

THE GREAT DIVERGENCE: POLITICAL ACCOUNTABILITY AND EXTRACTIVE CAPACITY IN VIETNAM AND CHINA IN THE REFORM ERA

NGUYEN KHAC GIANG
Victoria University of Wellington

Abstract

Using a historical institutionalist approach, this paper argues that changes in political accountability in the late 1980s, resulting in a more collective system in Vietnam and a centralised regime in China, led to the divergence of extractive capacity in the two countries. While the former moves towards a tax state model with an increasing dependence on the non-state sector and direct taxation, the latter depends on the state sector and indirect taxation for fiscal revenue. The different characteristics of extraction might pose different risks to the resilience of the two communist regimes.

Keywords: authoritarian resilience; tax state; market reform; state-owned enterprises; historical institutionalism

Introduction

Taxation implies politics (Bates 1989). The historical evolution of a state is closely correlated with the changing way it generates revenue. As the famous American slogan of ‘no taxation without representation’ goes, there is a widely held notion that the more democratic a state is, the more taxes it can extract. This notion has encouraged generations of political scientists and economists to compare how extractive capacity functions in democracies and autocracies (Acemoglu and Robinson 2006; Cheibub 1998). However, few studies examine how politics influences extractive capacity in autocracies. If each dictatorship is undemocratic in its own way (Svolik 2012, 20), are the extractive capacities of dictatorships different and why?

This paper addresses this question by focusing on Vietnam and China, two authoritarian regimes that have similarities in culture, revolutionary origin, ideological roots and economic development (Abrami, Malesky and Zheng 2013) yet possess different characteristics of rule and extractive capacities. This creates a perfect ground for a comparative study of two similar cases (George and Bennett 2004, 50). Specifically, using a historical institutionalist approach, I argue that political accountability had a strong impact on how extractive capacity was organised in the two countries after their respective reform eras. In Vietnam, political changes after *Đổi mới* (Renovation) in 1986 allowed the reformist faction to adopt a reform strategy that has become increasingly dependent on the non-state sector and direct taxation for fiscal revenue. This change, in turn, had a positive feedback effect on the regime’s behaviour: as non-state taxation

became the main source of income, the state was pressured to be more responsive to popular demand. In contrast, the Tiananmen Incident in 1989 and its political consequences concretised a conservative approach in preserving state dominance in China during the 改革开放 (Reform and Opening Up). As the regime was provided with a stable fiscal revenue, Beijing was allowed to maintain low accountability. However, this situation resulted in what Zhang (2017) calls a two-edged problem of growth and representation: to foster economic growth, the regime needs to tax more and thus become more accountable, yet doing so will create an undesirable liberalising pressure.

Before I proceed, it is important to clarify the concepts of political accountability and extractive capacity. In democratic theories, political accountability is often treated as electoral accountability, which is the ability of citizens to hold the state accountable by casting the ballot. This conceptualisation, however, is not suitable for analysing accountability in a non-democratic context where free and fair elections are non-existent. Furthermore, it neglects the internal aspect of accountability: ruling elites are not unitary, and different accountability mechanisms exist among them. Consequently, this research operationalises accountability as the effective representation (Moncrieffe 1998) of both the ruling coalition (internal accountability) and the population (external accountability). The former refers to the ability of different branches of state power to hold one another accountable, while the latter refers to the ability of the population to hold the state accountable. Extractive capacity is defined as the capability of a state to extract revenue to meet its fiscal need. Taxation is the most well-known component, but extraction in this sense includes non-tax revenues, such as natural resources in 'rentier states' (Herb 2005) or incomes from state-managed economic activities in 'domain states' (Schumpeter 1991).

