

Topic:**The Socialist Calculation Debate Revisited: the Case Study of Vietnam**

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Date: 1/July/2004

Abstract:

The paper aims to review the theoretical debate on the model of market socialism to further understand the experiences of Vietnam's economic transition. The model of Lange's market socialism is not reflected in the case of Vietnam, where the quickly emerging private sector, liberalization and decentralization of the economic system have contributed significantly to Vietnam's economic success. These features are relevantly understood from the Austrian school of thought. Nevertheless, the experiences of Vietnam suggest some issues for further development of the Austrian school of thought. Some features such as positive role of the socialist government and relatively significant contribution of state enterprises to Vietnam's economic growth are beyond the argument of the Austrian school of thought and the political economy approach.

Introduction

The praxeological nature of economics is the process of Aprioristic reasoning, which is purely conceptual and deductive. Thus, the empirical evidence is not able to reject or confirm the theories. However, observing empirical evidences can provide various inputs to think about the development or revision of the existing theories. Thus, while defining the praxeological methodology of economics, Mises also indicates the role of experience for the economic theory that “The end of science is to know reality... experience merely directs our curiosity toward certain problems and diverts it from other problems. It tells us what we should explore, but it does not tell us how we should proceed in search for knowledge” (Mises, 1998:64).

The socialist calculation debate has been intensively revived since the collapse of the Soviet Union in early 1990s. Most of Austrian economists agree the fundamental flaw of the socialist system is the lack of private property rights, and market exchanges and prices. Nevertheless, the economic transition in the socialist countries like Vietnam and China has become more complicated than that.

Since late 1980s, Vietnam has been in transition from a centrally planned to market economy. The dominant feature of this transition is that Vietnam has established a “parallel” structure of its economic system, where the socialist state ownership exists in parallel with private ownership. Yet, it is striking that Vietnam has been quite successfully achieving its high economic growth, poverty reduction, an increase in living standard. The major concept of Vietnam’s economic system has been termed “Vietnam’s market socialism”, where the market economy could exist in tandem with socialist institutions. The socialist institutions here include the dominance of state ownership and dictatorship of one-party system-Vietnam’s Communist Party (VCP, 1987; NPI, 1994; Lane, 1996; Kornai, 1992, 1998).

One of the major problems of the socialist system is whether or not such market socialist system is efficient to ensure the survival of the socialist countries. If state enterprises do not perform well, the model of market socialism might not work efficiently as argued by the Austrian school of thought.

Given the above theoretical and empirical context, this paper attempts to use the experiences of Vietnam’s economic transition to contribute to the historical debate between Lange and Austrian scholars (Hayek and Mises) on the economic feasibility of socialism in 1930s and 1940s.

The rest of this paper includes four sections. Section 2 reviews the theoretical debate on the model of market socialism. Section 3 indicates that the model of market

socialism in Vietnam is a policy option, rather than a theoretical choice. Section 4 clarifies how the Austrian school of thought contributes to an understanding of Vietnam's experiences. Section 5 concludes.

2. The Socialist Calculation Debate: a Theoretical Review

Since 1917 (Russian Revolution), classical socialism has emerged in twenty six countries around the world, including Central and Eastern Europe (CEE), Africa, Asia, and South America. In 1986, the socialist system accounted for about 34.4 per cent of the world population and 30.7 per cent of the earth area. This system has three characteristics: State ownership of means of production; centrally planned mechanism; One-party political monopoly with the Marxist-Leninist ideology (the Dictatorship of the Proletariat).¹ After the nearly half century of its existence, the socialism system in CEE has proven to be an inefficient economic system as presented in Table 1. Table 1 indicates that while the GDP per capita in the classical socialist countries grew much slower than that of the capitalist countries which had a similar or lower level of the GDP per capita in 1950, the labour cost per capita in the classical socialist countries is much higher than in Portugal which has the highest labour cost among the capitalist countries.

¹ Some authors call it as the state socialism; the others call it as the command economy. This paper calls it classical socialism, but these concepts are not different from each another in nature (See Lane, 1996; Kornai, 1992).

Table 1: Growth and Labour Costs, 1950-1973-1989

Countries	GDP per capita		Annual Number of Working Hours per Capita	
	(USD at 1985 relative price)			
	1950	1973	1989	1989
<i>Socialist countries</i>				
Hungary	2.481	5.517 (222.4)	6.722 (270.9)	839 (113.7)
Soviet Union	2.648	5.920 (223.6)	6.970 (263.3)	933 (126.4)
Czechoslovakia	3.465	6.980 (201.4)	8.538 (246.4)	936 (126.8)
<i>Capitalist countries</i>				
Austria	2.869	8.697 (303.1)	12.519(436.4)	687 (93.1)
Portugal	1.608	5.598 (348.1)	7.83 (459.1)	738 (100.0)
Spain	2.405	7.518 (321.6)	10.081 (419.2)	591 (80.1)
Greece	1.456	5.781 (397.1)	7.564 (519.5)	657 (89.0)

Source: Calculated from Maddison, 1995: 93-111

Note:

- The figures inside the bracket () represent the percentage of the figures in 1973 and 1989 in comparison with the figure of the reference year 1950.
- Portugal's labour cost =100, the other figures in brackets of the final column show out the relative labour cost in other countries in comparison with the labour cost of Spain which has the highest labour cost among the capitalist countries in the table.

