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State versus State: The Principal-Agent Problem in Vietnam's Decentralizing Economic Reforms

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The overarching topic of this volume is the exercise of political power in Vietnam. Various chapters illuminate the Communist Party of Vietnam's (CPV) staying power (Vu), dissent and its repression (Kerkvliet, Thayer), selection methods in an authoritarian assembly (Malesky), and civil society (Wells-Dang) and accountability (Vasavakul). All these chapters focus on the CPV's relationship with the rest of society. This chapter adds a different approach by analyzing relationships within the CPV – between central and provincial Party elites. This principal-agent problem emerged after the 1986 *doi moi* market reforms, which gave provincial leaders more influence in Ha Noi, as provincial revenue increasingly paid the bills of the central treasury. Moreover, international economic integration altered dependencies within the state. The economic performance of localities began to depend less on domestic factors than on foreign direct investment (FDI) and international trade; thus local cadres may look to foreign investors and markets as they seek rents from political office. Such a constellation poses a challenge to central authorities, because local leaders can engage in fence breaking – a process of pushing the legal envelope as far as possible, and on occasion intentionally overstepping provincial legal authority during interprovincial competition for foreign investors. Contestation within the CPV at different levels of the Party apparatus is likely to impact forms of dissent and coercion, the development of civil society, and of course the (s)election processes of Party leaders. The findings of this chapter thus complement other research presented in this volume.

The chapter addresses the question how the center maintains control over provincial Party leaders. Are provincial leaders of economically successful provinces re-shaping the Party's discourses and policies,

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or is the central Party – the principal – capable of imposing itself and keeping its agents in line? The literature on China, after whom Vietnam has modeled its reforms, has addressed this issue in some detail, but has failed to come to a clear conclusion. Some authors find that the principal rules *from the top down* through direct control of local agents, via the positive and negative sanctions of promotion and demotion. Others find that local officials can advance their political careers not by obedience to the Party line, but by being economically successful. In this *bottom-up view*, the central Party's ability to impose discipline is reduced and officials are rewarded for their ability to maintain social peace through economic success.

This chapter suggests that Vietnam pursued a bottom-up strategy. The center warned fence breakers about their actions while letting the experiments go forward. Where they succeeded, the center legalized them ex post. Most importantly, successful fence breakers were elevated to top political positions. Fence breaking is evidence that the CPV considers its own interests best served by economic growth and the resultant social peace. Such behavior conforms to Olson's "stationary bandit" terminology, in which an elite with a long time horizon self-limits its predation in return for future gains (Olson 1993: 567).

In the following, the chapter lays out the principal-agent problem in the era of China's entry into the global economy and discusses a cross-section of the China-related literature on the problem. Then, it explains the Vietnamese decentralizing economic reforms and their impact on center-province power relations and on the political fortunes of provincial leaders. The special focus in both sections is on the question whether obedience to Party doctrine or economic success is a better determinant for career advancement for local officials in China and Vietnam. It concludes by analyzing similarities and differences between the two countries and their impact on principal-agent theory.

The principal-agent problem in the China literature

Scholars who have studied the domestic political changes associated with integration into the global economy have suggested that local leaders whose subunits benefit most from international interactions demand increased local autonomy. Centrifugal forces that reduce the power of the central government come to the fore and can ultimately lead to the disintegration of the state (Alesina and Spolaore 1997; Hiscox 2003). Disintegration is an extreme outcome that is unlikely in a state like China or Vietnam, both of which have developed a national narrative

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over many centuries. But the principal-agent conflict remains a constant political problem.

Global market integration leads to winners and losers because the cost of being small diminishes with modern communication and transportation technologies (Alesina and Spolaore 1997). Subnational economic units can make use of their natural endowments without the transaction costs that used to make small units inefficient. As a result, regions or provinces with better human capital, beneficial geography, natural resources, and similar advantages will thrive under conditions of international market integration, while the "hinterland" will fall further behind. These hinterland regions will either oppose integration or demand compensation from regions that benefit from these changes, in return for consenting to free trade policies (Arzaghi and Henderson 2005; Garrett and Rodden 2003). This assumption, that the interests of regions in a country begin to diverge as soon as parts of the country gain while others lose, forms the base of the principal-agent conundrum. A government can hold its provinces together and keep the cadres in line as long as they are all in one boat, but faces increased challenges in doing so when some gain more clout than others.

The research conducted on this question in China investigates by what means the principal attempts to stay in control, via bottom-up or top-down strategies. Edin (2003) and Yu Zheng (2009), for example, find evidence in support of the bottom-up assumption. Edin investigates the Chinese central state's extractive capacity after decentralizing reforms and concludes that through a policy achievement evaluation, cadres are incentivized with monetary and career rewards to implement the targets passed down from Beijing to the provinces and townships. Failure to implement these targets, or being subject to a large number of complaint letters, reduces the cadre's chances of moving up in the Party hierarchy and of obtaining a merit bonus. Importantly, Edin finds that the most important criterion for promotion is keeping social peace, measured by absence of violence or mass protests, followed by economic success. This finding suggests that the central Party values its long-term survival above all else, including short-term rent seeking. The Party values economic progress not as an end goal in itself, but as a means to maintain legitimacy through success, which in turn increases its chances for survival.

