OECD DEVELOPMENT CENTRE

Working Paper No. 140

(Formerly Technical Paper No. 140)

RURAL INDUSTRIAL DEVELOPMENT IN VIET NAM AND CHINA: A STUDY IN CONTRASTS

by

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Research programme on:
Reform and Growth of Large Developing Economies

OECD OCDE

September 1998
CD/DOC(98)10

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ACKNOWLEDGEMENTS

The author would like to thank Colm Foy, Kii Fukasaku, Maria Rosa Lunati, Nguyen Minh Tu, Nguyen Xuan Nguyen, Gary Smith and Paul Stott for their comments on an earlier draft.

RÉSUMÉ

Hormis leur poids démographique et le niveau de leur PIB, la Chine et le Viet Nam ont de nombreux points communs. Toutes deux sont des économies en transition d'un système socialiste à planification centralisée vers l'économie de marché. Toutes deux étaient des sociétés largement paysannes à l'aube des réformes dont l'un des premiers acquis importants a été la libération des forces productives de l'agriculture. De fait, l'amélioration rapide des niveaux de vie en milieu rural compte parmi les succès remarquables obtenus dans les deux pays.

S'agissant du développement industriel, les différences de résultats postérieurs aux réformes sont au contraire plus marquées que les similitudes. L'industrie a rapidement progressé dans les deux cas, beaucoup plus en moyenne que l'agriculture. Toutefois, le moteur de cette croissance diffère dans les deux pays. En Chine, ce sont les entreprises villageoises et rurales — à propriété d'abord collective puis, plus récemment, privée — qui ont tiré la croissance industrielle, les entreprises publiques restant pour leur part loin derrière. Au Viet Nam, la croissance a été comparable dans les entreprises privées et publiques, le secteur étatique conservant par conséquent sa prédominance en matière industrielle.

Le dynamisme du secteur public vietnamien est toutefois en partie une illusion statistique, car les coentreprises associant les entreprises publiques et les firmes étrangères sont généralement comptabilisées dans le secteur public. A l'inverse, de nombreuses entreprises villageoises chinoises conservent leurs liens traditionnels avec les administrations locales, faussant ainsi leur étiquette d'entreprises « privées ». Ces divergences dans le développement industriel de la Chine et du Viet Nam ne se résument pas toutefois à un simple problème de définition. Elles renvoient également à des différences de politique bien réelles, ainsi qu'à des situations de départ différentes. Si les deux pays ont conservé des réglementations défavorisant le secteur privé, la Chine a néanmoins adopté une stratégie de « croissance au-delà du plan » qui passe par la promotion d'entreprises non publiques. Cela n'est pas le cas au Viet Nam. En outre, pour des raisons historiques, l'environnement institutionnel chinois en milieu rural est beaucoup plus favorable que celui du Viet Nam à l'apparition d'entreprises capables de contourner les dernières restrictions imposées au secteur privé.

Le Viet Nam paie le coût de ses efforts pour conserver la suprématie des entreprises publiques. Il a dû leur consacrer une part substantielle d'une offre de crédit pourtant limitée, et ce faisant, s'est également privé du processus plus rapide de création d'emplois qui va de pair avec l'investissement du secteur privé. Les disparités de revenus entre urbains et ruraux semblent se creuser plus vite au Viet Nam qu'en Chine et l'expérience de cette dernière (corroborant celle d'autres pays) laisse penser que la création d'emplois non agricoles en milieu rural est un moyen efficace de compléter les revenus et d'améliorer leur régularité. C'est pourquoi, si les décideurs vietnamiens cherchent à accélérer le développement rural, ils doivent d'abord réaliser en quoi le cadre politique et institutionnel actuel a pu freiner la croissance industrielle en milieu rural. Il est possible de tirer de l'expérience chinoise des leçons utiles, même si la Chine doit désormais s'efforcer de clarifier les droits de propriété encore flous qui caractérisent toujours les entreprises rurales.

SUMMARY

Apart from size of population and GDP, China and Viet Nam have a good deal in common. Both are economies in transition from socialist central planning to the market. Both were largely agrarian societies on the eve of their reforms and, in both, unleashing the productive forces of agriculture was an important early reform result. Indeed, a rapid improvement in rural living standards is among the outstanding achievements of both countries.

In the case of industrial development, the differences in their post-reform experience are more striking than the similarities. In both countries, industry has grown rapidly since reforms, much more rapidly on average than agriculture. Yet, the motor force of industrial growth has been different in the two countries. In China, rural township and village enterprises (TVEs) — first collectively and more recently privately owned — have led industrial growth, with state enterprises lagging far behind. In Viet Nam, growth has been comparable in state and non-state enterprises, with the result that the former maintain their dominance of the industrial sector.

To some degree the dynamism of Viet Nam's state sector is a statistical fiction, since joint ventures between state enterprises and foreign companies are generally included in the state-owned enterprise (SOE) sector. On the other hand, many of China's TVEs have traditionally had links to local governments that makes the label "non-state" enterprises problematic. The differential industrial development experience of China and Viet Nam is not, however, purely a function of definitional *legerdemain*. There have also been real policy differences, and differences in initial conditions, that help to explain the difference in performance of their industrial sectors. While both countries have lingering policy biases against the private sector, China has embraced a strategy of "growing out of the plan" through the promotion of non-state enterprises. Viet Nam has done nothing comparable. Also, for historical reasons, China's rural institutional environment provided more fertile soil than Viet Nam's for the emergence of enterprises that could circumvent remaining restrictions on private enterprise.

The effort to maintain state enterprise dominance has been costly in Viet Nam. Not only has it consumed a significant share of a scarce credit supply, but in the process it has pre-empted the more rapid job creation associated with private sector investment. Rural-urban income disparities appear to be widening faster in Viet Nam than in China, and the experience of the latter as well as of other countries suggests that the creation of off-farm employment in rural areas is an effective way of boosting rural incomes (and providing greater income security). Thus, as they search for ways to accelerate rural development, policy makers in Viet Nam need to be aware of how the existing policy and institutional framework may have discouraged a more rapid rural industry growth. China may have some useful lessons to offer in this regard, though China too now faces the challenge of clarifying the vague property rights that until now have characterised the TVE sector.

PREFACE

Using post-reform, real per capita GDP growth as the measure, China and Viet Nam are indisputably two of the most successful economies in transition. The transition in China has been studied widely, but there is also a growing body of literature on Viet Nam's transition. Nonetheless, to date, few comparative studies of transition in the two countries have been carried out despite the interesting comparisons to be made — e.g. with respect to macroeconomic policy and state enterprise reform.

This study focuses on one particular puzzle noted by a number of analysts: why has post-reform Viet Nam not witnessed a phenomenon resembling the Chinese boom of rural township and village enterprises? This research was motivated by the underlying policy concern of widening rural-urban income disparities in Viet Nam and the recognition that rapid rural non-farm employment growth in China has helped to hold such disparities in check.

The author argues that although history played a role in creating different initial conditions in the two countries (e.g. in China, higher rates of institutional savings and a more diversified pre-reform rural economy), reform-era policies are a more important explanation for the divergent rural development paths of the two countries. A political commitment to state-led industrial development appears to have remained stronger over a longer period in Viet Nam than in China, with the result that state industry has continued to consume a large share of the economy's scarce capital.

Gradually, the situation is changing. Despite remaining obstacles, notably its limited access to bank credit, private industry is growing rapidly in Viet Nam, as in China. In the process, private industry is creating more jobs per unit of investment than the state sector. Ultimately, the need to provide productive jobs in Viet Nam for a rapidly expanding rural labour force is likely to tip the balance toward giving freer rein to private industrial enterprise than has been the case until now. That this is also an effective formula for redressing the rural-urban income imbalance should be another powerful argument in its favour.

This paper is part of the Development Centre's 1996-1998 programme of work on Reform and Growth of Large Developing Countries.

Jean Bonvin
President
Development Centre
September 1998

I. INTRODUCTION

In certain respects, the market transitions of China and Viet Nam have been similar. Both were still largely agricultural societies on the eve of reforms and, in both, agrarian reforms — a shift from collective to household production and from state procurement to market transactions — yielded dramatic productivity gains. With respect to industrial development, there were also some early similarities — e.g. allowing entry by non-state enterprises into once state-dominated sectors, and permitting state enterprises to sell a growing portion of their output at market prices. Subsequently, however, their industrial development paths have diverged markedly: *i)* in China the non-state industrial sector has grown much more rapidly than state industry, while in Viet Nam it has not; *ii)* in China, rural industry has blossomed in the two decades since reforms began in 1978, while in Viet Nam nothing comparable to China's "township and village enterprises" (TVEs) have emerged in the dozen years since *doi moi* (renovation) began[1]. What explains this divergence, and why does it matter?

This paper is largely devoted to answering the first part of the question, but first a few observations on the second part. Non-farm employment can provide two valuable benefits to rural households: income diversification and faster income growth than provided by agricultural activities alone. Rural-urban income gaps are widening in Viet Nam, a matter of some concern to the government. Short of large-scale rural-to-urban migration, growth of productive off-farm employment is the surest way of holding them in check.

The divergent industrial development experiences of China and Viet Nam can be explained by a combination of differences in their pre-reform institutional development and differences in reform-era policies (and the behavioural and institutional responses they set in motion). Of the two, the latter are probably the more important. In short, Viet Nam's post-reform policies have tended to be more strongly state- and urban-biased than China's. While neither government has established a level playing field for state and non-state business, Viet Nam's has more actively favoured state-owned enterprises (SOEs) over non-state enterprises and urban areas over rural areas.

China's pre-reform rural industrialisation drive created a group of enterprises — still nominally part of the "collective" economy — that, while often pre-reform loss makers, were able to exploit market opportunities opened up by reforms. The migration of educated cadres from urban to rural areas during the Cultural Revolution injected managerial skills into those enterprises and established links with urban markets. Their collective ownership and sponsorship by local governments enabled them to tap formal rural credit markets to finance diversification and expansion and, more generally, helped reduce the transaction costs of operating in an institutional framework still biased against private enterprise. Rural surpluses were bolstered by favourable post-reform movement of agriculture's terms-of-trade and the resultant increase in farmers' incomes. At the central level, government credit and tax policy also favoured rural township and village enterprises, with growth of this sector viewed as an antidote to the stagnation of the state enterprise sector.

Viet Nam's pre-reform situation was somewhat different from China's (lower initial savings rates, negligible agricultural surpluses, a heavier reliance on foreign aid), but perhaps more important has been the different post-reform experience. While reforms boosted Vietnamese rural incomes, farmers enjoyed a smaller and shorter-lived terms-of-trade improvement than in China. Continued state monopoly of agricultural input supplies and certain product markets has deprived farmers of a larger share of agricultural productivity gains. State credit allocations — the lion's share of all formal credit — have continued to favour state enterprises. Until recently, limited reach of — and lack of confidence in — formal rural credit institutions have made it difficult to mobilise rural savings for medium- to long-term investment. What off-farm investment has occurred has been largely by household enterprises with little access to formal credit channels. Relying on owners' savings, reinvested profits and small-scale informal sector borrowing, these enterprises generally remain small and undercapitalised. Unlike in China (with its commune- and brigade-run enterprises), on the eve of Viet Nam's reforms there were few existing rural enterprises that could capitalise on the new market opportunities.

The next section outlines the broad patterns of rural development pre- and post-reform, focusing on non-farm activities and more particularly on rural industry[2]. Section III then examines the major factors that have conditioned rural enterprise formation and growth in the two countries, notably trends in rural incomes and savings, rural factor markets (in particular credit markets), product market opportunities, and government tax and interest rate policies[3]. The final section summarises and discusses policy implications.