From Table 1, we calculate the lag of GDP per capita growth behind of the socialist countries in comparison with Spain, which has the lowest level of GDP per capita in 1950 as follows:

Table 2. Increase in the Lag behind Spain

(Percentage: Spain's GDP per capita =100)

	1950	1973	1989
Hungary/Spain	103.2	73.4	66.7
Soviet Union/Spain	110.1	78.7	69.1
Czechoslovakia/Spain	144.1	92.8	84.7

Table 2 shows that the socialist countries were losing in the race of improving productivity through the process of technological innovation against the capitalist system. The economic growth in the socialist countries in 1950s, 1960s is not lower than that of the capitalist countries, but the source of the high economic growth is derived from forcing more investment into the state enterprises, rather than from an increase of total factor productivity. The contribution of total factor productivity into the economic growth in these countries can be clearly observed in Table 3 as follows:

Table 3. Share of Factor Productivity in the Output Growth of Output

Countries	Period	Average Annual Rate of Change		Share of Factor Productivity
		Output	Factor Productivity	
Socialist				
Czechoslovakia	1960-1975	3.0	1.0	0.33
	1976-1980	2.2	0.7	0.29
	1981-1988	1.4	0.1	0.07
Poland	1960-1975	5.1	2.4	0.47
	1976-1980	0.7	-0.6	-
	1981-1988	1.9	0.2	0.40
Soviet Union	1960-1975	4.6	1.2	0.26
	1976-1980	2.3	0.5	0.22
	1981-1988	1.9	0.5	0.13
Capitalist				
France	1960-1973	5.8	3.9	0.67
	1973-1979	2.8	1.7	0.56
	1979-1988	1.9	1.5	0.75
Japan	1960-1973	10.8	6.6	0.61
	1973-1979	3.6	1.8	0.43
	1979-1988	4.1	1.8	0.43
Britain	1960-1973	2.9	2.2	0.76
	1973-1979	1.5	0.5	0.60
	1979-1988	2.2	1.9	0.95

Source: Kornai, 1992:187, table 9.6

V. I Lenin once announced, at the outset of the socialist system, that the race between the capitalist system and socialist system would be decided by the advancement of the efficiency (Kornai, 1998: 35). Note that the backbone of classical socialism was the dominance of state enterprises. Thus, the economic decline of the classical socialism at this time was blamed for the inefficiency of state enterprises and failure of the centrally planned system.²

Facing the economic decline of the socialist systems, most of the socialist countries attempted to introduce the market reform and economic incentives into the

² In the centrally planning system of the classical socialism, the system of information transmission in the classical socialism was seriously distorted and suppressed, when state enterprises attempted to transmit the inaccurate information: The managers of state enterprises tended to exaggerate data that reflect favourably on themselves and minimise those that could reveal their shortcomings. Furthermore, the bureaucratic system in the classical socialism reflected the risk-aversion of subordinates: managers of state enterprises usually underestimated the output possibilities and overestimated the input requirement. The information system was so distorted and suppressed that there was the third and second economies (Kornai, 1995)..

state enterprises and decentralising the centrally planned system to establish the model of market socialism such as Yugoslavia (1950-1990)³, Hungary (1968-1989), Poland (1981-1989), China (1978-now), and Vietnam (1986-now), the Former Soviet Union (1985-1989). Applying this model in practice is, partially, the attempt to rescue the socialist system from the economic failure of the classical socialism in the race against the capitalist countries. Thus, the pragmatic market socialism is emerged from the failure of the classical socialism. In early 1990s, the collapse of the former Soviet Union and Central Eastern European countries is usually considered as the failure of the model of the pragmatic market socialism. Nevertheless, at the same time, Vietnam and China have still sustained the pragmatic market socialism for over two decades with successful economic achievements. Therefore, it is relevant to re-examine the historical calculation debate on the model of market socialism in 1930s with the recent empirical evidence of Vietnam.

Several market socialists such as Fred Taylor (1929), H.D. Dickinson (1933), Abba Lerner (1934), and Oskar Lange (1936, 1944, 1970) described the theoretical model of market socialism where capital goods are owned by the state, while the consumers' goods are free to be selected by consumers. It was possible for socialist countries to have all the advantages of market economies without disadvantages caused by private property and the frequently associated large concentrations of wealth. The market mechanism alone has some disadvantages for economic development in the socialist countries: First, the market mechanism is a cumbersome slow-working servo- mechanism. It operates with time-lags and may not be convergent at the equilibrium level and cause some much unpleasant business fluctuations; Second, another disadvantage of the market is that the price fluctuation could cause income effects: gains or losses to various groups of the people; Third, the market can not be a sufficient foundation for long-run economic investment and development, because the market price only reflects the present condition of supply and demand, while long-run investment planning can change the supply and demand through the technological advancement. Thus, the market socialism model is the combination of centrally planned and market mechanism. In this model, there are three types of agents: households, the Central Planning Board (CPB) and socialist

³ Yugoslavia is a special case of the pragmatic market socialism, which has the following features: the dominance of self-managed units under social ownership and the dictatorship of the proletariats. However, this system could not avoid the common syndrome of the inefficiency of the dominant social ownership within the context of the monopolistic political system with the socialist ideology dominance.(See Kornai, 1992 and Stiglitz, 1994)

managers who share the decisions guiding the economy. The market mechanism can be guided by the principles: freedom of choices of consumers in consumption goods market and freedom of choice of labourers to occupations in labour market, reflecting the demand prices of consumption goods and labour services. The managers of the state enterprises were assumed to be public officials, who are no longer guided by the profit maximisation rule as in the capitalism market. There are two rules imposed by CPB, which aim to maximise the consumer's preferences and welfare of the societies as follows: (1) They must attempt to minimise average cost of production at any level of output; (2) The output has to be fixed so that prices must be equal to marginal costs of products. The first rule is similar to the efficiency rule in the capitalist firms. The second rule is only applied to the capitalist firms in perfect competition, at which marginal utility is equal to marginal cost of products, the condition for maximizing the welfare of both producer and consumer. In the meantime, the CPB is responsible to fix the initial price of capital goods, consumption goods and labour service on the condition of equilibrium between supply and demand. If any price differs from the equilibrium price at the end of accounting period, there would be a surplus or shortage of the commodity in question. CPB could adjust the disequilibrium price by 'trial and error' method which increases the price when demand exceeds supply and reduce them in the opposite case. The price system set up by CPB is considered as *an accounting rule* for state enterprises. Thus, CPB could replace the functions of the market mechanism in controlling prices. In term of long-term investment, correcting the failure of the market for promoting long-term investment and economic development, CPB can determine the public capital accumulation rate to ensure a rapid industrialisation in the socialist countries.