Along similar lines of research, Maskin et al. (2000) and Montinola et al. (1996) posit that competition among provinces leads to improved economic performance and is thus tolerated by the center. The argument for decentralization is that local authority is closer to the constituents and better positioned to understand local needs, an argument known as *allocative efficiency* (Tiebout 1956; Oates 1972; Buchanan and Tullock 1962). Along this line of argument, Hongbin Li and Li-An Zhou (2005: 1760–61) find that "the likelihood of promotion (termination) of provincial leaders increases (decreases) with their economic performance. The findings support the view that the government uses personnel control to motivate local officials to promote economic growth."

Contrasting these results, two studies by Sheng and Shih et al. support the top-down view of principal-agent relations. Sheng (2009) finds that the center maintains control through its power to promote and demote. In other words, the central government may rely on successful provinces for its fiscal well-being, but provincial officials remain dependent on the center for their careers. In China, a political career opens doors to financial success. The central government's ability to make or break career advancement remains a powerful factor in keeping provincial leaders in line. In Sheng's telling, not only did the center forestall demands for greater autonomy among provincial cadres; it even managed to tighten control over the most successful, coastal provinces. It did so by sending to those provinces governors and other high-ranking officials with a long experience in Beijing, to ensure that provincial leaders would feel closer allegiance to the center than to the province where they temporarily worked. This "bureaucratic integration" focuses on central policies and careers in the central government. Sheng hypothesizes a correlation between bureaucratic and market integration: the greater a province's integration into international markets, the stronger will the bureaucratic integration be. This is to say that Beijing is less concerned that a hinterland province may exhibit secessionist tendencies than a wealthy one, which could more easily afford to chart its own course.

Sheng identifies three groups of actors: the winner and loser provinces and the central government. Winners want to retain more of their gains and are willing to push for increased autonomy. Losers may also push for more autonomy, in order to re-impose the more closed economy whose demise led to the emergence of the wealth gap between winners and losers. All provinces have an interest in carving out autonomous space, albeit for different purposes. The central government, whose claim to legitimacy is based on the common purpose of the nation, counteracts these tendencies and tries to maintain control by opposing demands for increased autonomy by both types of regions. This argument is one of *divergence of interest*, which the center has to counteract. Sheng's results show that bureaucratic integration is negatively correlated with the amount of tax revenue a province retains. These results indicate – in

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direct contrast to Edin's findings and the hypothesis about Vietnam in this chapter – that agents prefer to make the principal in Beijing happy in hope for a promotion, rather than to serve their local constituents.

Shih et al. (2012) arrive at a similar result from a different angle. Their research uses a biographical database of China's top leaders to identify the causes for promotion into the highest positions of central power. Based on McGuire and Olson (1996), who argue that encompassing political systems (in which the elite represents a large segment of society) exhibit better economic growth performance than fractious ones, Shih et al. hypothesize that if the Chinese Party had a long time horizon, it would favor economic growth for all in order to promote social peace and Party survival. If, by contrast, the Party is afraid of being overthrown, it would focus on short-term predation.

The results of the study indicate that economic performance of local leaders has no impact on promotion to the Central Committee. Relevant factors are personal ties to higher-level officials, provincial revenue collection and transfer to Beijing, and education level of the cadre. The study concludes that factional loyalties and providing immediate rent for the Party outweigh encompassing goals, such as growing the economic pie for all. Careers run through Beijing, not performance at the provincial level – a top-down rather than a bottom-up career path.

Another study adds process to the mix. Zheng's (2009) empirical review of career paths shows how changing conditions alter actors' preferences. Studying how a strong, authoritarian state like China could signal enough commitment to investors' rights, he argues that after the creation and the success of the first industrial zones, the inflow of FDI led to an alignment of interests between provincial and central elites. Initially, some political leaders saw high growth as a legitimation of their rule, while others, the conservatives in the central party structure, were more concerned with loss of ideological purity. Inland politicians did not like the special arrangements benefiting coastal provinces, but over time, the success of the special economic zones aligned interests of the various actors and created an equilibrium among central government, coastal, and inland provinces in which no one had a strong interest in changing the status quo. Simultaneously, the composition of the central party leadership changed in the 1990s. The wealthy coastal provinces began to send more officials to the top positions in Beijing as it became obvious that their economic experiments were successful. Until 1992, officials from Beijing, Shanghai, Tianjing, and Sichuan regularly served in the Politburo. Later, Guangdong and Shandong gained increased access to the halls of power (Yu Zheng 2009: 16–17). This shift,

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Zheng argues, empowered liberals and marginalized conservatives in the center, making the center look more like the successful provinces rather than keeping the provinces in line with central policies.

Zheng, then, bridges the two poles. He recognizes the importance of factional politics in the Party, but in his interpretation of the data, the bottom-up faction with its encompassing view ends up winning. Clearly, the China literature is not conclusive. In the following section, we take a close look at Vietnam's approach to reform, internationalization of the economy, decentralization, and the principal-agent problem. Then we return to China and propose a comparative analysis of the China literature and our findings in the Vietnam case.