II. MARKET REFORMS AND RURAL ENTERPRISE DEVELOPMENT

China and Viet Nam were both predominantly agrarian societies on the eve of their reforms, with agriculture accounting for over 70 per cent of employment. They were also both planned economies, with agricultural labour organised into collective production units expected to meet centrally-dictated production targets, using state-provided credit and material inputs and selling output to state trading monopolies at fixed prices. To some degree, incentive problems created by the system of collectivised agriculture and state procurement had begun to be addressed earlier, but the major market reform initiatives are generally dated from 1978 in China and 1988 in Viet Nam[4]. The nature of rural reforms in the two countries was broadly similar, consisting of: *i)* restoring responsibility to households for agricultural production decisions, and allowing households to dispose of their surplus as they choose, and *ii)* moving towards competitive market price determination for farm inputs and outputs.

These reforms gave a strong boost to agricultural production and to productivity growth (see Table 1). In China, real agricultural GDP grew by 5.6 per cent a year in the decade following reforms before slowing slightly in the more recent period. Viet Nam experienced a slightly less dramatic growth spurt following reforms, but its agricultural growth has matched China's over the last eight years. In *per capita* terms, growth in China's food production has far outstripped Viet Nam's (partly because of considerably slower population growth). These production gains were reflected in rising rural income and consumption levels. Net *per capita* income in rural China rose by an extraordinary 20 per cent per year from 1978 to 1985, then slowed to 4.1 per cent per year, 1985-96. During the latter period, urban *per capita* incomes rose slightly faster, by 5.7 per cent per year (SSB, 1997). While data are not available for Viet Nam for the first few years following reforms, from 1991 to 1995 rural *per capita* income grew at the more modest rate of 2.7 per cent per year; meanwhile, urban *per capita* income rose by 8.8 per cent per year (World Bank, 1997*b*). The weaker growth of rural incomes in Viet Nam than in China is not principally a function of underperforming agriculture[5], as Table 1 makes clear, but rather a function of underperforming rural industry and other off-farm activities. The importance of non-farm employment to rural welfare in China is evident from the fact that, while peasant households' *per capita* income rose by 7.2 per cent per annum 1978-96, rural households as a whole enjoyed average annual *per capita* income growth of 10 per cent[6] (SSB, 1997). As Table 3.4 of World Bank (1997*a*) shows, there is a rather strong positive correlation between the expenditure decile of rural households and the off-farm share of their total income.

China and Viet Nam have both seen a widening of income disparities, including rural-urban disparities, during the reform period. In China, immediately after reforms, the rural-urban income gap narrowed quite sharply, with rural real *per capita* income climbing from around 43 per cent to 63 per cent of urban income (World Bank, 1997*a*). From the mid-1980s, however, the gap has widened rapidly, but in all likelihood it would have widened even faster were it not for strongly rising rural non-farm incomes. From 1985 to 1995, rural incomes declined relative to urban incomes by 15-20 per cent. While steep, this is not as steep as the decline in relative incomes in Viet Nam during the first half of the 1990s. From 1990 to 1994, rural *per capita* GDP fell from 25 per cent to only 18 per cent of urban *per capita* GDP, a decline of almost 30 per cent (World Bank, 1997*b*)[7].

While on the one hand market reforms weaken government's control over income distribution, on the other they can weaken control over population movements, thus allowing migration to moderate rural-urban income disparities. Historically, population mobility in China and Viet Nam was strictly controlled through urban household registration systems. From 1965 to 1978, the urban share of China's population was unchanged at 17.9 per cent; from 1965 to 1988 the urban share of Viet Nam's population rose only slightly, from 17.2 per cent to 19.9 per cent. Since reforms, rural-to-urban migration in China has greatly increased, with the urban share of population rising to 29.4 per cent in 1996[8] (SSB, 1997). In Viet Nam, by contrast, there has been very little change in the urban share of population since reforms: in 1995, it stood at only 20.5 per cent (GSO, 1996*b*). This is difficult to reconcile with the widening income gap, unless official or other barriers to population mobility are still binding (e.g. the limited development of the urban housing market). What is clear, however, is that with such low rural-to-urban migration and without significant rural off-farm job creation, rural-urban income disparities are likely to continue to widen.

Table 1. **Comparison of Agricultural Performance, Pre- and Post-Reform**
(per cent per annum)

	Change in per hectare rice yields		Increase in real agricultural GDP		Growth of per capita food production	
	China	Viet Nam[a]	China	Viet Nam	China[d]	Viet Nam[d]
1970-1978	2.0	-1.0	1.8[b]	…	1.5	1.1
1978-1988	2.9	3.4	5.6	2.7[c]	2.8	2.0
1988-1996	2.0	2.8	4.5	4.5	5.3	2.4

Notes: [a] Viet Nam: 1974/76-80, 1979/81-88, 1988-95.
[b] Refers to growth rate of real "National Income" in agriculture.
[c] 1984-88 only.
[d] 1971-79; 1979-88; 1988-96.
Sources: China: SSB,(1990, 1992, 1997); Viet Nam: FAO (1982, 1990, 1996), GSO (1996*a*).

Both countries have followed the classic pattern of structural transformation, wherein agriculture shrinks as a share of GDP and industry and services expand; the decline in agricultural employment lags the decline in GDP and the growth in industrial employment lags the growth in its GDP share (see Table 2). In China, the onset of reforms does not appear to have constituted a structural break; structural change has been more or less continuous from the beginning of reforms to the present, though the recent decline in the tertiary sector's share of GDP is perhaps unusual, reflecting the phenomenal growth of industrial output since 1990. In Viet Nam, data problems aside, the pattern of post-reform evolution seems to have been different. In the initial reform period — i.e. from 1985 to 1990 — the share of agriculture in employment actually rose slightly, reflecting the reabsorption into farming of laid-off state sector workers and demobilised soldiers as well as improved income prospects in that sector. What is most striking in the Vietnamese case is the rapid growth in the GDP share of services (the tertiary sector) in the immediate post-reform period; China's increase was also rather large. This reflects in part the response to pent-up demand for services, which are generally undersupplied in planned economies. With a lag, the employment share of services has also risen significantly in both countries, which one would expect as new entrants are attracted by the relatively high returns enjoyed by the early entrants into what is a highly labour-intensive sector. (This sector is heterogeneous, including — besides relatively well-paid jobs in organised services — a large number of often low-paid informal sector jobs.) Also, the rise in employment shares has been much steeper in services than in industry, which is a reflection of the generally slower productivity growth in the former than the latter (see Table 3).

It is clear from the last column of Table 2 that Viet Nam remains a far more agriculture-dependent economy than China. In terms of agriculture's employment share, Viet Nam in 1995 is where China was in 1985. Vietnamese industry's employment share, even by 1995, had not reached Chinese industry's employment share on the eve of reforms. Still, the growth of industrial employment in Viet Nam during the first half of the 1990s was a respectable 4.2 per cent per annum, i.e. only slightly less than China's industrial employment growth, 1985-92.

Table 4 provides a breakdown of the employed labour force in China and Viet Nam for rural areas as well as the national average[9]. It shows the greater weight of industry in rural employment in the former. It is noteworthy, however, that given the larger share of rural employment in total employment in Viet Nam than in China, *rural* industrial employment is actually a somewhat larger share of *total* industrial employment in the former than in the latter.

Table 2. **Sectoral Breakdown of GDP and Employment**
(per cent)

	1978		1985		1990		1995	
	GDP shares	Employment shares	GDP shares	Employment shares	GDP shares	Employment shares	GDP shares	Employment shares
China								
-Primary	28.1	70.5	22.6	68.7	19.0	52.0	12.4	52.2
-Secondary	48.2	17.4	49.4	18.3	52.0	20.9	61.5	23.0
-Tertiary	23.7	12.1	28.5	13.0	30.6	16.7	26.1	24.8
Viet Nam								
-Primary	…	…	51.4	72.9[a]	40.7	74.6	34.0	67.9
-Secondary	…	…	31.3	13.9[a]	22.5	12.1	27.7	12.7
-Tertiary	…	…	17.3	13.2[a]	36.9	13.3	38.3	19.5

Notes: [a] 1986 figures.
The shares are based on real values, i.e. adjusted for differential sectoral inflation. In the case of the 1985 GDP shares for Viet Nam, however, it was not possible to make this adjustment. Thus, the change in sectoral shares between 1985 and 1990 may be somewhat exaggerated if, for example, inflation in the tertiary sector was significantly higher than elsewhere.
Sources: China: SSB (1997); Viet Nam: World Bank (1992; 1997).

Table 3. **Growth in Sectoral Employment and Labour Productivity**
(per cent per annum)

	Agriculture		Industry		Services	
	Employment growth	Labour productivity growth	Employment growth	Labour productivity growth	Employment growth	Labour productivity growth
China						
1978-85	1.35	5.08	5.91	4.09	8.01	4.41
1985-92	3.04	0.93	4.55	6.48	6.50	3.02
1992-96	-2.42	7.29	3.27	12.33	8.37	0.67
Viet Nam						
1990-95	1.30	3.06	4.18	8.29	11.38	-2.10

Notes: Labour productivity growth: rate of growth of sectoral GDP per person employed in that sector.
Sources: SSB (1997), Tables 2-9 and 4-2; GSO data cited in World Bank (1997*b*), Tables 1.3 and 2.2.A.

Table 4. **Structure of the Employed Labour Force, 1996 (%)**

	Vietnam		China	
	National	Rural	National	Rural
Agriculture	69.8	81.6	50.5	71.2
Industry	10.6	6.8	23.5	14.0
Services	19.6	11.5	26.0	14.8

Note: In 1996, the *rural* employed labour force in China was 71 per cent of the national total; in Viet Nam, 81 per cent of the active population in that year was in rural areas.

Sources: Viet Nam: MOLISA (1997), *Status of Labour-Employment in Vietnam 1996*, Statistical Publishing House, Hanoi; China: State Statistical Bureau (1997), *China Statistical Yearbook 1997*, China Statistical Publishing House.

Rural Industry in the Pre- and Early Reform Period

Developments over the pre-reform decade (1968-78 in China, 1978-88 in Viet Nam) hold important clues to what impact reforms would have on these two economies. A major difference during this period was in the course of rural development.

Beginning in the 1960s, China pursued a rural industrialisation strategy designed to provide local sources of supply of producer goods to agriculture — promoting the “five small industries”: iron and steel, farm machinery, cement, fertiliser, and coal and hydroelectric power. While the construction of individual plants often occurred on an uneconomically small scale, by 1978 there were collective (commune- and brigade-run) industrial enterprises scattered through most provinces of China. Johansson and Ronnås (1995) note several conditions favourable to rural industrial development during the 1970s: *i) per capita* grain production had recovered to a reasonably comfortable level after the disaster of the Great Leap Forward; *ii)* labour immobility kept labour very cheap in the countryside; *iii)* the method of labour compensation (based on “work points”) constituted an effective means of forced saving; *iv)* greater autonomy of SOEs in disposing of their output outside the plan improved the input supply situation for rural enterprises; *v)* high administered prices of many state-produced industrial goods left much room for entry by competitors; and *vi)* the possibility to pool resources at the commune level facilitated risk-taking and larger investments needed to reap scale economies.

These rural enterprises were often managed by local Party secretaries like directors of communes and leaders of production brigades. Rural industry also developed in some other sectors (e.g. construction materials), though ironically not in agro-processing since the state procured agricultural materials to supply urban-based state-owned agro-processing enterprises. In 1978, then, there were almost 800 000 rural industrial enterprises in China (and a total of 1.5 million rural enterprises). Many of these commune and brigade enterprises (CBEs), particularly in the “five small industries”, were money losers (Wong and Mu, 1995), while others profited only because of effective local monopolies.

