made losses in order to drive out their local partners . . . [and] criticised some executives employed by foreign-backed firms for being irresponsible and not active enough in protecting Vietnamese rights in businesses” (Duong, 2000:1).

The unease and hostility towards foreign interests is embedded in a social and political system unaccustomed and ill-adapted to private ownership. Vietnam has not embraced unfettered market capitalism and the government remains committed to maintaining the leading role of state owned enterprises (SOEs) in the economy. The 1992 Constitution and the last Party Congress, in June 1996, reaffirmed the pre-eminent position of SOEs. A cobweb of regulations and financial market distortions slant the playing field in favour of SOEs. Preferential clauses in the Land Law allow SOEs, but not private firms, to use land as a capital contribution in joint ventures and as security for bank loans. State enterprises draw nearly 70 percent of the volume of credit available from the four state-owned banks, which collectively provide roughly 80 percent of the total credit available in the economy

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<sup>10</sup>The campaign was officially commenced by the signing into law of Decree 87/CP. Two years earlier, in 1993, party and state officials had been warned to limit their association with foreigners to business only and not to engage in social intercourse (Pike, 1994).

<sup>11</sup>The campaign created significant confusion, with the removal of advertising signs for foreign companies, such as Kodak, Pepsi and Heineken, occurring unevenly across the country.

(Le Dang Doanh, 1996: 18; Nguyen Manh Hung, 2000: 99). Largely excluded from formal credit markets, domestic private sector firms have been forced to rely on cash holdings or borrow from informal sources at interest rates as high as four to seven percent per month (Riedel, 1997: 64). By the end of the 1990s, private enterprises accounted for less than 10 percent of GDP, motivating the World Bank *et al.* (2000) to comment that “the climate for the private sector has been grudging rather than supportive. Here Vietnam differs markedly from China, where the private sector has been recognized openly as a key partner in the country’s development”.

The protracted development of private enterprise and supporting legislation fuels the scope for abuse of public office for private gain. The dismantlement of central planning has both magnified the ability of ministries and government agencies to resist the imposition of central will and devolved resource decision-making away from top state planners. Middle level cadres within the government and SOEs have become “the main actors in the process of law-making and law implementation in their areas” (Vasavakul, 1996: 47). The scope for administrative discretion is significant, given extensive gaps in the legal framework (Chi, 1996). Each piece of formal legislation is the product of very extensive and intensive consultations across ministries, such that enacted laws exhibit varying degrees of inconsistency. Correspondingly, legislation is subject to differing interpretations, applications and numerous clarifying documents.<sup>12</sup> The flexibility in legal interpretation and application fosters what the Australian Ambassador to Vietnam described as “a gap between top-level pronouncements and delivery down the line” (Boyd, 1995: 5). Similarly, the World Bank *et al.* (2000) elliptically noted the “need for institution-building that will gradually establish the rule of law as the basis of government-business relationships”.

Foreign firms entering such an environment encounter three very strong sets of incentives encouraging corruption. Firstly, public officials, particularly at the provincial and local levels, possess high degrees of autonomy and discretionary decision-making concerning the operations of MNEs. Secondly, official wages are very low, averaging about US\$25 per month (World Bank, 2000). Thirdly, foreign firms face an environment not only characterised by unease with private ownership, but also one in which they potentially represent the only competitors to powerful SOEs. The ideological commitment to SOE economic prominence is underpinned by the reluctance of individual ministries

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<sup>12</sup>The clarifying documents take a number of forms. Laws passed by the National Assembly are the highest form of legal instrument and when not in session, its Standing Committee can pass ordinances. Decrees, usually accompanied by more detailed regulations, are passed by the government to implement laws or ordinances. Individual ministries then issue circulars, as guidelines to how the ministry will administer a law, ordinance or decree.

to forego further resources and status beyond that already lost through the adoption of market based planning. In an institutional setting of extreme flux, officials within ministries and SOEs wield considerable power to distort the playing field for MNEs. The shock to the *status quo* is both ideological and pecuniary and invokes a compensatory response that exposes MNEs to high risk of Type II corruption, as well as 'legitimate' actions of government policy that induce highly discriminatory treatment of economic actors.