Decentralization and principal-agent relations in Vietnam

The CPV officialized market reforms in December of 1986. This momentous change was not as much a result of a sudden change of mind within the highest Party strata as it was the accumulation of the lessons of continuous local experimentation and fence breaking. In 1986, foreign investment was nonexistent, more than seven in ten Vietnamese lived below the poverty line, and the economy required support from the Soviet Union (Dang Phong 2004).

Prior to the reforms, the Party tightly controlled allocation of all economic resources, and the flow of goods was strictly limited. Trade across district lines was not allowed for many basic items of daily use. Only the government had the legal right to ship goods across district lines and distribute them according to government plans through ration coupons. Since districts are fairly small political entities below the province level – the number of districts in 2010 was 599 (GSO 2010) – with these restrictions in place, legal trade was essentially limited to the local market in the immediate vicinity of the producer. When the system was abandoned, agriculture exhibited rapid gains in productivity.

Following the liberalization of agriculture, Vietnam's dominant economic sector at the time, the government began to court foreign investors, first to produce goods for which a domestic shortage existed, later for export production. The export-led growth model has taken hold and is the dominant economic policy priority today. Within a decade of *doi moi* reforms, FDI flows increased from nil to $8.6 billion in 1996, making Vietnam the world's second-biggest recipient of FDI by share of gross domestic product (World Bank 1997). Commitments of FDI between 1988 and 1998 totaled $35 billion for over 2,500

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projects (Mai 2004: 22). Ho Chi Minh City and neighboring Dong Nai received 60 percent of all approved projects (Malesky 2004a: 287). As a consequence, regional income differences increased. The average difference between the richest region (the Southeast) and the poorest (the Northwest) grew from 2.1 times in 1996 to 2.5 times in 1999 and 3.1 times in 2002 (GSO and UNFPA 2006: 10). The second decade of *doi moi* brought with it a significant acceleration of economic performance. Total committed FDI between 1986 (*doi moi*) and 2008 had grown to some $98 billion, across 9,800 approved projects (Ninh Kieu 2008); 8,600 projects were operational (Chinanet 2008).

In 2008 alone, the country expected $20 billion in new commitments prior to the onset of the global financial crisis. To put these numbers in perspective, 2007 saw more than double the realized investments of 2006, which stood at $4.1 billion (Chinanet 2008). This made Vietnam one of the world's top destinations for FDI. With 85 million people, the country received more FDI than India, and roughly one-third as much as China. When measured in relation to the size of the economy, Vietnam is the world's top FDI recipient among developing or transitional nations (Foreign Investment Advisory Service, in Malesky 2008: 100). The second decade of market opening is associated with export-oriented foreign investment, improved regulations and tax incentives for exporters, and the creation of dozens of export processing zones. At the end of 1999, 14 export processing zone projects had been approved (Mai 2004: 43); in 2012, the Ministry of Planning and Investment counted 283.

The FDI-based development formula is important, as FDI and the pressures brought to bear by investors have altered the relations between political agents in Vietnam. One of the crucial changes since *doi moi* can be found in the altered relationship between central and provincial elites. Economic success, and particularly success in attracting foreign investors, is highly concentrated. Between 1988 and 1998, Ho Chi Minh City in the Southeast region and Ha Noi and the port city of Hai Phong in the Red River Delta region received a cumulative 54.7 percent of committed FDI (Mai 2004: 101). Binh Duong and Dong Nai, two provinces adjacent to Ho Chi Minh City in the Southeast region, were investment poles as well. The other five regions combined received less than 20 percent of FDI (ibid.: 104).

Thanks to their economic prowess, the top provinces find themselves in a position of growing importance for the central government's treasury. Table 4.1 shows that 11 of the 63 provinces contribute to the central treasury; the other provinces are net recipients. The top

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Table 4.1 Net contributors to the central budget

Province	Region	Percentage of revenue retained in province
Ho Chi Minh City	Southeast	26% vs. 74% to central treasury
Ha Noi	Red River Delta	31% vs. 69%
Binh Duong	Southeast	40% vs. 60%
Dong Nai	Southeast	45% vs. 55%
Ba Ria-Vung Tau	Southeast	46% vs. 54%
Khanh Hoa	South Central Coast	53% vs. 47%
Vinh Phuc	Red River Delta	67% vs. 33%
Quang Ninh	Northeast	76% vs. 24%
Da Nang	South Central Coast	90% vs. 10%
Hai Phong	Red River Delta	90% vs. 10%
Can Tho	Mekong River Delta	96% vs. 4%

Source: Ministry of Finance 2008.

contributors account for almost all the fence breaking. The central government depends on their continued success to be able to distribute money to poor areas of the country. Since the government has made continuous improvements in living standards its raison d'être, the success of the high-performing provinces finances the government's political promise.