Following reforms, their numbers decreased somewhat, mostly through merger and consolidation. In the new environment, facing greater competition and a hardened budget constraint, the more nimble CBEs were quick to alter their output mix, taking advantage of new consumer goods market opportunities as well as new sources of input supply. For instance, with the end of the state agricultural procurement monopoly, local enterprises could now purchase agricultural raw materials on the open market for further processing. Those enterprises near urban centres frequently became subcontractors to large urban-based enterprises, offering the attraction of lower land and labour costs. Productivity in the CBEs increased substantially between 1978 and 1982, partly as a result of a shift to higher quality output and partly due to a shift towards labour compensation more closely tied to performance.

The significance of China's pre-reform rural industrialisation drive was not so much in its impact on the geographic distribution of industrial output (of total industrial output in 1978, only 9 per cent was produced in rural areas) as in its having created the organisational nuclei of what would be renamed in 1984 "township and village enterprises" (TVEs) — a major source of industrial output and employment growth over the past 20 years.

In Viet Nam, prior to *doi moi*, the state maintained an official trading monopoly on most goods. All state and collective enterprises, whether in agriculture or industry, were required to purchase inputs from and sell outputs to state trading companies. Still, already by the early 1980s, there was considerable "fence-breaking" in the sense of informal market transactions (Fforde and de Vylder, 1988). The government effectively sanctioned such activity in January 1981 with its adoption of the "Three Plans" system for industry. Plan A represented the traditional system, while under Plan B firms were allowed to produce their assigned output with inputs procured at market prices and sell that output at market prices. Under Plan C state firms could produce "minor products" unrelated to their original production assignments, most of which were sold on the market, with firms entitled to retain up to 90 per cent of profits generated (Naughton, 1996). It has been estimated that in 1986 only 30-40 per cent of the goods produced by the state consumer goods industries and collective handicraft enterprises, whose production expenses were subsidised by the state, passed through the state trading network (Porter, 1993).

The extra-plan activities of state and collective enterprises were more widespread in urban than in rural areas before the onset of reforms. Farm households were gradually accorded greater autonomy within the agricultural co-operatives, but the co-operatives themselves had little autonomy *vis-à-vis* the state. They continued to act principally as conduits for channelling agricultural surpluses to support industry, the government machinery, and the urban populace. Luu and Khuc (1995) note three main problems facing rural co-operatives in making the transition to diversified rural enterprises: generally negative perceptions of co-operatives on the part of farmers, limited knowledge of business management on part of co-operative executives[10], and a shortage of capital. Their inability to adapt to the changed environment following reforms accounts for their rapid demise throughout much of the countryside.

There was a certain amount of de-concentration of industrial development from urban centres, particularly in the northern half of the country, prior to 1975 (largely as part of the war effort). Post-unification, up to the eve of reforms, there was little further development of rural industry. Perhaps the major reason for this was the very limited size of the investible agricultural surplus (as production stagnated and food shortages emerged in the late 1970s). During 1977-79, Viet Nam's staples output *per capita* was only about 250 kg of paddy equivalent (Fforde and de Vylder, 1996)[11]. While weather was one cause, an important factor was very low grain procurement prices (less than 10 per cent of the market price), which not only discouraged production but also induced farmers to withhold supplies from the state trading monopolies, creating shortages in urban areas. While production began to recover with the reforms of the early 1980s, it was 1989 before Viet Nam enjoyed a sizeable exportable grain surplus (Fforde and de Vylder, 1996). From 1978, foreign assistance from Western countries also declined steeply. Thus, even if the government had wanted to encourage off-farm rural investment, it is not clear from where the investible surplus would have come. (From 1985 to 1989, national investment averaged under 10 per cent of GDP[12], compared with 29 per cent in China over the period 1973-77.)

Post-Reform Development of Rural Industry

China and Viet Nam remain transitional economies where an emerging private enterprise sector coexists with a sizeable state-owned sector that still enjoys certain privileges. In short, while much less tilted towards the state sector than it once was, the playing field is still not level. It is in access to credit that the most important biases remain. In effect, through the state-owned banking systems in the two countries, state-owned enterprises (SOEs) have continued to enjoy a less than binding budget constraint.

The decollectivisation of agriculture and the growth of the service sector have meant that, in both China and Viet Nam, state-controlled production activities have shrunk dramatically in relation to privately-organised production. In the industrial sector, however, the story is less clear-cut, and the experience of the two countries has been quite different. At the onset of reforms, state enterprises[13] dominated the industrial sector, even more so in China than in Viet Nam. In 1978, Chinese state-owned enterprises accounted for over three-fourths of industrial output, with the remainder coming from collective enterprises. In Viet Nam, in 1986, the state share of industrial output was over 60 per cent, with the rest divided between co-operatives and households[14]. In the former, the decline in the relative importance of state industrial production has been steep and swift. By 1993, state industrial production was overtaken by collective industry (mostly TVEs) and, by 1995, by private industry as well. In Viet Nam, by contrast, statistics show an increasing share of SOEs in industrial output, rising towards three-fourths (i.e. on a par with China's pre-reform SOE share) (see Figures 1a.[15] and 1b.). Why this divergent development? There are two main types of factor: *a)* differences in central government industrial strategy and policy, and *b)* differences in the institutional context and facilitating environment for non-state enterprise development at the local level.

Figure 1a. China: State/Non-State Shares of Output

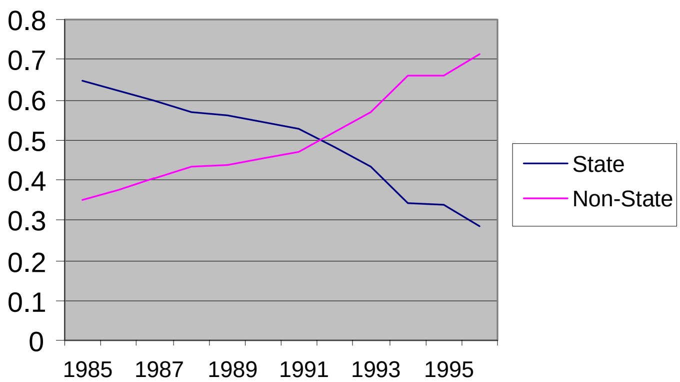
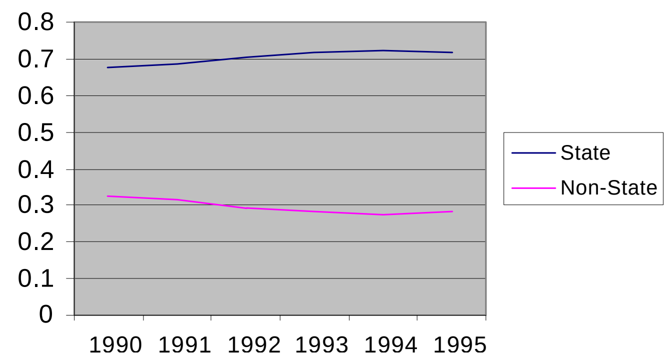


Figure 1b. Viet Nam: State/Non-State Shares of Industrial Output

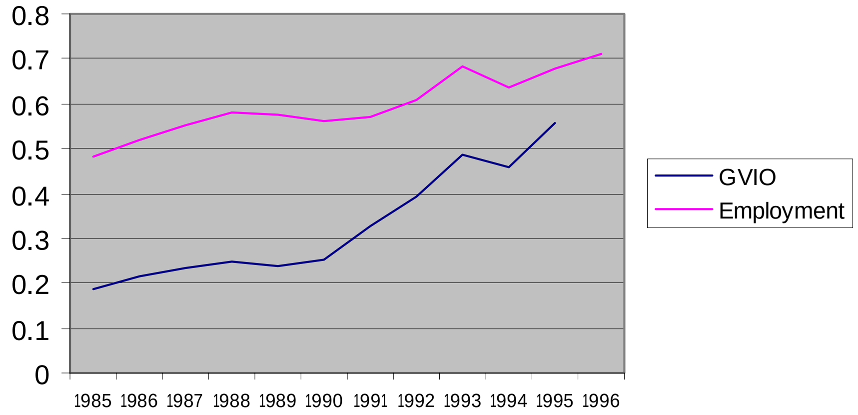


In China, the central government, saddled with a highly inefficient state-owned industrial sector, actively encouraged the growth of non-state enterprises. It was expected that a dynamic non-state sector would both provide healthy competition to state enterprises and facilitate the restructuring of the latter by absorbing redundant state workers. Naughton (1995) has characterised the Chinese strategy as "growing out of the plan". The collectively-owned TVEs were a key element of the strategy. Economically speaking, they provided an organisational form conducive to mobilising local savings and pooling risk[16]; politically speaking, their ownership could be reconciled with official ideology ("socialist market economy with Chinese characteristics"). Their close links to local governments gave them advantages not enjoyed by private enterprises, such as access to credit from state-owned rural financial institutions, though their budget constraint was harder than that facing SOEs. This has been apparent during periods of credit stringency, when state enterprises received preferential access to a diminished credit supply while collective units like TVEs faced a severe credit squeeze, causing numerous bankruptcies. For instance, between 1988 and 1990, the number of TVEs declined by almost 400 000; between 1994 and 1995, it declined by almost 3 million (over 10 per cent). One reason for the vulnerability of the TVEs to successive credit squeezes is that, in the mid-1980s, when credit to rural enterprises became very cheap, their debt reliance rose steeply, with the ratio of loans to total capital stock increasing from 8 per cent in 1978 to 27 per cent by 1986 (Peng, 1994).

While facilitated by central government policies, the growth of rural non-farm enterprise in China was largely a spontaneous, grassroots response to the new market opportunities opened up by reforms[17]. As rural reforms took hold in 1981-82, the commune structure within which the rural enterprises were embedded began to unravel (not unlike in Viet Nam); most communes were abolished during 1983-84. Their functions, however, were divided between townships that assumed responsibility for government operations and local economic committees (under village or township auspices) that took over economic management. While the latter were still government bodies, Naughton (1995) argues that they enjoyed more autonomy than the old communes. In part this was because decentralising fiscal reforms gave greater decision-making responsibility to local governments that also retained a larger share of the income generated by enterprises under their control (Peng, 1994).

Between 1985 and 1996, the number of Chinese TVEs has roughly doubled, to over 23 million, with the number of industrial TVEs growing from 4.9 million to 7.6 million (of which some 1.5 million are TVCEs operated by township and village governments). The labour force employed by TVEs has also roughly doubled over this period to 135 million people (about 10 per cent more than in state-owned units), 79 million of whom were employed in industry (SSB, 1997). Thus, TVE employment (in all sectors) rose from 19 to 28 per cent of rural employment and TVE industrial employment rose from under half to over two-thirds of economy-wide industrial employment (see Figure 2). Over the same period, the TVE contribution to gross industrial output rose even more steeply, from under 20 per cent to 55 per cent. Perhaps most significantly for the rural population, as of 1995, the value added of non-agricultural TVEs was 20 per cent larger than agricultural GDP, and the value added of industrial TVEs alone was 90 per cent of agricultural GDP.

Figure 2. **China: TVE Share of Industrial Output and Employment**



Note: GVIO: gross value of industrial output.
Industrial employment is defined as the sum of employment in mining and quarrying, manufacturing, electricity, gas and water, and geological prospecting and water conservancy (the last being negligible).

Source: SSB, (1996; 1997).