This paper analyses the development of political accountability and extractive capacity in Vietnam and China in three stages: authoritarian stability (from the late 1970s to the early 1980s), authoritarian crisis (from the late 1980s to the early 1990s) and authoritarian consolidation (from the early 1990s to the present) (Figure 1). By focusing on the two macro-level variables, this paper follows other studies of historical institutionalism by examining large processes and paying special attention to contextualised situations and temporal elements (Pierson and Skocpol 2002; Pierson 2004). Taking the definition of critical junctures as 'relatively short periods of time during which there is a substantially heightened probability that agents' choices will affect the outcome of the interest' (Capoccia and Kelemen 2007, 348), the second stage can be regarded as a critical juncture. Effectively, the choice of the research period aligns this study with the critical juncture framework presented by Ruth and David Collier (2002, 30–31), which includes the analysis of the antecedent conditions, the cleavage that triggers the critical juncture, and its legacy. While the two regimes shared relatively similar antecedent conditions, the Tiananmen Incident served as a contingent event (Mahoney 2000, 153) that put China's political development on a vastly different trajectory vis-à-vis Vietnam's after the critical juncture.

The analysis is carried out in four steps. First, I examine the antecedent conditions in the two countries before the critical juncture, paying particular attention to the two regimes' fiscal situations. This section explains how the pre-reform fiscal systems in Vietnam and China were largely rent-based, therefore political accountability only

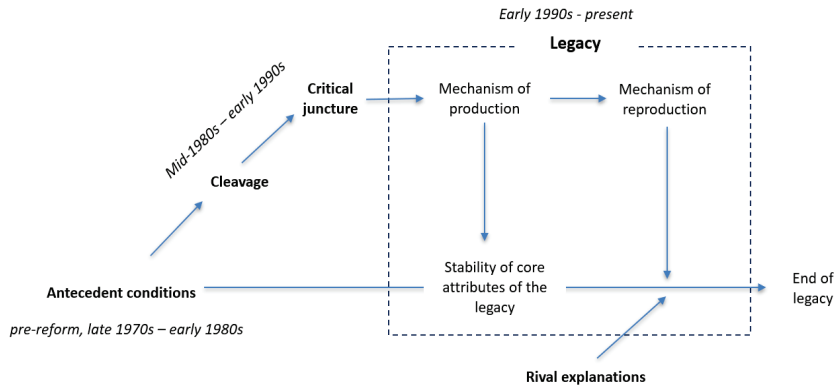


Figure 1: Building blocks of the critical juncture framework in the case of Vietnam and China. Source: Author's adaption of Collier and Collier (2002, 30).

played a minor role in the rulers' calculations for fiscal survival. This situation changed in the second stage of authoritarian crisis, where the cleavage created by the discrepancy between the market reforms and the socio-political constraints of the communist rule appeared. The changes in political accountability during this period had both immediate and long-term impacts on the extractive capacities of Vietnam and China.

Next, I examine the critical juncture's legacy in terms of extractive capacity, namely, the development of a tax state in Vietnam and a quasi-tax state in China. To do so, I compare two factors that determine the nature of extractive capacity – the role of state-owned enterprises (SOEs) and the characteristics of the taxation system – in the two regimes. This section also explains how a political system with more diverse interests prevented Vietnam from adopting the Chinese model of state-led development. In a way, it examines how choices made during the critical juncture have created the increasing returns processes that self-generate path dependence in the two regimes (Pierson 2000). Fourth, I examine alternative explanations of the development of extractive capacity in Vietnam and China that could challenge the explanatory role of political accountability. The paper concludes with a discussion of key results and methodological limitations.

Antecedents: Extractive Capacity in Pre-Reform Vietnam and China

Pre-reform Vietnam and China can be considered as non-tax states. Both countries were under a centrally planned system, where taxation was not important because all surpluses from SOEs and, to some extent, households were extracted and transferred to the state budget (McKinnon 1992, 99). There was a slight difference in the source of income: non-tax revenue, particularly from SOEs, was the main source of the Chinese government's income (Ma 2000, 20), while foreign aid played a key role in Vietnam's budget revenue. In a sense, before the reforms, Vietnam and China were typical of 'rentier state' and 'domain state' models respectively.