This fiscal prowess has been translated into increasing autonomy – an autonomy that was not given by Ha Noi but taken by provincial leaders. These leaders have wrestled away decision-making powers from the center as their provinces grew and provided more resources to the central state. The early success stories pushed the envelope, with the support of foreign investors, who enjoyed the improving business climate. The argument was that since investors like what they get, any push-back from the center would reduce the attractiveness not only of these particular provinces, but of Vietnam overall. Not surprisingly, there is a clear connection between success in attracting FDI and in paying into the central government's treasury.

All these changes during *doi moi* point to the same questions the China literature posed: With the growing importance of a handful of provinces to the central treasury, did the principal in Vietnam maintain control? Did Vietnam follow the top-down or the bottom-up approach? Does the Party see its fortunes in the long run, which would point toward encompassing goals of legitimacy through growth and increased living standards for all, or will the elite grab what it can and prepare to run?

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It is of note that the policy reversal from a collectivist, planned economy to a market system with focus on international investment arose from the dire needs of an extremely poor and malnourished population, not a sudden change of heart by local cadres. Too many of the leaders had spent much of their lives in the jungles fighting capitalism just to turn around and adopt it. It was only through the trickling up of popular demand and satisfaction with the reforms on the ground level that reformers could win their argument. This popular demand came with improved living conditions where market forces were introduced, often in fits and spurts. The new system was sustained and strengthened by the success of the early movers. While officials at the central level may not have appreciated the gradual devolution of power toward the local level, they recognized that it was in their own interest to accept the rise of the province. The most successful provinces provided the treasury in Ha Noi with the funds that permitted the fiscal transfers to poorer parts of the country, thus maintaining social cohesion and the legitimacy of the Party, which could claim that it was making all Vietnamese better off. A *harmony of interests* emerged between the center, which depended on tax revenues from the most successful provinces, the provincial officials in the poorer provinces who received transfer payments that allowed them to stay in their constituents' good graces, and the officials in the successful provinces who benefited from the success of their provinces and the increasing autonomy that made this success possible (Jandl 2011, 2013). Centrifugal forces are kept in check by this harmony of interests rather than by coercive measures.

It is to the mechanisms by which a harmony of interest is established and maintained that we now turn. Fence breaking creates realities on the ground that are difficult to repress as long as they are successful, are viewed positively by a large share of the population, and end up increasing the center's tax take from a province. Interprovincial competition produces pluralistic contestation that creates what federalists call a "commitment device" (Weingast 1995) against elite collusion and excessive rent seeking.

Fence breaking: the push of the market

In stark contrast to the market reforms in Eastern Europe after the fall of communism, Vietnam's institutions stayed intact throughout the reform period. The central government, grudgingly at first, accepted local reforms as a necessary, ideologically questionable evil as long as it fed the people and helped the Party maintain its performance legitimacy. Unlike Gorbachov's simultaneous *glasnost* and *perestroika* – political and

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economic reforms – Vietnam, as well as China half a decade earlier, focused entirely on improving living standards to stave off any discussion of political change. In that process, they pragmatically learned from historical experiences. Fence-breaking experimentation started prior to 1986, especially when provinces tried to harness market forces to increase food production. As Malesky (2004b: 164) points out:

> These reforms were in response to the economic crisis, so they were not so much improper [with respect to communist doctrine] as necessary behavior that discipline would slow but not stop. If the Party was to retain its relevance it had to allow necessary local reforms to be legitimized and even spread. Therefore pressure from the bottom combined with an accurate sense of urgency resulted in major change of direction for the communist country.

One famous example dates to 1978, when Ho Chi Minh City ran low on food. Officials wondered why nearby An Giang province, a rice basket, could provide so little of Vietnam's staple to the country's biggest city. The Ho Chi Minh City People's Committee Chairman and Politburo member Vo Van Kiet sent a procurement official to An Giang. The official reported that farmers had rice but would not sell it at the legally prevailing price. She could get it only by breaking the law. Kiet reportedly told her to get the rice; should she go to jail, he, Kiet, would bring her rice to her cell. Ho Chi Minh City received the rice, its population was fed, nobody went to jail and Kiet became prime minister. Soon, rice was sold everywhere at the new price paid in An Giang (Dang Phong 2004: 30–1).

In Long An, leaders effectively abolished the state price system. Seeing the positive results of marketization, other provincial leaders visited to study Long An's experience. Because of that interest, even the conservatives had to let the experiment go forward. As hardships increased and problems seemed to be solved by innovative ideas, these ideas took hold and more and more leaders changed their position. The rest were removed (ibid.: 33–5).

These and other incidents of fence breaking set the stage for the 1986 reforms at the central level. As Susan Shirk points out about China, the Communist Party system may not be democratic in terms of national elections, but the principles of contested politics apply within the Party apparatus. Leaders cannot swim against the current of the opinions of rank-and-file officials, at the risk of being pushed out at the next Party Congress (Shirk 1993). In Vietnam, these changes based on intra-Party

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popular opinion were pushing policy. At the Sixth Party Congress in 1986, key reform policies were now written into national law, including the principle of a multisectoral economy, the acceptance of private and foreign investment, a market economy for a number of commodities, and concentration on certain spearhead sectors of the economy where a great need or competitive advantage existed. Fence breaking did not stop with the victory of early pro-market officials. It continued straight into the new, open economy, now with respect to regulations regarding the investment climate.