In contrast to China, even under *doi moi* the Vietnamese government has continued to adhere to a policy of state-led industrial development. A sympathetic interpretation would be that the government initially had limited options since, in the absence of the organisational equivalent of China's CBEs, state-owned enterprises were the only ones in a position to supply many industrial goods. To the extent that the policy bias persists, however, this rationale becomes a self-fulfilling prophecy.

At the local level, the two types of industrial organisation in Viet Nam that most closely resemble China's TVEs are locally-owned SOEs and industrial co-operatives. In the mid-1980s, with "fence-breaking" becoming more widespread, local SOEs proliferated, but most were small and undercapitalised. At first still enjoying access to subsidised inputs (mostly in the form of aid from the eastern bloc), they profited from selling a sizeable share of their output on the free market[18]. With the austerity measures taken to control inflation, including the curtailment of state subsidies and of credit for working capital, profits were squeezed and many went bankrupt. Their numbers were drastically reduced: in the first few years of *doi moi*, the total number of SOEs was halved, from 12 000 to roughly 6 000, with local SOEs accounting for most of the decline[19]. In the industrial sector, in 1986 there were some 2 500 local SOEs; by 1995 their number had been reduced to 1 400 enterprises contributing 23 per cent of industrial output. While — following an initial production decline — local industrial SOE output has grown during the 1990s, it has lagged the overall industrial average and significantly lagged that of centrally-owned SOEs.

Viet Nam also had a co-operative industry sector on the eve of reform. Indeed, co-operatives were the main non-state institutions in the industrial field. Like SOEs, they were closely integrated into the planning system, producing to state order and trading at fixed state prices. In 1989, the co-operative sector was cut loose from state subsidies and ceased to enjoy preferential interest rates (McCarty, 1993). Thus, these enterprises faced financial difficulties even worse than those of local SOEs and many went bankrupt[20]. In some instances, individual members purchased assets and formed household enterprises; in others, co-operative members voted to corporatise and issue shares. From 37 650 in 1986, the number of industrial co-operatives fell to only 8 830 by 1991 and 1 650 by 1994, by which time they accounted for less than one per cent of industrial output.

Since reforms began, the number of private industrial enterprises in Viet Nam has grown very rapidly. For example, from 1987 to 1994 the number of sole proprietorships and shareholding companies grew tenfold to reach 4 900, and in the latter year there were almost half a million household enterprises. Still, their combined contribution to industrial output (including the remaining co-operatives) was only slightly more than one-fifth. This despite the fact that, in the latter year, non-state enterprises accounted for almost 80 per cent of industrial employment. This suggests that, compared to SOEs, private industrial enterprises have very small average revenues per enterprise and per worker employed.

Table 5 shows the evolution of industrial output by ownership type. Four features stand out: *i)* the large size of the state sector relative to the non-state sector (3.5 times larger in 1995); *ii)* the strong output growth of centrally-owned SOEs; *iii)* the large share of non-state industrial output accounted for by private household production; and *iv)* the very rapid growth of private companies' output, albeit from a small base. While the private company sector accounted for just one-fourth of non-state industrial output in 1995, its share was rising rapidly. This is a positive development in that these companies tend to be much larger than household enterprises and better able to compete with the state industrial sector. Their growth, however, is perhaps less dramatic than it seems, as it was accompanied by an equally steep decline in output of the co-operative sector, and it is possible that a sizeable portion of the private company growth represents a mere ownership change — i.e. privatisation of once co-operative enterprises[21].

One major reason for the strong growth of central SOE industrial output has been the expansion of Viet Nam's petroleum production. The fuels sector grew 10 percentage points faster than the rest of state industry from 1990 to 1995, increasing its share of state industrial output from 16 to 22 per cent. Another factor has been the widespread practice of foreign investors' entering into joint ventures with SOEs. The latter have provided two assets not readily obtainable from private partners — access to land and help in cutting through government red tape. Since, depending on equity shares, many such joint ventures count as SOEs in official statistics, they contribute much to registered SOE output growth[22]. Figures for 1995-6, showing the foreign-invested enterprise industrial output share separately, suggest that state-foreign joint ventures could account for almost a third of SOE output, and that share is rising (see Mallon, 1998, Table on p.6). Private domestic enterprises continue to face numerous obstacles that have retarded their growth, including restrictions on applying the value of land-use rights as equity to joint ventures and — perhaps most importantly — limited access to credit (discussed below). Thus, they have remained on average very small. While the state sector has grown principally through rising turnover per enterprise, the private sector has grown through a proliferation of small enterprises with little change in per enterprise turnover (see Table 6).

Table 5: **Viet Nam: Gross Industrial Output Value by Ownership (billion 1989 dong)**

	State-Owned Enterprises			Non-State Enterprises		
	Total	Central	Local	Total	*Of which:* Private Companies	Private Households
1990	14 011	6 438	7 573	4 525	137	3 120
1991	15 471	7 435	8 036	4 872	229	3 896
1992	18 117	9 155	8 962	5 338	513	4 310
1993	20 410	10 602	9 808	5 769	826	4 509
1994	23 170	12 090	11 080	6 418	1 192	4 971
1995	26 584	13 824	12 760	7 503	1 783	5 504
1996 (est.)	29 504	15 787	13 717	…	…	…
Avg. annual growth, 1990-1996	13.2%	16.1%	10.4%	10.6%[a]	67.2%[a]	12.0%[a]

Notes: [a] 1990-95 for non-state enterprises.
Sources: General Statistical Organisation data, reported in World Bank (1997*b*), Table 8.1; GSO (1996,1997).

Table 6a. **Viet Nam: Size of State and Non-State Industrial Enterprises**
Average Gross Output Value per Enterprise (million 1989 dong)

	All SOEs	Central SOEs	Local SOEs	All Non-State
1991	5 953	13 617	3 914	10.7
1992	7 988	17 048	5 177	14.2
1993	9 927	20 427	6 381	12.5
1994	11 608	22 941	7 543	12.9
1995	13 577	25 180	9 056	12.2

Sources: General Statistical Organisation (GSO) data, reported in World Bank (1997*b*), Table 8.1, and GSO, *Statistical Yearbook 1996*, *1995* and Statistical Publishing House, Hanoi, 1996 and 1997.

Table 6b. **Size of Domestic Enterprises by Ownership Type (as of Dec.1994)**

	Total Number	*% with size of capital (in millions of dong):*			
		less than 1 000	1 000 to 4 999	5 000 to 9 999	10 000 or more
State-owned	5 873	*27*	*39*	*13*	*21*
Central	1 940	*13*	*35*	*16*	*36*
Local	3 933	*34*	*41*	*12*	*14*
Non-state	17 143	*87*	*10*	*1*	*1*
Collective	1 867	*88*	*10*	*1*	*1*
Joint stock	118	*14*	*28*	*12*	*46*
Limited liability	4 242	*69*	*26*	*3*	*2*
Private	10 916	*95*	*4*	*…*	*…*

Note: As of 1994, the dong/dollar exchange rate was 10 962; so, one billion dong roughly equaled $90 000.
Source: *Economic Census of 1995,* reported in IID-STP (1998).

While data on rural *versus* urban non-state industrial output growth are not available, a rough calculation of “rural” industrial growth was made by subtracting from the national total the figures for the major cities/provinces (viz., Hanoi, Haiphong, Thua Thien — Hue, Quang Nam — Danang, and Ho Chi Minh City). From 1990 to 1995, rural industry (on this definition) grew at less than half the rate of urban industry — 7.7 per cent *versus* 15.3 per cent (based on GSO, 1997, Table 83).

One feature of rural industrial development in Viet Nam deserves special mention — the so-called "craft villages" of the Red River Delta, which date back to before independence. The province of Ha Tay has one of the highest concentrations of such villages (some 73) but they are scattered throughout the delta[23]. While after independence the state tried to collectivise production in the handicraft industries, its efforts met with only limited success. State and co-operative enterprises contracted out work to family enterprises, a sizeable portion of whose production found its way onto the open market. Other households maintained total independence from state marketing networks (Luong, 1993). The post-reform demise of the *de jure* state trading monopoly and the collapse of many state-sponsored co-operatives has led to a resurgence of traditional craft production and exchange networks. In quite a few cases (as suggested above), private enterprises have risen from the ashes of the failed co-operatives[24].

Ownership and Control of Rural Non-Farm Enterprises

The collectively-owned township and village enterprises of China represent a transitional ownership form that has proved well-adapted to overcoming some of the constraints faced by non-state enterprises in the context of incomplete market reforms and underdeveloped rural capital markets. Those initial strengths, however, could eventually prove to be weaknesses.

Weitzman and Xu (1993) describe the TVCEs as "vaguely-defined co-operatives". While nominally TVCEs are owned by the entire community, these "collective owners" do not typically have clearly defined shares, even when workers are expected to invest in a TVCE as a condition for employment. This leaves local governments, as putative representatives of the owners, free to make decisions that shareholders would normally make, e.g. about the disposal of enterprise profits. The principal advantage of TVCEs over rural private enterprises would appear to be their easier access to formal credit markets for financing investment, while their principal advantage *vis-à-vis* state-owned enterprises lies in their being subjected to greater market discipline (i.e. a harder budget constraint). Their peculiar ownership structure may, however, create certain incentive incompatibilities. Since TVE profits provide a sizeable portion of the financing of the local government operating and capital budgets, there can be a trade-off between reinvestment in the individual enterprise and public finance objectives[25]. The decoupling of government administration from local business enterprises has long been a goal of market reforms, and this is reflected in recent experimentation with transforming these enterprises into shareholding companies that could then concentrate on maximising shareholder value, paying taxes like other companies to contribute to the provision of local public goods.

One might legitimately ask whether Viet Nam is not better off for having by-passed this transitional ownership form. Would it not be preferable to concentrate on promoting private ownership with clearly defined and recognised private property rights? In theory, yes, but the fact is that the Vietnamese economy exhibits some of the same transitional features as China's economy, which have discriminated against the development of private enterprise and created an organisational niche which, in China's case, has been filled by the TVCEs. Of course, it would be better to eliminate the niche by eliminating remaining discriminatory policies and practices disadvantaging private enterprise. In the meantime, however, the absence of an organisational form like TVCEs in Viet Nam has left a rather wide gap in its industrial structure between large SOEs on one side and tiny household industries on the other, with only a small (but growing) number of medium-sized non-state enterprises in between. Without the competition posed by such enterprises, state enterprises are likely to face only weak pressure to adapt and make themselves more efficient (though imports — whether legal or smuggled — exercise additional market discipline).

Recent Vietnamese experiments in "equitisation" of state-owned enterprises have some of the features of the TVCE phenomenon in China, though so far on a very small scale. One example in Haiphong[26] involves a private detergent and consumer products manufacturer spun off from a local state-owned paint company. The latter has a minority equity stake in the former, and the ongoing relationship has given the private company access to office space and cheap credit, as well as assistance in dealing with the government bureaucracy. In the six years since the government's equitisation programme began, only 18 SOEs have sold shares to workers or outsiders. With evidence of superior profitability of several equitised enterprises (see World Bank, 1997*b*, Table 3.2), more SOE managers may become sympathetic to this approach. (As — contrary to expectations of job losses — employment has actually increased in many enterprises following equitisation, SOE workers may likewise become more sympathetic; this is apt to be especially true where workers stand to benefit as shareholders of the equitised firms.)

III. FACTORS SHAPING RURAL ENTERPRISE DEVELOPMENT

In a predominantly agricultural society, rural non-farm enterprise development depends in the first instance on the generation by agriculture of an investible surplus and the retention of a significant portion of that surplus in rural areas. At low levels of development, a rising agricultural surplus may well be used for investment in on-farm technical improvements and crop diversification. Also, initially, rising rural incomes and savings may be channelled into construction, as families invest in better quality housing. In time, a growing share of investment tends to go to non-farm activities. Rural credit institutions perform the crucial intermediary function of pooling individual rural household savings and allocating them to high-return investments, whether in agriculture or in rural non-farm enterprises.