To ensure the equality in the market socialism, Lange raises a *principle of income formation*, in which income of consumers is composed of two parts: receipts for labour service performed in state enterprises and the other part being a social dividend derived from the capital and the natural resources owned by the society. The social dividend can be distributed equally per head of population, or according to age or size of the family that does not reflect the choice of occupation. Thus, this principle of income formation is different from the income distribution in capitalist firms that the income distribution in the capitalist firm is not only based on labour service, but also private capital contribution of the owners. In brief, this model composes of three significant components: dominance of state enterprises and centrally planned system, and free labour and consumption markets in which the state

enterprises are considered as the engine for the rapid industrialisation and economic development in the socialist countries.

The model of market socialism was critically rejected by the Austrian school of thought. Involved in this debate, are two branches of the Austrian school of thought: one is guided by Mises (1920, 1936, 1998, 2000); and the other by Hayek (1940, 1944, 1945, 1988).

Mises pointed out that socialism faced serious economic calculation problems as follows:

First, in the market socialism, it is assumed that the economy is a system of static general equilibrium and perfect market, where all data (tastes, values scales, alternate technologies, lists of resources) are known to everybody; the costs are known and always equal to prices. According to Mises (1920), CPB is not able to make the calculation of profit and loss, because in this system, there is no market price which reflects subjective valuations of both consumers and producers. Instead, the socialist calculation in kind is to be substituted for monetary calculation. While there are million types of consumers' goods and production factors of heterogeneous quantities, CPB is not able to compare the number of this product to the number of others. Thus, CPB can not know what consumers' goods should be produced and which combination of production factors should be used to produce each consumers' goods. Rejecting the use of mathematical equations in the economic calculation, Mises argues:

“In the capitalistic economy it is possible to make calculations on the basis of our present-day knowledge. It may be that mistakes will occasionally be made because unexpected events interfere with our plans and expectations. In the socialist state however it would not even be possible to calculate on the basis of our present knowledge. Those who think that it would be possible to apply the equations of mathematical economics for making the calculations fail to see that included among the items of which these equations are composed are unknown preference scales belonging to a situation which is unreal and can never be realized in practice. The circumstance that they are unknown frustrates all attempts to use the equations for purposes of economic calculation.” (Mises, 2000:32).

Clearly, consumers with their subjective values participate in the exchange, and then define the market prices, through which their preferences for some goods, relative to others by purchasing and refusing to purchase are demonstrated. CPB cannot measure the total utility of consumers, because there is no unit for preferences.

Second, another grave flaw of the market socialism model is that it concentrates on free consumers' good market, while there is no capital market price.

In the capital market, factor prices are determined by the intensity of entrepreneurial demands relative to the opportunity cost of these factors. These prices are the monetary denominator, which helps to measure different units of the production factors, therefore permitting entrepreneurs to efficiently allocate factors across the production of consumers' goods through the cost-benefit analysis. The real problem is the existence of all markets for land and capital that producers decide what the stocks of various consumer goods should be. In the system of fully state-owned capital goods, CPB has no capital market prices to make the rational calculation of cost-benefit analysis as in free capital market (see the review of this point in Reynolds, 1998).

Third, the general equilibrium model of the market socialists is a world of certainty where entrepreneurship has no role. The actual world is constantly changing with systematic uncertainty. Entrepreneurs, who use their own assets and resources for achieving profits and avoiding losses, become the crucial factor in economic system who is ignored in the general equilibrium of the market socialism. In free market capitalism, the entrepreneurs have strong incentives to pursue greater profit and to avoid losses. Such feature is not applicable to the capital goods or land market under socialism where all resources are controlled and owned by the government. The market socialists look at the economic problem from the managerial perspective, who seeks to make profits or avoid losses, given a fixed framework of a given external allocation of capital to the firm itself (Mises, 1998: 703-4). However, a managerial function is only a subsidiary function of the entrepreneurship. Entrepreneurs are speculators, promoters, investors and money lenders whose behaviours effectively determine the relevant structure of capital and commodity exchanges. The crucial problem is to allocate capital to firms and industries. In the market socialism, it is difficult for CPB to tell their managers to act as entrepreneurs, while both CPB and managers have no profit incentives to do so.

While Mises indicated the calculation problem of the market socialism with regard to the lack of private property and the market price system, For Hayek (1945) and his followers (Kirzner, 1988, and Yeager, 1994), the major problem for the socialist planning board is its lack of knowledge. Hayek argues that in the capitalist economy, price is a valuable means of disseminating knowledge from one individual to another. Hence, the argument for the free economy and against the market socialism rests on an argument from ignorance, rather than the calculation problem as raised by Mises (Rothbard, 1991:66). According to Hayek (1945), the nature of

human knowledge and information is so dispersed that it can never be fully codified and transmitted, especially knowledge attached to a particular time and place, which can not be aggregated into statistics information. The central planning based on aggregate statistic information can not take into account this information. Thus, price set up by CPB could not reflect the relative scarcity of resources. Further, CPB must solve hundreds of thousands of simultaneous equations equivalent to a huge number of produced commodities. Long before the data is collected and the equations are solved, the results would be outdated by changes in the economies. Therefore, decision-making process will be more efficient if it is left in hands of private owners in both consumer and capital goods and price mechanism which bear the price information of relative scarcity of resources through which private enterprises with profit motives can flexibly react to. Hence, it is concluded that there is the superiority of private over public ownership and price mechanism over centrally planned mechanism in term of using the disperse knowledge and information.