Market opening represented an experiment for the Party, and the risks of negative fallout had to be contained. The government tried to restrict this new free-market model geographically to the south, far away from the political center Ha Noi. In the early stages of *doi moi*, the central government licensed all new investments, and placed the vast majority of them in Ho Chi Minh City and adjacent Binh Duong and Dong Nai. Provinces had no say in the matter and could at best lobby the investors to request that their project be located in their province. Seeing the benefits, these three main beneficiaries of FDI began to push the envelope and started to license investors themselves. As the center continued to receive ever-increasing tax revenues, it refrained from cracking down. The “one door – one stop” policy for licensing began as a fence-breaking experiment in Binh Duong province and in Ho Chi Minh City. It was first criticized in the official newspapers, but then legalized. The *New Foreign Investment Law* of 1996 authorized Ho Chi Minh City and Ha Noi to license projects with a value of up to $10 million directly; other provinces could license projects worth up to $5 million – some ignored the limits. Also in the south, some provinces violated customs laws to provide intermediary goods for firms. No leaders were punished (Malesky 2004b: 181–82). An even more obvious indication that success leads to enhanced bargaining power occurred in the early 1990s. Some leaders were punished for selling land to investors illegally, yet all of those punished were from economically less successful provinces, while similar activities by officials from Ho Chi Minh City, Song Be (now Binh Duong), or Dong Nai were not pursued (ibid.: 176). As a consequence of the obvious devolution in power, line ministry officials who, due to dual subordination, reported to both Ha Noi and the provincial People’s Committee began to show more loyalty to the province (ibid.: 189–90).

Fence breaking is a bottom-up process. Assuming local cadres are rational actors who have their own best interest in mind (instead of a moral obligation to do what is right regardless of the consequences for them), they disobey the principal only if they are confident that

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successful policy outcomes will be to their benefit. The history of fence breaking in Vietnam is therefore difficult to reconcile with Shih's and Sheng's findings on China (see earlier) that success through fence breaking leads to punishment.

Since economic reforms in Vietnam started with fence breaking, the province had already established itself as the center of successful experimentation at the time the central government adapted the legal code to reflect the changes on the ground. The next section describes the mechanisms by which competition among provinces is responsible for the harmony of interest among the major interest groups in Vietnam.

The province in Vietnam's economic reforms

The most trade-integrated provinces with the highest FDI levels soon enjoyed a high quality of life. As social indicators improved, Vietnamese voted with their feet by migrating to these high-growth provinces in large numbers. Table 4.2 provides a poverty count and Table 4.3 shows migration flows into the wealthier FDI-receiving regions. For the provincial governments, this means not only an opportunity for rent seeking, but also a good argument for political promotion. For the center, it means that these provinces are at the same time allowing large numbers of Vietnamese to improve their lives *and* paying the bill for the central government as it supports the poorer provinces through transfer payments. For a government that has staked its legitimacy on economic

Table 4.2 Poverty count by province

	Poverty headcount index (%)			
	1993	**1998**	**2002**	**1993–2002**
Nation	58.1	37.4 (–20.7%)	28.9 (–8.5%)	–29.2%
By region				
Red River Delta	62.7	29.3 (–33.4%)	22.4 (–6.9%)	–40.3%
Northeast	86.1	62.0 (–24.1%)	38.4 (–23.6%)	–47.7%
Northwest	81.0	73.4 (–7.6%)	68.0 (–5.4%)	–13.0%
North Central Coast	74.5	48.1 (–26.4%)	43.9 (–4.2%)	–30.6%
South Central Coast	47.2	34.5 (–12.7%)	25.2 (–9.3%)	–22.0%
Central Highlands	70.0	52.4 (–17.6%)	51.8 (–0.6%)	–18.2%
Southeast	37.0	12.2 (–24.8%)	10.6 (–1.6%)	–26.4%
Mekong River Delta	47.1	36.9 (–10.2%)	23.4 (–13.5%)	–23.7%

Source: Headcount calculations by Phan and Coxhead (2007), based on Vietnam Living Standard Survey 1993, 1998, Vietnam Household Living Standard Survey 2002, 2004, Vietnam Development Report 2004. Additional calculations by author.

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Table 4.3 Gross inter-provincial migration flows – 2004–09

	Place of residence, April 1, 2004							
Place of residence, April 1, 2009	**Northern Mountains**	**Red River**	**Central Coast**	**Central Highlands**	**South-east**	**Mekong River**	**Total in-migration**	**Net migration**
Northern Mountains	–	70	13	3	4	1	91	–180
Red River	160	–	98	9	19	4	298	–42
Central Coast	8	29	–	29	36	9	110	–665
Central Highlands	27	29	79	–	23	7	166	41
Southeast	73	195	570	83	–	713	1635	1510
Mekong River	2	9	15	2	43	–	70	–664
Total out-migration	270	331	775	125	125	734	(2361)	–

Note: Numbers do not add up due to rounding.