If credit markets are sufficiently integrated across regions, local investments need not be constrained by local savings. Where this is not the case however, i.e. where credit markets are fragmented geographically, the local supply of investible funds depends heavily on local savings, hence on local incomes. Where product markets are also segmented geographically (e.g. because of poor infrastructure and high transport costs), profitable investment opportunities also depend to a significant degree on local income levels and growth rates. One would therefore expect rural non-farm enterprise development to be more advanced in more prosperous rural areas, and indeed the evidence presented below supports this.

In the specific circumstances of transition encountered in China and Viet Nam, i.e. where underdeveloped infrastructure slows the emergence of a national market, rural non-farm enterprises may be able to take advantage of a temporary local monopoly in certain new markets created by rising incomes, notably for consumer goods, or to compete for a share of the profits hitherto monopolised by state-owned enterprises, e.g. in agricultural processing or certain producer goods. The existence of such profit opportunities is itself a stimulus to new entry and intensified competition.

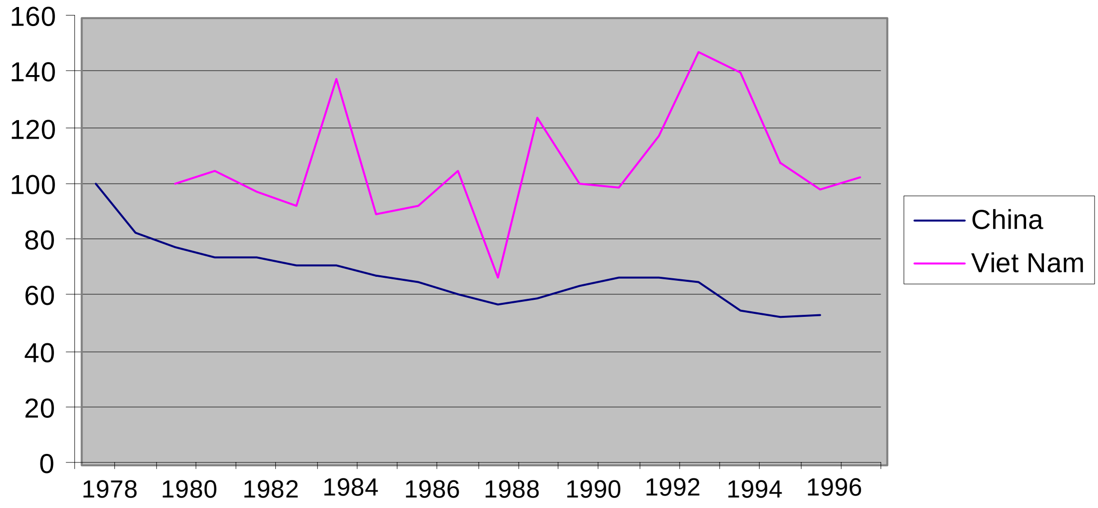
Government tax policies can also have an impact, positive or negative, on rural non-farm enterprise development, though in practice they have probably been of lesser importance than credit access and market conditions.

Rural Incomes and Savings

China's and Viet Nam's rural areas were both very poor on the eve of reforms. In 1978, Chinese rural household incomes were roughly equivalent to $110 *per capita* (at the official exchange rate[27]). In Viet Nam, as of 1992/93, average *per capita* rural income was around $85 (also at the official exchange rate), so at the inception of reform (*circa*, 1988) it must have been somewhat less. Rural household savings in China in 1978 were roughly 13.2 per cent of net income. In Viet Nam, in 1992/93, they averaged 18.5 per cent of household income; once again, they were probably somewhat lower on the eve of reforms.

While productivity improvements are largely responsible for increasing the size of the investible agricultural surplus, where credit markets are localised, then movements in agriculture's terms-of-trade are the main determinant of how much of that surplus is retained in rural areas. Rural reforms in both countries — by freeing grain and other agricultural markets from price controls — provided an initial boost to agriculture's terms-of-trade (see Figure 3). In China, for example, by 1984 the rural retail price of industrial goods had fallen by 30 per cent from its 1978 level relative to the purchase price of farm products. The improvement in Chinese agriculture's terms-of-trade resulted in a sizeable resource transfer from state industry to rural areas for rural industrial capital formation. This contributed to a rapid rise in rural savings. Between 1978 and 1985, the amount of rural household savings held in financial institutions increased ten-fold to reach $20 billion equivalent (though still under $25 per rural inhabitant).

Figure 3. Agricultural Terms of Trade



Note: China: Ratio of rural retail price of industrial products to purchase price of farm products (1978 = 100); Viet Nam: *1st series* (1980 = 100): Ratio of free market retail price of "other consumer goods" to that of "foodgrain and foodstuff"; *2nd series* (January 1990 = 100): Ratio (for January of each year) of price of manufactures to price of agricultural products.

N.B. The joining of the two separate indices for Viet Nam is not a serious problem, as the 1990 value for the first index is roughly 99 (i.e. almost identical to the base-year value of 100 for the second index.

Sources: China: SSB, 1997, Table 8-2; Viet Nam: World Bank, 1993, Table 6.1; 1995; 1997.

In Viet Nam, movements in agriculture's terms of trade have been far more erratic than China's. The data for the 1980s also shows no trend improvement in agriculture's terms of trade (consistent with Fforde and de Vylder, 1996). By 1996, the price of agricultural products relative to manufactures was virtually identical to the relative price at the beginning of reforms (Figure 3). While since the second half of 1994 there has been a marked increase in the price of food relative to manufactures, this is largely a function of increased processed food prices not farm-gate prices.

Government rice policy explains a good part of the agricultural terms-of-trade story. Rice exports have until very recently been a state monopoly[28] subject to quota restrictions. The persistent differentials between domestic and international rice prices suggest that the quota restrictions have been binding and the state trading companies have made windfall profits (much of those transferred to the government treasury[29]). In 1995, for example, the export unit value of Vietnamese rice was $269 per ton, while the wholesale price in the Mekong River Delta was $205 per ton (Goletti and Minot, 1997).

If Vietnamese farmers have seen less favourable terms-of-trade movements than their Chinese counterparts, they have enjoyed comparable productivity improvements (as discussed in Section I). In raising grain yields, Vietnamese farmers have done particularly well in recent years; in China yield improvements have slowed markedly since the mid-1980s. Beyond growth in traditional crop yields, both countries have seen diversification into livestock and into other crops. In Viet Nam, cash crop production (coffee, cashews, sugar) has grown especially rapidly[30]. Data are not available to trace the allocation of investment in rural areas of China and Viet Nam among traditional cropping improvements, agricultural diversification, and off-farm investments. It has been suggested, however, that the high profitability of China's rural industries, particularly in the early years following reforms, may have diverted investment away from agriculture, perhaps contributing to the slowing of productivity improvements.

If the market for investment capital is highly localised, then the amount of formal credit available depends on local financial intermediation and the level of local development (Peng, 1994). Cross-county regressions for China (Peng *et al.*, 1997) do show a strong positive relationship between local *per capita* agricultural output and *per capita* rural industrial capital. It seems likely that credit markets are also rather localised in Viet Nam, especially since compared with China a much smaller share of savings are intermediated through the banking system.

National savings and investment rates differed quite markedly between China and Viet Nam on the eve of reforms. In China, already in 1978, investment accounted for 38 per cent of GDP, and as less than one per cent of that was financed by foreign savings, national savings exceeded 35 per cent of GDP. In Viet Nam, by contrast, the level of national savings in 1985 has been estimated at only 5.6 per cent of GDP (Fforde and de Vylder, 1996). While the low level of monetisation of savings in Viet Nam makes accurate measurement difficult, even if the actual figure were double that, it is evident that the two countries embarked on reforms with widely differing investment potentials. Viet Nam's brisk economic growth (7.3 per cent per annum, 1987-96) would not have been possible if savings remained at that level. In fact, domestic savings rose rather steeply in the early 1990s, reflecting gains in both government and private savings. Between 1990 and 1993, national savings rate rose by 10 percentage points of GDP, to 17.4 per cent, where it has hovered since. A surge in foreign capital inflows after 1992 has lifted investment to 27 per cent of GDP[31] (high for Viet Nam's *per capita* income level but still 12 percentage points below China's investment rate).

Factor Intensities and Factor Markets

Labour-Intensive Industrial Development

In both China and Viet Nam, state-owned industrial enterprises tend to be far more capital-intensive than their non-state counterparts. This reflects a history of access to cheap capital, either as equity injections from the government or as subsidised loans from the state banking system. Also, average salaries (including benefits) of state enterprise workers tend to be relatively high, if not always in comparison with formal sector private wages in urban areas, then certainly in comparison with market rates in rural areas. As a result, a given size capital investment in the non-state sector creates many more jobs than the same size investment in the state sector. The ratio of labour to fixed capital in TVEs in China is some nine times that of state industry (Naughton, 1995). In Viet Nam, in 1992, the ratio of labour to fixed capital in private household industrial enterprises was ten times that in state industrial enterprises (ID-GSO, 1994). (While revenue per worker is also lower in the household sector, it is not proportionately lower[32]) Ronnås (1992) also finds that, within the non-state sector, rural enterprises are much less capital-intensive than urban ones; of those enterprises surveyed in 1991, the rural private enterprises were only about one-fourth as capital-intensive as the urban ones, while the difference in their labour productivity was much smaller — only about 5 per cent.

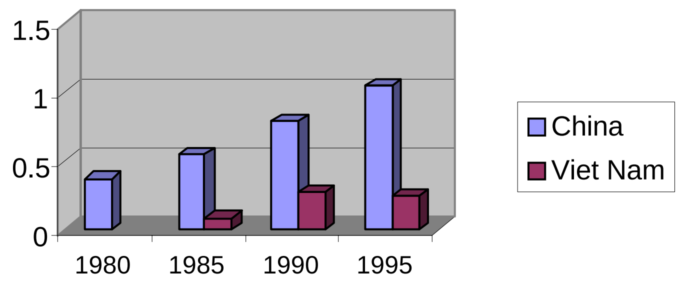
In a global context, both China and Viet Nam are labour-abundant and capital-scarce economies. An industrial growth pattern intensive in the use of capital, such as Viet Nam's SOE-oriented growth, is clearly incompatible with initial factor endowments. China's industrial development, which has been led since reforms by relatively labour-intensive TVEs, makes more efficient use of the country's scarce factor, capital[33]. A pattern of industrial development aligned to comparative advantage could be expected to yield a higher proportion of internationally competitive enterprises (see below).

Rural Credit Markets

There remains a wide gap between China and Viet Nam in the monetary depth of their economies, as reflected in the ratio of broad money (M2) to GDP[34] (Figure 4). The low level of financial intermediation in Viet Nam is indicated by the fact that roughly one-third of broad money in December 1996 consisted of currency outside banks (i.e. in circulation); in China, the comparable share was 12 per cent in 1996. In Viet Nam, while domestic credit expanded rapidly from 1992 to 1996, by the latter year it was only 21.4 per cent of GDP, compared with 90 per cent in China (1995).