Recently, some Austrian economists such as Salerno (1990, 1993, 1994), Rothbard (1991), Herbener (1996), Hoppe (1996), Hulsman (1997) downplayed or rejected the contribution of Hayek and his followers to the socialist calculation debate with three major arguments as follows:

First, to defend the position of Mises, they argue that the central problem of market socialism is not "knowledge problem". Even if CPB knew perfectly and enjoyed a perfect knowledge of all resources and all technologies, they still would not be able to calculate due to lack of a price system for the means of production. Lacking the market price, the entrepreneurs would not be able to appraise or to anticipate future prices, and to allocate resources accordingly. Thus, the Hayekian emphasis on "knowledge" problem is misplaced and misconceived. The aim of human action is not to "know", but to employ means to satisfy their objectives (Rothbard, 1991; Salerno, 1990, 1993, 1994, and Herbener, 1996).

Second, as Hulsman (1997) has argued, the price functions as means of communication and coordination, and generation of dispersed knowledge as raised by Hayek (1945) and Kirzner (1988) are not relevant. He argues that price only reflects the information on the exchange ratios of the past conditions, while human action is not only confronted with the past conditions, but also future conditions. Equilibrium price can not convey the dispersed specific knowledge, because particular knowledge of specific time and place are never known by anyone in their totality. Further, the market process does not lay in the communication of knowledge, but the price

formation helps to compare the projects in value terms. The argument that exchange ratios or price permit the coordination of decentralized knowledge is not relevant, because all individual actions are somehow coordinated, regardless of socialism or capitalism. The prices do not coordinate the actions of sellers and buyers, but they are the outcome of coordinated actions. Furthermore, there is no generation of knowledge through disequilibrium prices, because no past experiences tell which actions consumers and entrepreneurs should choose. Entrepreneurs must anticipate the future, and judge whether the same conditions will appear in the future as well. Thus, the term knowledge coordination, communication of prices obfuscates rather than express the market process.

Third, Hoppe more radically rejects the Hayekian argument that “Hayek’s contribution to the socialism debate must be thrown out as false, confusing, and irrelevant” (Hoppe, 1996:146). From the Misesian point of view, he argued that prices are the exchange ratios of various goods as a result of the voluntary interactions of distinct individuals based on the institution of private property. Without the institution of private property, the information conveyed by prices simply does not exist. Private property is the necessary condition of the knowledge communicated through prices. Thus, the absence of the institution of private property constitutes socialism's problem, rather than a lack of knowledge. Further, prices at “specific times and places,” do not make them private information in the Hayekian sense. In contrast, the information conveyed by prices is public information. It may be difficult to know all of the prices at a specified date and location. Yet it is possible to know either one, and with current computer technology. In addition, if the centralized knowledge is the problem, then it is difficult to explain why families, clubs, and firms do not face the same problem as socialism, while they involve some types of central planning. In socialism, decentralized knowledge is utilized no less than in private firms and families. What make private firms and families different from socialism is not the existence of lack of decentralized knowledge, but rather the absence of private property, and hence of prices.

One of the major challenges to socialism which has not been clearly analyzed by the Austrian school of thought is the incentive problem, because most of economists agree on the weak incentive structure under the equal income distribution of socialism. As Rothbard confirms that:

“Every one, socialists and non-socialists alike, had long realized that socialism suffered from an incentive problem. If for example, everyone under socialism was to receive an equal income, or in another variant, everyone was supposed to produce “according to his ability”, but receive according to his needs,” then to sum it up in the famous question: Who, under socialism, will take out the garbage?” (Rothbard, 1991:51)

Mises’s argument was not directly related to the well-known incentive problem. However, He also indirectly referred to the incentive and price problem of socialism as he argued:

“It is not possible to divorce the market and its functions in regard to the formation of prices from the working of a society which is based on private property in the means of production and in which, subject to the rules of such a society: the landlords, capitalists and entrepreneurs can dispose of their property as they think fit... Without the striving of entrepreneurs (including shareholders) for profits, of landholders for rents, of capitalists for interest, of the labourers for wages, otherwise, the successful functioning of the whole mechanism is not to be thought” (Mises, 1981:119)

Mises further warns about the income distribution and incentive problem of socialism that: “Enterprises are no longer directed by self-interests of entrepreneurs, but by labour leaders unfitted for the task will yield less, so that workers will not only earn no more than under a free economy, but considerably less” (ibid.:241). Thus, the inefficiency of the state ownership could not help to sustain the equal income distribution as raised by the market socialists (See the details of incentive problems of the Austrian school of thought in Steele, 1992:200-253; Klein, 1996).

The incentive problem of socialism has been recently extended with regard to the performance of the transition economies like Vietnam. Stiglitz argues that the model of market socialism is based on the assumption of perfect information and perfect competition which is similar to the neo-classical economics in analysing the static equilibrium of the economy, thus it provides a false sense of belief in the ability of market socialism to solve those resource allocation problems. However, he shows that both private and public ownership in different economic systems have their own failures in improving efficiency, thus it can not be said that private ownership is always superior to public ownership. For instance, both state and private enterprises meet the principal-agent problems, inefficiency of production caused by information asymmetry and high transaction cost problems. In the case of public goods, private firm may not be effective in internalising external effects. Therefore, with privatization of state enterprises, the state may not always improve the economic performance of the privatized state enterprises and the main problem here is how to

choose a suitable mix between private ownership and public ownership (Stiglitz,1994: 13).