Source: Population and housing census 2009.

progress for its citizens, the success of these provinces becomes the backbone of the government's claim to power.

Crucial to the story is that no province could monopolize the recipe for success, because capital, goods, and labor could flow almost freely from province to province. Charles Tilly's argument about Europe's exceptionalism is relevant here. He argued that democracy arose in Europe because after the demise of the Roman Empire, no dominant state emerged, leaving room for a multiplicity of nearby jurisdictions in a constant state of contestation. If a prince did not like a new idea, a new technology, or a new philosophy and oppressed it, people were free to pick up and literally walk across the border to look for a different government (Tilly 2004). In Vietnam's case, if a provincial government cannot provide reasonably good conditions or if government engages in excessive predation, investors, and also workers (who have become a scarce factor in the most economically active provinces), can pick up and go elsewhere. Predation is best checked if regular people have exit options. Economic success stories are credited to a federal organization structure, as prevails in the United States and Switzerland (Parente and Prescott 2000). Where citizens are free to move across jurisdictional borders as well, elites face declining fortunes in the longer run if they make decisions that are immediately utility maximizing for them, while suboptimal from a societal point of view. Competition for these mobile resources – capital and people – shifts bargaining power not only among elites, but also from elites to nonelites.

This ability of local elites to provide good business conditions to induce investors – and also workers, who follow the employment opportunities – to come to their province is key to the shifting bargaining power between interest groups. First, local elites gained significant bargaining power vis-à-vis the central elites in Ha Noi. Second, nonelite workers gained bargaining power because they were needed where the economic growth occurred. In places where a local elite is unable to create employment with decent salaries, or engages in excessive predation or a regulatory race to the bottom by reducing social wages, workers can pick up and leave. As the data show, large numbers of them do.

At this point, the central government is restrained in its actions by the fact that investors have been voting with their money by locating their factories in a small number of preferred provinces, and workers by voting with their feet, as they decided to migrate into these provinces. A mix of remittances from migrant workers and fiscal transfers from rich to poor provinces via the central government also keeps the less successful provinces afloat and allows the government to make a credible claim that the economy is indeed lifting all boats. Imposing central orthodoxy would disrupt the harmony of interests that has emerged among the three actors, winning provinces, losing provinces, and the central authorities (and workers who also benefit from growth). The winning provinces earn significant amounts of money, which offers the opportunity for rent seeking by officials, but also allows them to claim that their good work legitimizes the system and that they should therefore be promoted. The losing provinces may be falling behind in relative terms, but are aware that without the success stories that pay for the fiscal transfers and make large amounts of remittances possible (in addition to reducing the burden of underemployed young people, who can now migrate), they would be worse off. And the center claims legitimacy for distributing shares of the rapidly growing economic pie across the country. In direct contrast to Sheng's hypothesis, it appears that in Vietnam the central government would be more threatened by an economic downturn that leads to less employment and less money to be distributed than by continued success in the high-FDI provinces, even if the latter situation brings with it demands for more policy autonomy.

Autonomy and political careers in Vietnam

In a harmony-of-interest scenario, economic success promotes political careers at both provincial and central levels. As the theory suggests, leaders of successful provinces push for increased autonomy. Since their success also serves the interests of the less successful provinces through fiscal transfers, and the central state through legitimacy-conferring revenue to be distributed, none of the actors has a strong incentive to push for more radical change. Leaders in successful provinces can only engage in fence breaking because they know that the center needs them. Their fence breaking is tolerated because it serves the greater good of all actors; any excessive demands for autonomy would break that harmony of interest and provincial officials would be punished, as were those who broke central rules without concomitant economic success.

Foreign investment works as a bargaining chip for subnational jurisdictions when a convergence of interests exists between the higher and lower levels of administration. Provincial leaders benefit from increased economic activity in their province in a variety of ways. They can extract rents from the growing local economy. They can maintain their positions of power if they are seen as successful administrators of their province. And they can obtain promotions to central-level positions thanks to their performance at the provincial level. The center gains because of its ability to maintain social peace owing to its increased capability to transfer surplus money from the successful provinces into the hinterland. Thus, local success not only strengthens the hand of these reformers in the provinces, but also allows reformers at the center to make their case more forcefully (Malesky 2004b: 9).

Clearly, Vietnam has a strong governing party that ensures that local interests cannot entirely override national ones. On the other hand, the top-down pathways that Sheng and Shih (above) have described do not prevail in Vietnam. The assumption that career advancement will keep local cadres in line with central policy is not observable. Indeed, central government careers depend on local success, but success is defined in terms of maintaining social peace and order and paying into the central government's treasury by growing the revenue base. The most successful risers in the ranks were not those who defended Ha Noi's traditional line while on duty in the provinces, but those who challenged it effectively and achieved results that were in the interest of center and province.

One recent president, Nguyen Minh Triet, started out as Party leader in Song Be province (now Binh Duong), before taking over the same position in Ho Chi Minh City. He was one of the principal fence breakers, turning his rural Song Be into one of Vietnam's economic powerhouses. Vo Van Kiet (prime minister from 1991 to 1997), another key fence breaker, was one of the main supporters of *doi moi*. Gainsborough (2004: 264) points out that of the five Party leaders of Ho Chi Minh City between unification and publication of this book, only one did not move on the positions in the central government. Vo Tran Chi, a conservative critic of market reforms, retired.