Both regimes struggled with fiscal stability. As a consequence of the Vietnam War, Hanoi was highly dependent on foreign aid, both in the South, which depended on American aid before the Fall of Saigon in 1975, and in the North, which was subsidised by the Soviet Union and China. The end of the war turned US aid into US blockade and sanction, while funding from the Communist Bloc declined in real value (Dang Phong 2009, 19). Increasing tensions with its wartime ally China – which eventually led to the third Indochina War in 1979 – deprived the country of a major foreign donor. Beijing had provided aid of around 300 to 400 million USD per year to Vietnam during the Vietnam War (Dang Phong 2009, 18). Because of the war in Cambodia in 1978, the country lost nearly 200 million USD in aid from the West (Vo 1990, 102). Furthermore, the country's wars on two fronts – with China on the Northern border and Khmer Rouge's Cambodia on the Southern border – drained its financial and human resources. The consequences were disastrous. The budget deficit in 1981 alone tripled that of the whole period from 1976 to 1980 (Vietnamese Communist Party 2006a).

In China, after years of chaos due to the catastrophic policies in the Great Leap Forward and the Cultural Revolution, the economy was in dire need of reform (Meisner 1996). The new leadership at first attempted to rebuild institutions and recentralised the economy based on the ambitious Ten-Year Plan. However, the plan – which depended on unrealistic expectations of oil exploitation – collapsed by the end of 1978 (Naughton 1995, 71–74). The Third Plenum – which established Deng Xiaoping as the undisputed leader – decided to put forward an economic readjustment policy that shifted the focus onto agriculture and light manufacturing industry. Almost immediately, the economic situation improved. However, as a result of the changing economic policies – including a substantial increase in the purchase price of agricultural products, rural tax exemptions, the introduction of a reward system and the increasing financial power of the provinces and SOEs (People's Daily 1980) – the fiscal situation worsened. Fiscal revenue in 1981 decreased by nearly 10 per cent vis-à-vis the 1979 number, despite the decent economic growth (Zhao 1982, 159).

Deteriorating economic and social circumstances in both countries gave the regimes a pretext for market reforms as well as monumental changes in the critical juncture, with huge implications for their extractive policies.

The Cleavage and Critical Juncture

By the late 1980s, as a result of the market reforms, Vietnam and China had become increasingly dependent on taxation for budget revenue as each state gradually retreated from the economic sphere. In each country, the initial foundation for a tax state emerged, yet their paths diverged: Vietnam applied a 'shock therapy' by liberalising the economy in a short period of time, while China took a gradual approach and maintained a strong state presence in the economy. Consequently, while the former increasingly depended on the non-state sector for fiscal revenue, the latter's main source of income was still the state sector. The differences in each regime's political development during the critical juncture can explain this divergence.

In Vietnam, the ‘shock therapy’ and the move towards a market economy could not have happened if the Vietnamese Communist Party (VCP) had remained under the control of General Secretary Le Duan by the 6th VCP National Congress in 1986. The death of Le Duan, just a few months before the Congress, gave rise to a more collective leadership, under which different factions were able to promote competing economic policies. The decision to transform the economy from a centrally planned to a market-oriented one, for example, was not unanimously supported within the party; rather, it was fiercely opposed by the conservative faction. Indeed, the advisory team responsible for drafting the political report of the 6th Congress consisted of strong supporters of the planned system. Truong Chinh, who was appointed as the caretaker general secretary of the VCP, replaced the whole team with some of the most reformist minds in Vietnam at that time and thus was able to set the tone for the 6th Congress as a ‘*Đổi mới*’ (Renovation) Congress (Dang Phong 2008, 297–98). In addition, the three most senior leaders at that time – Truong Chinh, Pham Van Dong and Le Duc Tho – retired at the 6th Congress, levelling the playing field for the succeeding generations (Huy Duc 2012). Reformist leaders – including General Secretary Nguyen Van Linh, Vice Prime Minister Vo Van Kiet and Foreign Minister Nguyen Co Thach – were able to put forward a reform agenda. It is also noteworthy that, unlike China, SOEs were not considered a reliable source of income, and Hanoi had to increasingly depend on the non-state sector for revenue as foreign aid – their previous main income source – collapsed. This gave the leadership the opportunity to accelerate the ‘commercialisation’ of the state-dominated economy, where non-state actors played an increasingly important role (Nguyen Xuan Oanh 2001). Contributions from the state sector to budget revenue dropped significantly from 64.2 per cent in the period from 1986 to 1990 (Vietnam Ministry of Finance 2021) to just 28 per cent in 1995 (Vietnam National Assembly 1996). The sequence of impacts is illustrated in Figure 2.