Rowthorn and Chang (1993) and Balcerowicz (1995) agree that it is unclear that the private ownership is intrinsically more efficient than public ownership. The answer to this question lies not primarily in the purely conventional economics analysis, but rather in the sphere of politics and political economy. Adopting the political economy approach, they considered the state as a very special owner of state enterprises, differing from private owners in two aspects: First, the state is a political organisation, tending to maintain the popular support of its political constituents, rather than being profit-oriented in handling state enterprises, regardless of democratic or non democratic state; Second, the states have the monopoly on the creation of money, and on legislation. There is a tendency of the collusion between politicians and the managers of state enterprises to protect loss-making state enterprises. It means that state enterprises usually claim more resources from the state budget or state subsidies, rather than economize the resources and improve the efficiency. In the market socialism, the imposition of hard budget constraint on state enterprises can be politically impractical, because of the political opposition from those affected – for example, managers, workers, consumers... who were previously getting their goods at subsidized prices. In this case, privatization can be the most effective option, because with the enterprise in private hands, the political pressures for state subsidization may be greatly weakened and the only way for privatized enterprises to survive in the market mechanism without the state subsidies is to improve their efficiency.

In sum, the knowledge problem of Hayek and his followers is logically irrelevant. The lack of private property and market price as argued by Mises and his followers, and the incentive problem as raised by the political economy approach are the major challenges to the pragmatic market socialism. The next sections will look at the transition experience of Vietnam to illuminate these points further.

3. Vietnam's Market Socialism: the Theoretical or Policy Option?

Since 1975 Vietnam has attempted to build a centrally planned economy. Until 1986, Vietnam's economy contained two features of the classical socialism: state ownership monopoly and centrally planned management, where the government coordinated all economic activities of state enterprises by controlling production output and the input of state enterprises. No market price existed in this system. In a

centrally planned system, the government provided the materials and labour inputs to state enterprises freely. In return, state enterprises produced compulsory output in accordance with the orders of the government. The whole system was saturated with the ethos of rapid economic growth. The advantage of this planning system was that it enhanced government capacity to concentrate all human and material resources on the objectives of the industrial development (Fforde and Vyllder, 1996). Indeed, the annual growth rates of Vietnam's GDP, industrial output were very high during the period 1976-86 (5.6 percent and 8.5 percent per annum respectively) (Calculated from GSO, 1976-1990). Nevertheless, the reported statistic figures in this period might be deliberately distorted, when most of managers and bureaucrats tended to over-report their production results for their political and career promotions in a hierarchical system. It was proved clearly later that Vietnam suffered from shortage of food and consumers goods in 1980s.

In fact, the centrally planned system gave the state enterprises little interest in controlling costs or the value of its output. Profitability was not an objective of state enterprises, whose losses were covered by the banks' operation and justified by the principle that jobs must be protected. State enterprises had no freedom to decide what to produce and for whom to produce. In fact, the high economic growth of the state sector depended on the input supplies of the government or foreign aid, rather than economic efficiency (Anh, 1994). Furthermore, the trade system was fully dominated by state enterprises, where the Soviet enterprises supplied materials and equipment and in return, Vietnamese state enterprises produced final output for them. At this time, the trade activities of state enterprises were based on subcontracting relations and barter trade with Council of Mutual Economic Assistance (CMEA), where the exchange rate system was an artificial one and import and export were decided by the economic plans. Given the trading dependence on CMEA and the planning of the government, state enterprises did not play an active role in upgrading the quality of products and searching for new markets (World Bank, 1995: 79 and Ca, 1999:54).

The common problem of Vietnam's economic system in this period is the phenomenon of soft budget constraints, where state enterprises received regular external assistance from the state so that the state support enabled them to spend more than their own budget constraint would allow. Usually, under the soft budget constraint, the state acted like an overall insurance company taking over all the moral hazards with the usual well-known consequences: the insured would be less careful in protecting their wealth. When state enterprises expected such external financial

assistance, they had no incentives to pursue the efficiency objectives as usually happened in the socialist countries (see the concept of soft budget constraint in Kornai, 1986-1998).

Furthermore, while pursuing the government support, managers of state enterprises felt that when they could not pay the bills, someone else would step in and bail them out. Therefore, there was no compulsory limit on demand for input and investment. The soft budget constraint had a strong impact on total demand, thus the classical socialism system becomes a shortage economy.

Further, the production of state enterprises is not directed toward satisfying the demands of consumers. Thus, the quality and the amount of consumers' goods have degraded overtime. This feature is in contrast with the sovereignty of consumers in the capitalist market system. As Mises once referred to the market production in capitalism as follows:

“Neither the entrepreneurs or the farmers nor capitalists determine what has to be produced. The consumers do that. If a businessman does not strictly obey the orders of the public as they are conveyed to him by the structure of market prices, he suffers losses, he goes bankrupt, and is thus removed from his eminent position at the helm. Other men who did better in satisfying the demand of the consumers replace him” (Mises, 1998:27)

Vietnam's planning system which did not aim at satisfying consumers' demands tended to produce in accordance with administrative orders, rather than demands of consumers. Thus, even if this system obtained the high output growth, this high output growth rate was not satisfying consumers. In the mid 1980s, Vietnam's economy faced serious problems of inefficiency of state enterprises, vulnerability to a fluctuation of foreign aid, and shortage of capital and consumers' goods. Thus, to overcome these constraints, since 1986, the Vietnamese Communist Party introduced a comprehensive economic transformation from a centrally planned economy to market-oriented one. They introduced three major reform measures. First, the government attempted to improve the performance of state enterprises by introducing the profit-based accounting; eliminating the compulsory directives issued by the government; reducing the government subsidies; liberalizing the market mechanism (CIEM, 1997: 34-35). The reform measures aimed to create economic incentives and autonomy for state enterprises to operate under the market mechanism as private enterprises. State enterprises were no longer subject to the compulsory production targets. The enterprises had to operate according to the principles of profit and loss accounting and self-management in finance. Capital ceased to be provided free to enterprises from the state. Enterprises were put on a self-financing basis and had to