The career paths of successful officials in Vietnam follow Edin's and Zheng's view (appointed to central positions of power *after* success in the province), rather than Sheng's and Shih's (sent to the province to enforce central doctrine). Yet with Vietnam's economy sagging in the aftermath of the 2008 global economic crisis, moving up the ranks through economic performance is becoming more difficult. At the 2011 Party Congress, reformist Prime Minister Nguyen Tan Dung had to fight for his re-election. Former Ho Chi Minh City Party chief and market-oriented reformer Truong Tan Sang was elected president. The third power position of general secretary of the Communist Party, however, went to Nguyen Phu Trong, a man who had risen through the Party ranks without a history of economic success or reformist attitudes.

Conclusion: lessons from Vietnam and China

Yumin Sheng (2009) hypothesizes that Vietnam, due to the similarity of its political structures and the way it fashioned its reforms on China's, should behave very similar to China on the question of principal-agent relations. This assumption proved incorrect. One potential reason is that China, with its size, its earlier reforms, and its different history, simply does not easily compare to any other country. But since some of the literature found that China is much more like Vietnam than Sheng and Shih et al. accept, the alternative view is that their studies misinterpret the data.

If Sheng is right about China, then China is a state in which political success results from obedience to doctrine. By contrast, Vietnam's system would be truly pragmatic in comparison, since personal careers are advanced by success, even if this success stems from challenges to doctrine and conventional wisdom. To be sure, China is an economic success story second to none. This makes Sheng's findings all the more puzzling. If provincial elites obeyed Beijing for career considerations, the implication would be that the Chinese leadership was either extraordinarily wise or outstandingly lucky. That a small band of aging, communist leaders, most coming of age during revolutionary, anticapitalist struggle, would be able to make long-term decisions about free-market capitalism so successfully is extremely unlikely. Vietnam's system of local corrections where the principal's wisdom falls flat is much closer to the orthodoxy of economic thought that holds that markets do well because they respond rapidly and efficiently to the innumerable stimuli in the system, and correct mistakes as they arise.

Sheng's work also contains some assumptions that defy the internal logic of his argument. If the center indeed sends Beijing-oriented cadres

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to the wealthy coastal regions to curb their potential for demands for more autonomy, then one would have to assume that the two openly secessionist provinces, Tibet and Xinjiang, would rate on top of the index. Tibet indeed rates high but still lower than some hinterland regions. Yet Xingjiang rates low on integration. Moreover, early protests against Beijing's policies came from hinterland provinces who resented the special treatment for the coastal ones. Based on the logic of assuring obedience, those provinces should also be governed by Beijing-oriented officials. In fact, there is no reason why any one province should not be, if control is the goal. Therefore, the great divergence in Sheng's integration index itself raises doubts about the theoretical usefulness of the data collected.

Both Sheng and Shih et al. point to provincial revenue retention rates as evidence of central control. If a wealthy province sends a lot of money to the center (Sheng) or if promotions are correlated with having provided a lot of revenue for the center (Shih et al.), the logical conclusion is argued to be that local officials value their careers in the center more than their economic success in the province. What goes unsaid is that revenue retention is a ratio. The higher a province's income, the more it has to send to the center. But the retained *absolute amount* can still be vastly superior to the amount retained in poorer provinces, even if the retention rate there is 100 percent. Table 4.1 has shown that in Vietnam, revenue retention rates in the most integrated provinces are extremely low, yet officials in exactly those provinces are fence breakers who push for better business regulations. Hence Sheng's data are open to a variety of explanations. Senior officials may be sent to the province to maximize tax revenue, which could very well lead to increased bargaining power for these officials. They could – and in Vietnam definitely do – make the argument that they provide the center the money it needs to keep the social peace in return for noninterference and a promotion down the road, and should be left alone with respect to the means to accomplish the task. This explanation, which suggests increased provincial autonomy, is just as consistent with the data as is Sheng's position of more central control. By contrast, the low levels of bureaucratic integration of provinces with high secession risk are clearly inconsistent with Sheng's argument. On balance, Sheng does not appear to have made his case.

The work by Shih et al. addresses some of the problems through rigorous use of control variables, but some of their conclusions remain dubious. It is assumed that leaders have too short a time horizon to focus on encompassing, long-term goals. Instead, they emphasize rent seeking and short-term power retention. To maintain power among

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the many factions, top officials intentionally promote cadres who have not distinguished themselves in the province, to keep the best qualified competitors at arm's length. A serious logical problem arises: How can one explain the stunning success of China's economy over three decades if each generation of leaders is – by design – less qualified than the previous one?