Prior to reforms, neither China nor Viet Nam had well-developed rural credit institutions. With agricultural production integrated into the plan, investment funds were allocated from the state budget, and banks were little more than the disbursement arms of the finance ministry. While informal credit markets have long existed in rural areas, they have been used primarily for consumption and short-term working capital loans. The liberalisation of agriculture and the transfer of production decisions to households has stimulated the growth of rural credit markets. The degree of formalisation of rural credit has been rather different between China and Viet Nam. The use of land as collateral for borrowing has been complicated in both countries, but particularly in Viet Nam, by disputed claims to land use rights in the wake of rapid de-collectivisation. Even where individuals have combined into joint liability groups, credit institutions often still impose a collateral requirement (e.g. members' houses or personal property) (World Bank, 1995).

Figure 4: Ratio of Liquidity (M2) to GDP



Sources: China: IMF, *International Financial Statistics Yearbook 1997*;
Viet Nam: World Bank (1993; 1997).

In China, the collectively-owned TVEs were able to secure formal credit where individual rural entrepreneurs could not. Naughton (1995) argues that the sponsorship of China's TVEs by local governments greatly enhanced their access to capital. Local government officials act as intermediaries and guarantors of banking sector loans to TVEs, in effect spreading the risks incurred by TVE start-ups across the entire local community who, as "nominal owners", are expected to absorb the costs of failure. As a result, new enterprises have been able to start up on a larger scale than otherwise (and than private enterprises), with a higher degree of mechanisation and more modern technology.

With implicit official guarantees, TVEs have been able to tap the large pool of household savings mobilised through the Rural Credit Co-operatives (RCCs[35]), which expanded dramatically during the 1980s. Following reforms, rural households rapidly emerged as the major depositors in the RCCs, with their share of total deposits rising from one-third in 1978 to two-thirds in 1983 and 82 per cent by 1992. The portion of the RCCs' loan portfolio going to collective agriculture declined steeply after 1978, while the share going to rural enterprises increased rapidly (from 27 per cent in 1978 to 37 per cent in 1983 and 60 per cent by 1992)[36]. The credit co-operatives emerged as the major source of financing for the TVCEs in particular; in 1991, for example, 39 per cent of TVCE investment in fixed assets came from bank loans (roughly two-thirds of that from RCCs), compared to 32 per cent from retained earnings (Peng, 1994). A survey of privately-owned TVEs found, in contrast, that the largest source of start-up capital was equity contributions from owners/staff (almost two-thirds of total start-up capital) (Peng, 1994). (These firms were also on average less than one-tenth the size of the TVCEs surveyed in terms of capital stock.)

In Viet Nam, the underdevelopment of formal rural credit markets has been a major hindrance to the mobilisation of capital for investment in rural non-farm enterprises. For a number of years there has been a severe credit shortage, even for investment in agriculture[37]. Low savings rates are at the root of the problem, but the limited intermediation of savings through financial institutions compounds it. The state sector has long had first claim on the short supply of credit at preferential interest rates. In 1991, for example, rural credit accounted for only 5 per cent of Agribank's loan portfolio, with the other 95 per cent destined for state enterprises. In 1992, the balance shifted quite dramatically, with the rural credit share rising to one-third. It is estimated, however, that only about 10-15 per cent goes to fixed capital investment, with the overwhelming share consisting of production-related working capital loans (World Bank, 1995).

Thus, unlike China's TVCEs, rural enterprises in Viet Nam make very little use of formal credit channels to finance their start-up or expansion. In a survey of roughly 500 rural non-state enterprises conducted in 1991 (Ronnås, 1992), 44 per cent mentioned lack of capital as a severe difficulty faced at the time of establishment[38]. Consistent with this is the high dependence of these enterprises on own capital at start-up. Over 80 per cent of the start-up capital for rural non-farm enterprises consisted of own-capital, with interest-free loans a distant second at 7.5 per cent and informal sector borrowing another 5.4 per cent. In the early years following reform, credit from the formal sector played an insignificant role as a source of capital, with fewer than 3 per cent of rural enterprises raising some money from banks or credit co-operatives in 1991. As of 1993, a nation-wide living standards survey (SPC-GSO, 1994) found that about 72 per cent of private rural borrowing consisted of loans from informal sources like relatives, friends, and moneylenders[39]. The capital shortage implies, first, a slow rate of growth of rural industry and, second, a low level of technology in those enterprises that do start up (Ronnås, 1992). Interestingly, a comparison of the 1991 and 1996 Ronnås survey results shows that, over the period, the percentage of urban enterprises identifying "shortage of capital" as the main constraint on their growth declined steeply, while the corresponding percentage of rural enterprises increased (Hemlin *et al.,* 1998). In sum, while new start-up businesses have proliferated, they have generally remained small, undercapitalised and dependent on informal capital markets.

Viet Nam's *informal* capital market is well-suited to current conditions where household enterprises predominate, depending as it does on personal knowledge of each debtor and strict individual liability. It is much less suitable for the credit needs of Viet Nam's emergent economic structure, with a growing number of joint-stock companies and other forms of modern business organisation (de Vylder, 1995).

During the latter part of the 1980s, the government of Viet Nam allowed hundreds of credit co-operatives to start up as an alternative to the state-owned banks. These co-operatives provided funding to private enterprises denied access to bank credit. In 1990, there were some 300 such co-operatives in operation controlling deposits of almost $100 million (Fforde and de Vylder, 1996). These institutions were poorly supervised, had no reserve requirements and operated in many instances like pyramid schemes, offering very high interest rates. The collapse of some co-operatives in Ho Chi Minh City in early 1990 caused a more general panic, and depositors rushed to withdraw their money, forcing many co-operatives and many small businesses into bankruptcy. Public confidence in the financial system was seriously shaken, and the share of savings held in financial institutions in Viet Nam remains low. A 1992/93 survey found that less than 10 per cent of household savings were held in the form of savings deposits or bonds, and another 10 per cent in local currency. The largest portion (44 per cent) was held as gold and the next largest as real assets (property — 20 per cent) (SPC-GSO, 1994).

In March 1994, the State Bank of Vietnam (SBV) launched an experiment in 78 districts of 14 provinces to establish People's Credit Funds (PCFs) as a way of filling the gap left by the failure of the rural credit co-operatives in the early 1990s. These are the only formal institutions in Viet Nam that mobilise substantial savings from rural households. As of October 1997, some 930 PCFs had been established in 51 out of 61 provinces, with roughly one-half million members and with loans outstanding of 1.3 trillion dong (roughly $107 million) — still a tiny fraction of total credit[40] (Nguyen, 1998). Whereas branches of Agribank and the rural shareholding banks only reach as far as the district, the PCFs are supposed to reach down to the lowest administrative level, the village[41]. Also, the PCFs offer a range of products to their depositors, and, together with the state insurance company (Baoviet), they offer a voluntary deposit insurance plan in an effort to provide depositors with some security.

Recently, the banking system in Viet Nam has been expanding the share of loans extended to non-state enterprises. This is partly a function of the entry of private local and foreign banks that, besides themselves providing a source of capital to private entrepreneurs, have induced state commercial banks to reallocate their portfolios[42]. Also, in rural areas, credit to farm households has been expanding. As a result, the non-state sector's share of total domestic credit increased steeply, from under 10 per cent in 1991 to just under half in 1996 (World Bank, 1997*b*). In rural areas, as of 1997, the non-state credit share stood at roughly three-quarters — but less than 10 per cent of all rural credit went to industry (GSO, MPI data cited in Nguyen, 1998)[43].

Privately-owned rural enterprises in China have frequently faced credit constraints similar to their Vietnamese counterparts. To expand their scale of production, therefore, they have resorted in some instances to consolidation through the formation of joint-stock companies. Commonly, the owners of small workshops would purchase shares in the new company, in some cases with the local government as an additional partner. Workers in the new enterprises are also frequently expected to contribute capital in return for a share of profits (along the lines of traditional workers' co-operatives). Some enterprises have sold shares (or fixed dividend bonds) directly to the local public. Finally, in some of the coastal areas in particular, foreign capital has flowed into the rural enterprise sector, either through overseas remittances or through direct investment by overseas Chinese and others (Peng, 1994).

It seems doubtful that small rural enterprises (or urban ones for that matter) in Viet Nam have resorted to similar strategies to overcome credit constraints on their expansion, since there is presently no "shareholding culture" in the country[44]. The 1997 enterprise survey by Ronnås and associates[45] shows very rapid asset growth between 1991 and 1996 in the cohort of rural enterprises covered by both the earlier and the later surveys. What is striking about the survey results is that, for the sample as a whole, assets are virtually the only variable showing positive growth over the period[46]; the number of rural enterprises, employment, value added, and income all decline, suggesting that increasing investment was a key survival factor in the face of intensifying competition. By 1996, between 29 and 37 per cent of rural enterprises (depending on ownership type) interviewed in 1991 had gone out of business; on the other hand, between 20 and 30 per cent enjoyed value added growth of over 10 per cent per annum during the period (Ronnås, 1998).

The close relationship in China between local banks, local industry and local governments, while it has tended to promote rapid rural industry development, has its drawbacks. The first and most obvious is the moral hazard problem, whereby implicit local government guarantees of bank loans encourage excessive risk exposure. Compounding the problem is the power local governments may exercise over banks to direct lending to favoured enterprises. Also, local authorities have an incentive to expand local lending insofar as it accelerates local development, without full consideration of the macroeconomic effects of all localities' pursuit of similar credit expansion. In effect, the costs in terms of excess demand and higher inflation are not fully internalised by local decision makers since they spill over to other localities (Naughton, 1995). This has been a factor in the "stop-go" cycle that has marked Chinese growth, indicating the need for continued central direction of credit policies.

Land Markets and Land-Use Restrictions

Land is valuable not only as a direct productive input but also as a mortgageable asset providing access to formal bank credit. Access to land *per se* does not appear to pose a serious constraint on rural enterprise development in Viet Nam. Hemlin *et al.* (1998) find that for only a very small percentage of rural enterprises is "inadequate premises/ space" identified as the main constraint on growth. A more serious problem is that the illiquid state of the land market (in part because of restrictions on transfers of land-use rights) makes banks reluctant to accept land as collateral, even though it is now permitted by law. Moreover, as Mallon (1998) points out, only SOEs are allowed to contribute their land-use rights as equity in joint ventures with foreign investors, handicapping private enterprises in attracting foreign joint venture partners.

Land availability does affect the development of rural industry at a more general level: the higher the ratio of agricultural land to the rural workforce, the less incentive there is for off-farm employment. Thus, one would expect that, all else equal, rural industrial growth would be slower in areas with lower population densities. Econometric estimates for Chinese provinces confirm this relationship, with employment and investment in rural industry significantly and negatively correlated with the ratio of farmland to rural labour force (Peng *et al.,* 1997).

Characteristics of Product Markets

Market Structure and Enterprise Profitability

Reforms in both countries have seen the share of output subject to state procurement at controlled prices drastically reduced. Not only do non-state producers transact business at market-determined prices, but a growing proportion of the output of the state sector is sold on the market.

Market prices are not necessarily competitive prices. During the transition, price distortions have only gradually diminished, partly because of continued subsidies to state enterprises (e.g. through the banking system), partly because of persistence of local or regional SOE monopolies, and partly because of continued trade-related distortions (tariffs and non-tariff barriers). Non-state enterprises in a position to contest domestic monopolies could potentially earn sizeable profits. To compete head-to-head with the SOEs, however, often required more capital than private entrepreneurs could raise. Hence, the advantage of the TVCEs in China with their ready access to bank credit.

Probably a more common market strategy of TVEs than direct competition with SOEs has been to exploit market niches that went unserved by SOEs or that have only recently appeared with rising prosperity. Here too there have been sizeable profit opportunities for early movers, though entering these markets generally requires less capital and — for this reason — they tend to become overcrowded more quickly.