provide for their own capital needs through loans or savings. These measures provided greater production autonomy. Thus, in general, differing from the Former Soviet Union countries, Vietnam attempted to restructure, rather than privatize state enterprises in 1990s. Second, Vietnam's economic reform was to shift the government attitudes and policies towards the roles of the private enterprises. Resolution of the Fourth Conference of the Vietnam Communist Party states that the government encourages and accepts the long-term existence and positive effects of the family, individual and private enterprises in production and services. It also guarantees the private property rights. It accepts their legal incorporation/identity and equality before the law in their production and business activities (VCP, 1987:12-46). The resolution aimed to provide a basis for non-discrimination between state and private enterprise. Third, trade and market price has been gradually liberalized. In consumer's good market, price, supply, demand have been no longer controlled by centrally planned system. The government set up a planning system, in which the basic questions of an economy such as what, how, and for whom Vietnam's economy produce are fully implemented by themselves also in the consumers good market.

Therefore, Vietnam's pragmatic market socialism is emerged from the failure of the classical socialism, rather than from the theoretical choice for the market socialism model. However, at present, Vietnam's pragmatic market socialism has some features similar to that of Lange: free consumer market; more or less dominant state ownership in the capital goods, the dictatorship of proletariats and monopoly of the communist party. Yet, Vietnam's market socialism is highly different from the theoretical illustration of the market socialism in an aspect that Vietnam's government does not have monopolistic centrally planned system to capital market, where non-state financial sector is emerging significantly. Further, in the whole economy of Vietnam, non-state sector has increasingly played an important role in sustaining high economic performance of Vietnam. Indeed, in the agriculture sector, the state sector accounted for nearly insignificant share of agriculture output. The non-state sector accounted for about 60 per cent of the industrial output in 2002. Furthermore, non-state sector has achieved a very high industrial output growth (about 15 per cent in 1998, 30.2 per cent in 2000, and 30 per cent in 2002) (IMF, 2003). The government has delivered the autonomy to state enterprises in their decision-making, thus no trial and error methods have been applied as suggested by O. Lange. In essence, this is the process of decentralization of decision making, so that state enterprises could involve in the market exchanges to make more relevant

economic calculation based on the free prices in consumers' goods and partially free capital market prices. In the pragmatic market socialism, market co-ordination replaces the central planning co-ordination and the compulsory planning is replaced by indicative planning. In fact, the state planning boards in different ministries have not intervened directly in business activities of state enterprises. While the prices of products in Lange's model of market socialism is fixed by central planners, state enterprises have certain autonomy in fixing the prices in Vietnam. In addition, the principal of income distribution as Lange described has never been applied in Vietnam.

Thus, the model of market socialism of Lange and the others is purely theoretical, while Vietnam's model of market socialism is a purely pragmatic policy option for economic development.

4. How the Austrian school of thought Explains the Economic Success of Vietnam?

While the emergence of the pragmatic market socialism of Vietnam is the policy option, rather than the theoretical choice, the Austrian school of thought could provide some relevant points to explain the success of Vietnam. As Mises and his followers indicate, the driving force of market economy development is the entrepreneurship under the private property right and market price. In fact, the reform process in Vietnam has gradually supported this driving force by setting up more favorable entrepreneurial environment for development of private sector and freeing of the market prices. Nevertheless, the knowledge problem as argued by Hayek and his followers is empirically irrelevant to explain the Vietnam's market socialism, because there is no direct planning system and the government does not intervene directly in state enterprises.

Emergence of Private Sector

As in other socialist countries, the official line of the socialist ideology considered private ownership as a vestige of capitalism tolerable at most in the short run. Thus, they imposed various constraints on the growth of the private sector, such as the limits on capital accumulation, number of hired labors or the threat of the past nationalization. Individuals were scared that one day they and their children would be

classified as the exploitative social class.⁴ However, variety of private activities spontaneously developed in various branches: private farming, service, transport, and manufacturing as well. In the classical socialism, the informal private sector existed under the forms of trading activity outside the framework of state enterprises, co-operatives or some informal activities were done by those employed in state enterprises outside the official working time. In transition to the pragmatic market socialism, private sector still grew spontaneously after the repression of the private sector was lifted. The evolution of the private sector in these countries resulted in high-income earnings which in turn encouraged individuals to invest in their business development further. In the meanwhile, the state sector has not provided such incentives for individuals as Rothbard argues:

“No government official regards himself as more than a transitory owner. As a result, while a private owner, secure in his property and owning its capital value, plans the use of his resource over a long period of time, the government official must milk the property as quickly as he can, since he has no security of ownership” (Rothbard, 2004: 1278).

In 1989, the share of state sector was about over 70 per cent of GDP, but over the economic reform period, this share reduced to less than 49 per cent of GDP in 2002. In fact, Vietnam has implemented several radical reform measures to shift from the socialist state ownership to private ownership. In 2000, the government issued the Enterprise Law to eliminate institutional constraints on the development of the private sector. In March 2002, the Communist Party formally recognized the private sector as an important element for economic growth, employment generation, income increase for government budget and population as well as poverty reduction, thus they endorse the various policies to support private sector. At the end of 2003, they eliminated around 180 types of bureaucratic licenses and permits; they reduced the duration of business registration from 15-20 days to 10 days. As a result, private property rights and business environment have become more secure and favorable for the private sector. Thanks to this radical change, between January 2000 and September 2003