Another unanswered question is why an authoritarian, but factional political system would have a shorter time horizon than another. The communist parties of China and Vietnam have planned for a long reign. If Shih et al. were correct, why have the parties in China and Vietnam placed so much emphasis on socio-economic development and not on the forms of pillage seen in other parts of the world? It is indicative that Shih et al. base the time horizon argument on McGuire and Olson; yet in their work, time horizon is but an afterthought. Their main aim is to illuminate economic reasons for elites to limit their rent seeking at certain levels that provide an optimal take in a given situation. Given the benefits the principal in China and in Vietnam reaps from the success in the most economically advanced provinces, McGuire and Olson are unlikely to underwrite the conclusions Shih et al. attribute to their theory. In fact, they write:

> Paradoxically, the same self-interest that leads an autocrat to maximize his extraction from the society also gives him an interest in the productivity of his society.... Thus a rational autocrat always limits his tax theft: he takes care not to increase his rate of taxation above the point where the deadweight losses at the margin are so great that his share of these losses offsets what he gains from taking a higher percentage of income. Second, the rational autocrat spends some of the resources that he could have devoted to his own consumption on public goods for the whole society. He does this because it increases his tax collections. (McGuire and Olson 1996: 76)

The CPV has made development the argument for its legitimacy. In a short-time-horizon-focused political system, it would be hard to explain policies like recent changes in mortgage lending in response to a real estate bubble risk and increases in inflation. The Party made decisions that hurt its own cadres, such as prohibiting the use of stocks as security for mortgages. Very few laborers and peasants have either stocks or mortgages. In this case, the Party is taking the long view.

Statistical analysis, in any case, does not lend itself to making causal claims. Sometimes, the classic method of meticulous process tracing

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yields more than correlations do. In this light, a recent biography of Deng Xiaoping (Vogel 2011) can add to the debate. In it, the detailed description of the ups and downs of reforms in China paints a picture that indeed indicates that China is different from Vietnam. In China, local officials had to look over their shoulders constantly to gauge which faction – reformers or conservatives – were on the ascent in Beijing. Siding with the wrong one could bring trouble to a provincial leader. In Vietnam, as Malesky (2008, 2004b) has laid out so thoroughly, the center lost control over the reforms early on – arguably even before the reforms were institutionalized during *doi moi*. The Party could not isolate successful reforms. A smaller country with a much more mobile population learned rapidly where there was enough food or better job opportunities. Asking Vo Van Kiet to undergo self-criticism for feeding his hungry people would not have worked in Vietnam. Factor mobility among provinces in this much smaller country makes the top-down approach more difficult.

Vogel's account appears to strengthen Zheng's conclusions. The comrades in Beijing started with a top-down approach, but over time, successful provincial cadres progressively took over the central apparatus and brought their ideas with them. The same appears to be the case in Vietnam, except that the transition was much faster there.

Moving beyond the regional comparison, the principal-agent relations in Vietnam also tell a story about domestic politics. The authors in this volume have come to various conclusions with respect to the dynamism of the Party in Vietnam. The analysis in this chapter does not see decay, but continued adaptation to social realities and challenges to regime survival. As both Kerkvliet and Wells-Dang (this volume) have pointed out, the Party exhibits a mix of toleration and repression. Dissent is generally tolerated when it addresses policies; it is repressed when it affects the Party itself, particularly its monopoly on power inscribed in Article 4 of the Constitution. This is consistent with the harmony-of-interest approach. Provincial leaders who breach a law but end up improving the Party's standing in popular opinion are tolerated and even promoted. It is unlikely that the CPV would brook dissent by even the most successful local cadre if such dissent were to weaken the Party itself. It is not surprising, then, that after all the successful fence breaking in Ho Chi Minh City, Binh Duong, and Dong Nai, these three provinces still send the great majority of their revenues to Ha Noi.

If we accept that repression is the response to a certain set of circumstances, toleration to another, the question arises whether the Party will become less tolerant as the economy slows down. The

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harmony-of-interest view suggests this to be the case, since the harmony is reflected in the sharing of the benefits that come from autonomy. As these benefits shrink, the principal has less interest to give the agents a longer leash. On the other hand, as the economy slows down, the principal may see it in its interest to allow even more deviation from the rules in an attempt to make up for the loss in revenue. The question is whether the agent can convince the principal that the longer leash will pay off, even in times of higher risk and broader contestation against Party policies. Naturally, success remains the critical factor. The rare intra-Party challenges to the sitting prime minister shortly after the 2011 Party Congress are an indication that Nguyen Tan Dung's credentials for economic success were seriously tarnished by the recent scandals in state conglomerates, which he had pushed.

In a final summary, Riker (1964) and Enikolopov and Zhuravskaya (2007) are correct in pointing out that a strong party is important to provide coordination and enforce the rules of the game. But in the Vietnamese case, the pathways of control between center and province are reversed. Based on the strong sense of nationalism, all politicians must support the nation. But in what way they do so is less controlled by central leaders' disciplining the party cadres than by the most successful reformers, who in the case of Vietnam have resided in just a few provinces. The norms to which officials are held for career advancement are determined much more in the economic growth pole than in the halls of the central government in Ha Noi. It is ironic for a country that has forged such strong rhetoric about the primacy of ideology that in the end, Vietnam appears to be *governed very pragmatically by success*.

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