In 1978, at the onset of reforms, the average rate of return on capital (depreciated fixed capital plus inventories) in Chinese rural enterprises was 32 per cent; inclusive of tax it was 40 per cent. Profitability declined rather steeply and steadily thereafter. By 1990, the after-tax profit rate was only around 6 per cent (and the pre-tax rate 13 per cent) (Naughton, 1995) as of 1996, TVE profit rates were virtually unchanged (SSB, 1997).

In Viet Nam, there is limited evidence on non-state industrial enterprise profitability. The Ronnås (1992) survey of rural enterprises finds that, between 1989 and 1990, the 252 enterprises reporting income data for both years experienced a decline in mean income of 46 per cent. The decline affected both large and small enterprises. Not too much significance can be attached to evidence for only two years, especially when the Vietnamese macroeconomy was still stabilising following a bout of hyperinflation and GDP growth was only moderate. Data for a longer period (reported in Ronnås, 1998) tell a similar story. Ronnås finds that, between 1991 and 1996, aggregate income of the cohort of rural enterprises covered by both the 1992 and 1997 surveys declined by 18 per cent (compared to a 6 per cent decline for urban enterprises). This figure includes those enterprises that went out of business, but does not capture the income earned by the many new rural enterprises that started up after 1991 (more than half of household rural enterprises and two-thirds of private rural enterprises covered by the 1997 survey). Thus, it gives a rather incomplete picture.

Indeed, the rather steep upward trend in new non-state industrial enterprise formation during the 1990s (with some year-to-year variation) suggests widespread profit opportunities. Between 1990 and 1995, the number of such enterprises (including private companies, household enterprises, and co-operatives) rose by almost 10 per cent per annum, reaching 610 000 in the latter year. A survey of rural non-farm enterprises finds that their profit on productive capital was around 20 per cent in 1996 (MARD, 1997). This figure is consistent with the 1996 profit rates reported in Hemlin, Ramamurty and Ronnås (1998) for Haiphong, Ho Chi Minh City and Ha Tay province, though the profit rate of surveyed enterprises in Hanoi was significantly lower. While it is unclear how closely these enterprises compete with SOEs, recent reports on the declining profitability of the latter (e.g. profit on capital declined from 19 per cent in 1995 to 11 per cent in 1996; EIU, 1998) suggest that such competition — as well as competition from imports — is intensifying. On the other hand, the tendency for government favoritism towards SOEs (plus the frequent existence of economies of scale) has led many small private entrepreneurs to avoid head-to-head competition in sectors where SOEs predominate[47].

Market Access

Access to inputs (including not only materials but also technology) and to output markets is an important influence on growth prospects of rural enterprises. This has favoured enterprises located in close proximity to major cities over more remote ones. The importance of geographic proximity is heightened by the poor state of rural transport infrastructure in both China and Viet Nam.

In the case of China, the advantages of location in or closeness to cities show up clearly in the data on industrial output. In 1987, areas under the administration of cities accounted for 91 per cent of state industrial production and 87 per cent of non-state industrial production. Much of China's rural industry is also concentrated in the fast-growing coastal provinces. In 1988, three coastal provinces — Jiangsu, Zhejiang, and Shandong — accounted for 17 per cent of China's rural population but 43 per cent of total rural industry and half of township and village industrial output. The growth of rural enterprises in the urban periphery has been facilitated by subcontracting and market relationships with urban-based enterprises. In the case of the three province-level municipalities — Beijing, Shanghai, and Tianjin — an estimated 60-80 per cent of rural industrial output was produced by firms subcontracting for urban factories (Naughton, 1995). Also, rural enterprises close to cities can draw on the urban skill pool: in a number of instances, rural enterprises have lured skilled technicians (active or retired) from urban areas with high salaries.

While domestic markets are the main outlets for rural enterprise production in both China and Viet Nam, in the former the TVEs — particularly those in the coastal provinces — have had notable success in penetrating export markets. As of 1995, approximately 9 per cent of total TVE output was exported, with the main exporting provinces being Jiangsu and Guangdong (*China Agriculture Yearbook 1996*). In the case of Viet Nam, a 1990 survey found that less than one per cent of sales of rural enterprises were export sales; by 1996 the export share had fallen to one-half of one per cent[48]. (For urban non-state enterprises the export shares were 3.5 per cent and 5.1 per cent respectively.)

In Viet Nam, Ronnås (1992) finds that about 43 per cent of rural manufacturing enterprises (excluding agro-processing) experienced some problem in securing adequate material input supplies, with these problems much more common in the north than in the south. While quantity problems appear to have diminished significantly since then, quality problems have become more serious (Hemlin *et al.,* 1998). Inadequate electricity and other energy supplies were also a serious constraint on rural enterprise development in the early 1990s. As of 1991, only one-third of the enterprises even made use of electricity and of those 42 per cent experienced problems of inadequate or unreliable supply. The power availability situation has improved in the meantime, and presumably the inflow of multilateral and bilateral development loans that began in the early 1990s should yield continued improvements not only in power supplies but in roads and other rural infrastructure.

Tax and Interest Rate Policies

As in other policy areas, the preferred approach with tax policy is one of non-discrimination either against or in favour of one particular group of enterprises (or other taxpayers), unless there is a convincing economic rationale. The intention here is not, however, to make an overall assessment of tax policy in these two countries, but merely to indicate how that policy may have impacted on the development of rural industry. For Viet Nam, interest rate policy is also briefly discussed, since in the past it has contributed to scarcity of term finance for enterprise development.

In China, the central government has encouraged a high rate of re-investment of enterprise earnings through preferential tax treatment. During the period from end-1978 until 1983, TVEs were especially favoured by a flat profit tax rate of 20 per cent, regardless of their profit levels. State enterprises, meanwhile, were subject to high taxes. The low TVE tax rate needs to be set against the fact that about 30-40 per cent of after-tax profit went to local governments to finance various community expenditures (so the effective tax rate was somewhat higher). After 1984, the many newly established private and co-operative firms in rural areas enjoyed the low taxes but without direct local government control over the allocation of their profits. These ownership types have grown especially rapidly in recent years, and they now make up roughly one-third of total rural industry.

In Viet Nam, taxation of non-state enterprises is not especially burdensome. Nominally, the profit tax system is not progressive, though the fact that many small household enterprises avoid paying taxes makes it so in practice. Ronnås (1992) finds that the mean income tax paid by rural enterprises is only marginally lower than in urban areas (4 per cent *versus* 4.2 per cent). Where rural enterprises do differ markedly from urban ones is in the proportion paying very low (less than 2 per cent) or no tax: in rural areas, those proportions are significantly higher.

More problematic in Viet Nam than official tax rates is the proliferation of fees and charges levied by local government officials, notably though not exclusively in rural areas. There are an estimated 30 or so fees and levies applied in many areas and these are occasionally topped up with *ad hoc* fees for financing specific projects (EIU, 1997). In some sense, these are analogous to the Chinese TVE profit share allocated for local expenditure on public goods provision, but the latter is codified and therefore can be factored into business planning more readily than the former.

The rather low level of financial intermediation in Viet Nam was noted above. This is partly explained by the government's past taxation policy towards the banking sector, partly by current interest rate policy, and partly by other factors like an inefficient payments system (World Bank, 1995*b*). Regarding taxation, until early 1996[49], bank operations were subject to turnover taxes ranging from 2 to 30 per cent, depending on the operation and type of bank. These additional intermediation costs translated into lower rates to savers and higher rates to borrowers.

Interest rate policy has also contributed to the scarcity of funds in Viet Nam for term financing. In the mid-1990s, the term structure of interest rates was such that the interest rate on medium-term loans was lower than the short-term rate (World Bank, 1996, Table 1.6). By end-1996, the situation was remedied as falling demand for short-term credit and falling inflation led to short-term rate cuts to below medium- and long-term rates (EIU, 1997-98).

IV. POLICY CONCLUSIONS

Broad similarities in initial conditions and reform strategies in China and Viet Nam mask some important differences that help explain their divergent experiences with rural industrial development. While China's rural industrial development has been more rapid than Viet Nam's, there is no presumption that the former followed a correct path while the latter did not. The main advantage of China's TVE boom has been the sustained improvements in rural household incomes that off-farm employment has made possible after the initial gains from agricultural liberalisation were largely exhausted. Considering the concern in Vietnamese policy making circles over a widening rural-urban income gap, it is sensible to ask whether there is anything to be learned from China's experience of rapid rural industrialisation.

The first lesson from the preceding analysis is that history matters. It is not determinative of policy options, but it is more difficult to work against the momentum created by prior institutional and organisational development than it is to work with it. China's prior history of rural industrialisation meant that there were organisations already on the ground in rural China prepared to seize the initiative once market freedoms were proffered. These institutions were transitional forms, adapted to surviving in an environment where purely private enterprise did not yet compete on a level playing field. Undoubtedly the collective TVEs benefited to some degree from remaining distortions in the transition to a market economy but, more to the point, they were a way for rural enterprises to develop outside the state sector in spite of those distortions.

Viet Nam embarked on reforms without the benefit of this rural organisational infrastructure. Perhaps also because of weak legitimacy of collective institutions in large parts of the country, transforming the remnants of the rural co-operatives into the nucleus of a rural industrial economy was problematic. On the other hand, in a number of instances, private entrepreneurs and joint-stock companies have taken over failed co-operatives, though their growth continues to be constrained by limited credit availability and restrictions on their access to foreign equity financing via joint ventures.

Post-reform policy differences also explain part of the divergence in development paths. Whereas central government policy in China strongly encouraged non-state (notably collective) enterprises as a way of gradually eclipsing the state-owned enterprises, Vietnamese policy makers have clung much longer to the hope of resuscitating the state enterprises as the leading industrial sector. This policy has come at a rather high price in terms of the deprivation of finance to non-state industry and the perpetuation of a more capital-intensive industrial structure than is appropriate to Viet Nam's labour-abundant economy.

Just as China's TVEs have not proved a panacea for the country's state-enterprise problem, and indeed have created new problems such as severe environmental degradation in rural areas, so too Viet Nam's path of industrial development under *doi moi* has not been totally ineffectual. Industrial output has grown vigorously during the 1990s, and Viet Nam has been quite effective (as has China) in attracting foreign direct investment into industry. Still, much remains to be done to ensure that domestic private entrepreneurs can play the dynamic role in industrial development that they do in the rest of the region and to ensure that the countryside is not left behind by an urban-biased pattern of development.

A few of the future policy challenges facing Viet Nam and China *a propos* of the topic of this paper are as follows.

In Viet Nam

For Viet Nam, perhaps the most urgent task is to restructure the state enterprise sector, to ensure that scarce credit is not consumed keeping unviable enterprises afloat. To the extent that loss-making or marginally profitable enterprises can be restored to financial health through equitisation, then this needs to be expedited. Insofar as the government is concerned about the employment implications of such restructuring, the evidence so far on post-equitisation employment suggests the net impact on jobs is apt to be positive. This is hardly surprising, as newly equitised enterprises are forced to compete in an environment where they no longer have ready access to subsidised capital and thus have strong incentives to alter their factor mix towards greater labour intensity. At the macroeconomic level, freeing up of a growing portion of the credit currently destined for SOEs should permit readier access to financing for non-state enterprises that, as shown above, employ many more workers on average per unit of capital invested than state enterprises. From this perspective, the slow pace of SOE reform is inextricably linked to the slow pace of employment growth and the rising unemployment problem.

Mallon (1998) provides a more detailed list of possible policy and institutional reforms that would work towards removing disincentives to private sector investment and growth. Some measures to encourage faster rural non-farm enterprise development may take time to put in place, particularly improvements to the country's crumbling transport and other infrastructure, but the progress in addressing power shortages is encouraging.