⁴ According to K. Marx, “ the monopoly of capital becomes a fetter upon the mode of production, which has flourished alongside and under it. The centralisation of the means of production and the socialisation of labour reach a point at which they become incompatible with their capitalist integument. This integument is burst asunder. The knell of capitalist private property sounds. The expropriators are the expropriated”. There was a distinction between small commodity production and genuine capitalism that the former uses only the labour input of family labour, whereas the latter uses the hired labour and thus become exploitative as it seeks the labour surplus from the hire labour. In this context, the ideology and practice of socialist countries has been very much influenced by Lenin’s frequently quoted dictum that “ small production engenders capitalism and the bourgeoisie continuously, daily, hourly, spontaneously, and on a mass scale” (Quoted in Kornai, 1992: 444).

year, more than 72,600 new enterprises have been established against 45,000 firms in the previous nine years. Their total registered capital is \$9.5 billion, four times the accumulated capital of the 1991-1999 period. These enterprises have generated around 2 million jobs. Thanks to the Enterprise law, the industrial sector has maintained a high annual growth rate of 14-15 percent. It was also attributed to growth in the private industrial sector, which stood at 18-20 percent and accounted for 25.5 percent of the whole industrial sector's total output (Ministry of Trade, 2004).

Table 4. Industrial Output Growth by Ownership

Ownership	Years							
	1996	1997	1998	1999	2000	2001	2002	2003
Non-state sector	12.1	10.8	7.8	5.3	12.2	12.7	11.7	11.7
Foreign-invested sector	22.0	23.1	24.4	20.9	18.6	12.6	14.5	16.1
Domestic private sector	11.8	9.5	7.4	10.8	18.4	21.5	19.2	18.8

Source: IMF, 1998-2003 and World Bank, 2004.

Table 4 indicates that before 1999 the output of the domestic private enterprises grew at lower level than that of state sector. However, thanks to the radical institutional reform of Vietnam's government, the domestic private sector has grown much higher than both state and foreign invested enterprises. Before 1990, most employees worked for the state sector. At present, 90 per cent of the labour force works in the non-state sector. Especially, the non-state sector is highly labour-intensive, so that it can absorb the relatively large portion of the labour force in comparison with the state sector (World Bank, 1999-2002).

In parallel with encouraging the development of domestic private enterprises, at the end of 1987, the government issued the law on foreign investment, which was considered as the most liberal in South East Asia. Most of sectors in the economy, in principal were open to foreign direct investment, which would be provided with incentives for promoting exports and foreign exchange earnings (Harvie and Hoa, 1997).

In the agriculture sector, decollectivization has occurred extensively in Vietnam since early 1980s. In essence, the decollectivization process is the break of the socialist productive collectives and quickly emerging private household production units, where households have legal land use rights to use their land very effectively.

In fact, the agriculture sector in Vietnam has been the third largest rice exporter in the World in 1990s (just behind U.S. and Thailand). In principle, the privatization and liberalization of agriculture sector has encouraged peasant households to increase the land productivity and agriculture output for food security and export of Vietnam.

In the financial sector, Vietnam transformed from a single state bank into a two-tier banking sector. The reform in the banking sector began in 1990 with the issuance of two banking decrees and the establishment of four state owned commercial banks. Since then, the banking sector has diversified considerably. There are now 48 joint stock banks, four joint venture banks, 27 foreign banks, plus more than 60 representative offices of foreign banks and almost 935 credit co-operatives. In the planned economy the financial sector belonged absolutely to the government. The economic reforms since 1986 have allowed private ownership to exist in the financial sector such as gold shops, joint stock banks, credit cooperatives (credit funds), foreign and joint venture banks, as well as representative offices of foreign banks, entered the financial sector. In addition, the government also allowed some big state-owned enterprises to establish their own financial companies. This revitalized the financial sector and incorporated market competition into the system. However, state-owned commercial banks still account for about 90 per cent of the total assets of commercial banks. The main customers of state commercial banks are the state enterprises. In addition, the state commercial banks play a major role in serving the large investment projects, especially infrastructure projects financed by the government. The other financial institutions have less market share than the state commercial banks (IMF, 2002).

As a result, the liberalization and the economic reform in Vietnam have contributed significantly to the economic success of Vietnam. In detail, Vietnam has achieved a very high growth rate (around more than 7 per cent over the period 1992-2003). Furthermore, the life quality has improved significantly. The poverty reduced from 58 per cent down to 37 per cent from 1992 to 1998 (IMF, 2003).

The relevant point of Mises's property argument in the case of Vietnam is that private sector has been booming in all sectors of the economy, which made the significant contribution to the success of Vietnam's economy. It might be relevant to argue that the economic incentives of private sector have accrued due to the liberalization, so that individuals can use their innovative abilities and resources efficiently for their own interests and Vietnam's economic development. The emergence of profit, rent, wages, and interests induce the development of private

sector in all sectors (agriculture, industry, banking sector). Therefore, this fact fully supports the importance of private property rights for Vietnam's economic development.

The market Price Emerged

Before the reforms, price and trade in Vietnam were centrally controlled by the planning authorities and could be carried out only by some state trading monopolies. Domestic prices were isolated from the influence of international prices through a complex system of multiple exchange rates and trade subsidies. Exports were discouraged due to overvalued exchange rates, while imports were impeded by an extensive system of quotas and licenses. Isolated from the world market, Vietnam relied heavily on its former CMEA partners to obtain basic commodities, such as petroleum products and fertilizers, while exporters were obliged to fulfil CMEA quotas (Council of Mutual Economic Assistance) (IMF, 1996).

At that time, the price system in Vietnam was best described as Mises writes:

“The question is market economy, or socialism? There is no third solution. The notion of a market economy with non-market prices is absurd. The very idea of cost prices is unrealizable... if commodities and services are to be sold below the price the market would have determined for them, supply always lags behind demand. Then the market can neither determine what should or should not be produced, nor to whom commodities and services should go. Chaos result” (Mises, 1998:394).