### **4.3. Consequences**

The recognition of corruption as a key constraint on Vietnam's economic performance has led to the introduction of a range of measures to achieve greater transparency and procedural clarity to administrative decision-making. Various decrees have sought to force all high ranking government employees and government officials to declare their property interests, bar family members of senior officials from positions in related enterprises, and prohibit officials receiving gifts from outside parties. Further administrative reforms have included designing procedures for filing complaints against officials and stronger penalties for corrupt officials. With respect to foreign firms, the scope for bribery has also been reduced through alterations to the number of permits and licenses required in addition to the initial investment licence, and clarification of the rights of state bodies to conduct inspections.

However, analysis of the surrounding environment for foreign firms in Vietnam presents an unsettling picture. As with all institutions, enforcement is critical to achieving changes in administrative practice. Yet, the highly evolutionary nature of the legal framework in Vietnam incorporates a lack of judicial expertise and judicial independence. Gillespie's (1993: 143) caution that "written laws and regulations can only be regarded as general guidelines, establishing the rough ambit of bureaucratic discretion" should resonate strongly against expectations of rapid change. Secondly, corruption is supported by an atmosphere of mistrust, which is at the very least tacitly approved by the highest levels of the state.

While it is possible that MNEs may treat Type I corruption as a *de facto* tax that is tolerated until it raises costs above comparable locations or significantly lowers the return on investment, Type II corruption cannot be considered a simple "cost of doing business". The loss of commercially confidential know-how or damage to brand reputations from un-prosecuted counterfeiting, for example, erode not just the profit line, but also the resources that form the basis of the firm's ability to compete. For Vietnam, the risk is that increasing evidence of Type II corruption, in particular, and an appearance of unease and discriminatory treatment towards foreign firms may drive out existing FDI, as well as repel potential new sources. Not only

does Vietnam require fresh sources of technology and capital accumulation to achieve its ambitious economic targets, it lacks the capacity to use facilities and workforces abandoned by exiting MNEs.

The ambiguity of Vietnam's transition also fuels corruption against local private enterprise, highlighting there are degrees of 'outsider' status. From a 1995–1997 survey of 259 privately owned manufacturing firms in Hanoi and Ho Chi Minh City, McMillan and Woodruff (1999) found that entrepreneurs could not rely on the courts for help, and that managers:

Maintained good relations with the local authorities, not only for help in obtaining licenses and permissions quickly, but also because the local authorities sometimes intervene in disputes in discretionary ways. One case (case #5) said he has good relations with the district People's Committee, and the committee would help him if someone tried to cheat him. Most managers, however, said they do not appeal to the authorities to help solve disputes. As one put it (case #9), the local authorities "just create problems for us rather than supporting us" (McMillan and Woodruff, 1999: 641.)

The climate of state 'sanctioned' discrimination against particular groups exerts many significant constraints on economic performance. Ambivalence not only directly feeds into 'official' discrimination that limits the capacity of local private enterprise to develop, but also implicitly supports corruption targeted against them. Foreign firms are both directly repelled by growing evidence of corruption and by the failure of the economy and the system of governance to transform sufficiently quickly.

## 5. Conclusion

A pressing question for Vietnam is what path the government and political system will take in the unfolding economic reforms. The *doi moi* reforms threaten the power and wealth of entrenched interests, as well as provide new and particularly lucrative avenues of rent-seeking to officials far down the governance hierarchy. In an institutional setting historically hostile to outsiders and undergoing significant change, Vietnam's property rights system is susceptible to corruption at all stages of state authority: in the definition of rights, the allocation to parties investing in the creation of know-how, intangible assets and physical goods, and in the enforcement of rights. By incorporating an explicit role for the 'rules of the game', the paper reveals the potential impact of these weaknesses on the incentives for foreign firms to operate in Vietnam. Such weaknesses also undermine incentives for private domestic enterprises to invest in capital formation and knowledge creation, further threatening economic growth prospects.

The changes expected of Vietnam are staggeringly complex and have been asked of few countries in such a short period of time. Undertaking an economic



transition from central planning to a system of market-based pricing is an extraordinarily complex process. The transition requires new laws on issues as diverse as bankruptcy, collateral for loans and intellectual property, as well as new skills within the judiciary and enforcement agencies to interpret and sanction breaches of rights. However, if private enterprise is to grow and assist the economy to absorb the million new participants in the workforce annually and raise the living standards of the approximately 37 percent of the population living in poverty, the transparency and reliability of the property rights system must be addressed (World Bank *et al.*, 2000:1).

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