In China

China's challenges are in some ways similar to Viet Nam's. State-enterprise reform also looms large on the agenda. While China, like Viet Nam, has postponed the day of reckoning partly out of concern for the employment effects of SOE restructuring, it has vigorously pursued an employment-creating strategy in the countryside through the promotion of TVEs. The result has been a dramatic reduction in rural poverty (and presumably in the threat of rural unrest)[50].

The task ahead for China is to sustain the momentum of rural enterprise and income growth. Though so far the awkward legal status of property rights in the TVCEs has not posed a serious barrier to such growth, in the future it seems likely that the move to transform these enterprises into shareholding companies will need to accelerate. The most dynamic sector of the rural economy in recent years has been not the TVCEs but their private cousins. As the remaining credit-market and other distortions that provided a rationale for the TVCEs gradually disappear with further reforms and institutional strengthening, so in all likelihood will the rationale for these transitional collective forms of organisation, at least in many of the production sectors where they are currently active.

NOTES

1. Naughton (1996) argues that in Viet Nam petty capitalist traders played an analogous role to China's TVEs (p. 289). As discussed below, however, their relative contribution to industrial production does not begin to approach that of the TVEs.

2. In general, the quality of the data is much better for China than for Viet Nam. Still, for both countries, it is not always possible to get data on "rural industry" separately. Thus, often the data and analysis are presented in terms of enterprise ownership (state, non-state) rather than location (urban, rural).

3. While the state of rural infrastructure (particularly roads but also irrigation, electricity, etc.) is another important influence on rural development, both countries have serious deficiencies in this area, especially in the more remote and less developed provinces.

4. *Doi moi* was officially proclaimed in 1986, but it was another two years before the important reform measures, notably the new land law giving long-term lease rights to farm households, were introduced.

5. Though, as argued below, less favourable agricultural terms-of-trade movements in Viet Nam than in China are a part of the story.

6. It is possible, even likely, that households classified as "peasant households" by virtue of the head of household's primary occupation derive a growing share of their income from non-farm activities.

7. Based on living standards survey data, as of 1992-93, average *per capita* urban household income was about twice the rural level. Assuming the aforementioned 1991-95 income growth rate differential were to persist to the year 2000, by that time urban *per capita* household incomes would be over three times rural ones.

8. The definition of "urban" has evolved during this period, so the rise in the urban share of the population is perhaps somewhat exaggerated. In particular, beginning in the 1980s, a number of rural counties were able to change their designation to "cities", with their populations thereby automatically becoming urban; also, in 1984-5, many rural "townships" were redefined as "towns", thereby also becoming urban. See Zhang and Zhao (1998) for a discussion of the evolution of the "urban" concept in China.

9. The national average for Viet Nam is taken from a different source (the first Labour-Force Survey) than the figures in Table 3, but they appear quite consistent.

10. Nguyen (1998) notes that, with some state employees having taken early retirement and returned to their home provinces, the supply of some kinds of managerial know-how has recently improved in the rural areas.

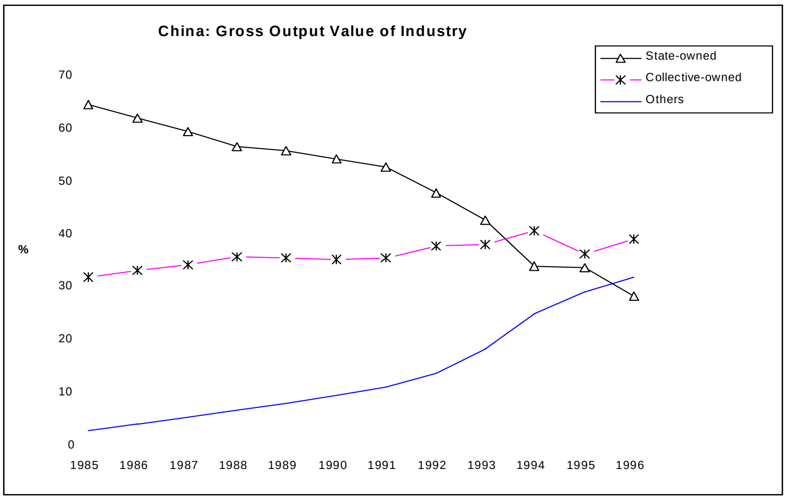
11. In 1980, Viet Nam's *per capita* annual grain consumption was 141 kilos compared with China's 1978 consumption of 195 kilos (Selden, 1993).

12. Figures are based on World Bank data cited in Table 8.1. of Fforde and de Vylder (1996).

13. Adam Fforde (n.d.) has pointed out the inconsistency in the definitions of "state enterprises" between China and Viet Nam: whereas, in the former, enterprises run by local rural governments (at township and village level) are designated "collective" rather than "state" enterprises, in the latter enterprises run by comparable administrative units would be designated "local state-owned enterprises". While this poses some problems of statistical comparability, it does not undermine the basic thrust of the argument here. For, while China's TVEs have thrived under reforms, Viet Nam's local SOEs have not. The nominal ownership of TVEs by local community members has, by some accounts (e.g. Chang and Wang, 1994), helped to retain a sizeable share of their benefits locally – e.g. through local reinvestment of profits and of tax revenues. To what extent has this been true of Viet Nam's local SOEs? This is a question requiring further research on evolving central-local fiscal relations.

14. During the 1978-79 economic crisis, the Vietnamese government relaxed some controls on private enterprise, as state employees and pensioners faced a decline in real incomes. In particular, the government sanctioned the formation of *independent* family enterprises among retired state employees as a supplementary source of income; these enterprises could sell their output directly in the market rather than as subcontractors to state enterprises (Luong, 1993).

15. In the following figure, the "non-state" share of Chinese industrial output is broken down into its "collective" (including local-government-owned TVE) and "other" (i.e. private and mixed) component; the latter has risen at a much faster rate, especially since the early 1990s:



16. Ho (1986) argues, however, that TVE growth was hampered, at least initially, by a lack of competent managers and technicians in rural areas. Naughton (1995) also argues that, on the eve of reform, TVEs had far fewer skilled employees, as well as less technology and capital, than state firms.

17. Byrd and Lin (1990) is one of the most comprehensive accounts of rural industrial development in China.

18. As discussed below, China's TVEs have probably derived some benefit by purchasing material inputs from SOEs that still enjoy state subsidies. I thank MariaRosa Lunati for bringing this point to my attention.

19. Some of this reduction occurred through mergers, while other enterprises were *de facto* privatised and still others ceased operation.

20. Do (1994) cites managerial deficiencies in the co-operative sector as a major reason why many failed to adapt to the removal of subsidies and the increased product market competition following reforms.

21. Indeed, the relatively stable state/non-state industrial output shares since reforms masks a dramatic restructuring within the non-state sector away from co-operatives (whose output share has almost vanished) towards private companies and individual households.

22. The equity share of the state enterprise in a joint venture is inflated because of the high price of land, especially in urban areas. This gives the state owner significant voice in enterprise decisions, including the disposal of profits, often to the consternation of the foreign partner.

23. Incidentally, gross industrial output growth in Ha Tay was among the fastest in the country, at 19 per cent per annum, 1990-95; the average for the "rural" Red River Delta (minus Hanoi and Haiphong), by contrast, was only 13 per cent.

24. See DiGregorio (1994) for a description of a plastic products manufacturer in Hanoi that has taken over from a defunct co-operative, using plastic purchased from nearby recovered materials dealers (p. 126).

25. By central government regulation, only 40 per cent of net profit can be distributed to local government "owners", and they must use a significant portion for social purposes, like construction of agricultural infrastructure, providing agricultural technology services, rural education, etc. (though local governments have been known to use some to invest in other enterprises under their control.) The other 60 per cent is retained by the individual enterprise for allocation to reinvestment, workers' bonuses and its welfare fund.

26. This account is based on Faith Keenan, "Private in Part", *Far Eastern Economic Review*, 12 March 1998.

27. Purchasing power parity (PPP) adjustment would yield somewhat higher rural income levels for both countries.

28. State enterprises have also had a monopoly on long-distance domestic rice trade, e.g. from the surplus south to the deficit north, purportedly to limit smuggling into China.

29. In 1994, SOEs in the trade sector where the second largest source of contributions to the state budget, only slightly smaller than industry.

30. UNDP (1998) notes, however, that Viet Nam has considerable potential for further expansion of the livestock sector and that most government support for agricultural diversification has focused on state-run plantation crops (e.g. coffee, sugar).

31. The wide gap between domestic savings and investment rates implies the need to sustain a large current account deficit; as long as much of that deficit was balanced by foreign direct investment (FDI) and foreign aid inflows, there was little cause for concern. Recently, however, FDI inflows have slowed markedly.

32. Revenue per worker in household industry was one-sixth that of state industry in 1992; if one excludes the "fuels" sector, the figure is one-fifth (ID-GSO, 1994).

33. As discussed below, however, China's TVEs have also appear to have enjoyed access to capital on relatively favourable terms.

34. While the Chinese M2/GDP ratio is in no sense "optimal", Vietnam's is low by almost any standard of comparison; e.g. in Bangladesh in 1995 the M2/GDP ratio was 38 per cent (IMF, 1997).

35. The Rural Credit Co-operatives are subordinate to the Agricultural Bank of China (ABC).

36. During this period, the loan portfolio of RCCs was still heavily influenced by the Agricultural Bank of China.

37. The World Bank estimates that total agricultural credit requirements in 1993 were around $3 billion, of which the Vietnam Bank for Agriculture and Rural Development (Agribank) was able to meet only around 30 per cent (World Bank, 1995).

38. This was slightly higher than for urban non-farm enterprises (38 per cent).

39. A more recent estimate (1997) puts the share of rural credit supplied through informal channels at 35 per cent, though it is not clear whether this includes zero-interest loans (Nguyen, 1998).

40. For example, as of end 1997, Agribank had some 22 trillion dong in loans outstanding and the banking system as a whole roughly 83 trillion dong (Nguyen, 1998).

41. The entry of the PCFs into the rural credit market has put competitive pressure on Agribank, which has made a major effort to extend its presence to the commune and village level in recent years (Nguyen, 1998). There are also 20 rural joint-stock banks that compete to some degree with both Agribank and the PCFs.

42. On the other hand, the government has recently passed a law that exempts state enterprises from having to provide collateral for bank loans (EIU, 1997).

43. Agribank has seen a swift rise in the private share of its loan portfolio, with outstanding loans to private borrowers rising from 355 billion dong in 1991 to 4,725 billion dong by September 1994 (roughly $420 million at current exchange rate) (World Bank, 1995).

44. It is only in 1998 that the Government of Viet Nam has given approval to an initial local experiment in the formation of a stock market (to be established in HoChiMinh City).

45. In 1997, Ronnås *et al.* conducted a follow-up survey of some of the same enterprises as in the 1991 survey (plus a group of new enterprises). Preliminary findings can be found in Ronnås (1998) and Hemlin, Ramamurthy and Ronnås (1998).

46. Wage labour also shows positive growth for household enterprises, as those that survived hired non-household workers, while those that perished had few if any wage workers to begin with.

47. See article by Joshua J. Levine, "Untapped Potential", in *The Vietnam Business Journal*, April 1998.

48. Another survey of 180 rural non-farm enterprises in the mid-1990s finds that exports accounted for around 12 per cent of their market (MARD, 1997).

49. At that time, the banking sector was exempted from turnover tax.

50. After an initial post-reform period of narrowing disparities, there is some evidence that regional income disparities in China have been widening again, particularly between the coastal and the interior provinces (see Jian *et al.,* 1996).

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