In fact, the prices given by the government was much lower than that in the black market, while Vietnam suffered from the supply shortage of both capital and consumers' goods. Thus, the government planning of the price in 1980s caused the serious economic crisis in Vietnam. Since 1989, Vietnam's government has gradually eliminated price control for most goods and increased prices for agricultural products. The 'two price' system (formal and subsidized prices and black market prices) that prevailed under the old system, and barriers to internal trade was totally eliminated. At the same time, the government limited most subsidies to state enterprises. The government also was to liberalize the trading system by relaxing restrictions on trade and opening up international trade. The exchange rate was unified where a system of auctioning foreign exchanges was organized, so that the more flexible exchange rate helped to promote export activities (World Bank, 1995: 78-81). Vietnam has multiple trade arrangements with various partners, including 1992 preferential trade agreement with European Economic Community; the 1995 membership in ASEAN Free Trade Area and the 2001 Bilateral Trade Agreement with the US (BTA). In 1995, Vietnam

submitted the application to join the World Trade Organization (WTO). It is expected that at the end of 2005, Vietnam will be a formal member of the WTO. The openness of Vietnam's international trade has had immediate impact on export earnings in Vietnam. For instance, right after BTA became effective in 2002, Vietnam doubled its garment export to the US market in 2002. The US became the third largest market for Vietnam's garment export, while the garment export accounted for 17 per cent of Vietnam's total export value in 2002 (World Bank, 2003).

Further, the government has allowed private enterprises since 1998 to export and import directly, rather than through trading state enterprises. Thus, in various industrial sectors, private sector contributed significantly to Vietnam's economic export. For instance, private sector accounted for 48.2 per cent of the garment export values in 1997 (Cuong, 2004:67-70).

The price and trade liberalization has had a significant impact on stabilization of Vietnam's economy. Indeed, in 1989 (before price liberalization), Vietnam suffered from hyperinflation that was in excess of 400% in 1988 that was symptomatic of the country's economic ills. The reforms promoted the increased use of markets to set prices, encouraged the development of the non-state sector for production and distribution of goods and services, and opened the economy to international trade. The remarkable fruits of these reforms were reaped one year later. The hyper-inflation was reduced to single-digits; export revenues doubled as a result of the devaluation and the increase in national savings and revenues from the newly-exploited oil helped offset some of the loss from diminishing Soviet aid and worked to ease the economic crisis. The ratio of exports to GDP rose from 22.8 per cent in 1990 to 35.5 per cent in 1996, and 54.7 per cent in 2001. Over the same period, the value of imports as a share of GDP rose from 23.4 per cent to 45.4 per cent in 1996, and 56.7 per cent in 2001 (CIE, 1998 and World Bank, 2002).

Unexplained Factors

Nevertheless, there are two major features which are beyond the prediction of the Austrian school of Thought and contradictory to the major argument of the political economy approach of Rowthorn and Chang (1993) and Balcerowicz (1995).

First, Vietnam's socialist government has been able to facilitate the comprehensive institutional reform which favors the economic development. For instance, Vietnam's government policy made a radical labour policy reform of the state enterprises in the industrial sector since 1987 (World Bank, 1996: 45-46).

Consequently, this policy also affected the whole employment force of this industry from late 1980s to early 1990s. Around half of millions of workers were sacked from state enterprises in 1992-1993 by this policy (Connor, 1996). This government policy contradicted the basic argument of the political economy approach that in the context of socialism, the governments tended to collude with state enterprises to favour the labour redundancy of state enterprises, because workers are their political supporters. Vietnam's government is leading the reform process since early 1980s during the collapse of Soviet Union. It needs further explanations for the role of government in ensuring the economic reform in Vietnam.

Second, it is striking that the marketization, rather than privatization of state enterprises in Vietnam has helped to improve the performance of state enterprises significantly. In detail, state enterprises have made significant contributions to high economic growth of Vietnam since early 1990s. For instance, the output growth of state enterprises is very high (13.8 per cent in 1997, 17.5 per cent in 2000, and 14.5 per cent in 2002) (IMF, 2003). It could be explained as follows. The process of marketization of state enterprises in essence provided the economic and political incentives and autonomy to managers of state enterprises to find ways of improving state enterprises at a certain extent. On the one hand, the government has hardened the budget constraints on state enterprises, so that managers of state enterprises must find to innovate themselves to survive. On the other hand, managers could get higher income as well as high political promotion in the government system from making state enterprises perform well (Cuong, 2004: 110-164). In addition, the process of development of private sector and foreign sector in Vietnam has created market pressure on state enterprises, so that state enterprises must improve themselves to exist in the market, given the decreasing government support. The dynamic development process of state sector in Vietnam has gone beyond the prediction of the Austrian school of thought on the important roles of private sector and market prices for economic development. This feature of Vietnam's economic reform also helps to reconsider the argument of the political economy approach that the socialist government will subsidize state enterprises, thus state enterprises are so much dependent on the government support, they will not innovate themselves for their development.

5. Concluding Remarks

In sum, the liberalization and emerging market institutions such as private property rights and free trade have helped Vietnam to achieve the high economic results over the reform period. It fits well with the prediction of Austrian School of thought on the role of private sector and entrepreneurship, rather than the theoretical model of market socialism. Nevertheless, the dynamic process of Vietnam's economic development goes beyond the analysis of the Austrian school, where state ownership still plays important roles to contribute to Vietnam's high economic growth. Furthermore, it is striking that the socialist government of Vietnam has been able to promote the economic reform within the context of dictatorship of proletariat and the dominance of the Communist party of Vietnam. It needs to reconsider further the arguments of both Austrian school of thought and political economy approach in these aspects.

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