In China, early reformist leaders attempted to transform the socialist fiscal model into a more market-oriented system in which taxation played a key role. In addition to improving the state budget, they wanted to create a political constituency to support further reforms, along with peasant smallholders, wealthy non-agricultural households in rural areas and reform-minded intellectuals (Naughton 1995, 190). However, the programme failed to materialise. The failure was political as much as economic: as a consequence of the worsening macro-economic situation in the late 1980s, the reformist faction was side-lined and eventually replaced after the Tiananmen Incident (Figure 3). The subsequent political centralisation allowed the central government to carry out unpopular changes, particularly fiscal policies (Chen, Hillman and Gu 2002; Chung 1994). SOEs remained the main income source for the state, accounting for more than half of total government revenue by the late 1990s (Qian 2003, 329). Moreover, the reform turned value-added tax (VAT) into the single most important source of income. Because VAT is a ‘hidden tax’,¹ it helps the regime defer the transformation into a genuine tax state so it remains what Zhang (2017) dubs a ‘half-tax state’.

1 Citizens might fail to notice the burden of VAT as the tax is included in the price of goods and services.

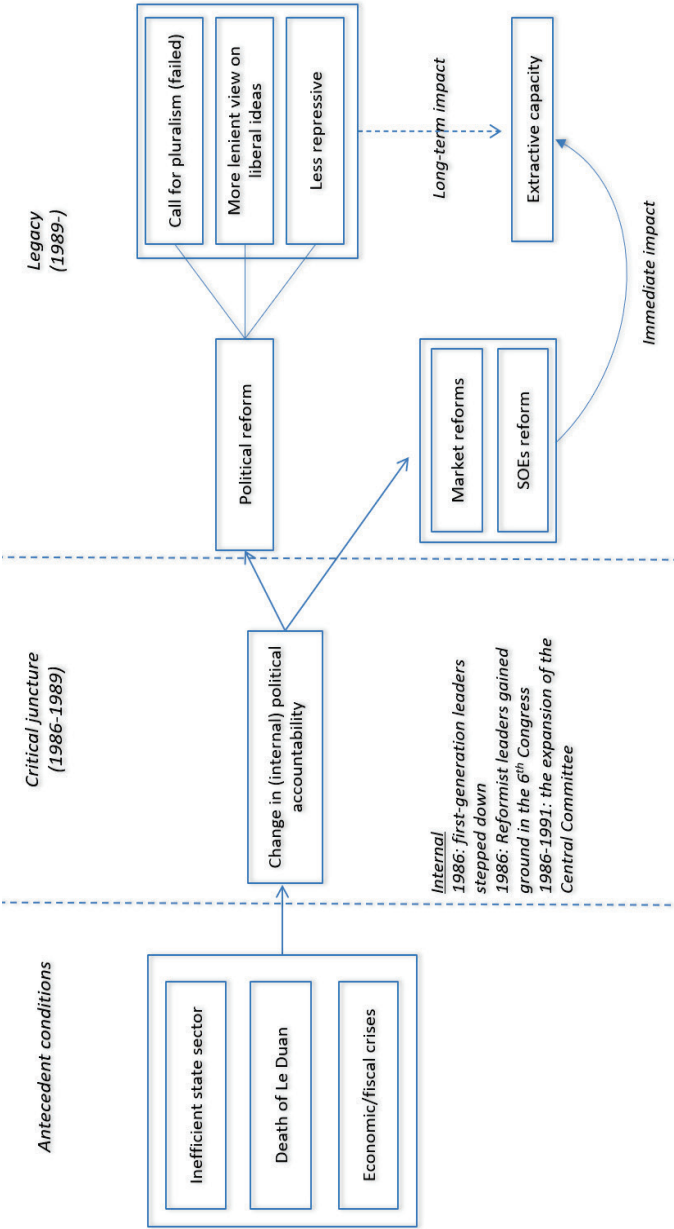


Figure 2: The sequence of political change and extractive capacity in Vietnam's critical juncture. Source: Author's design.

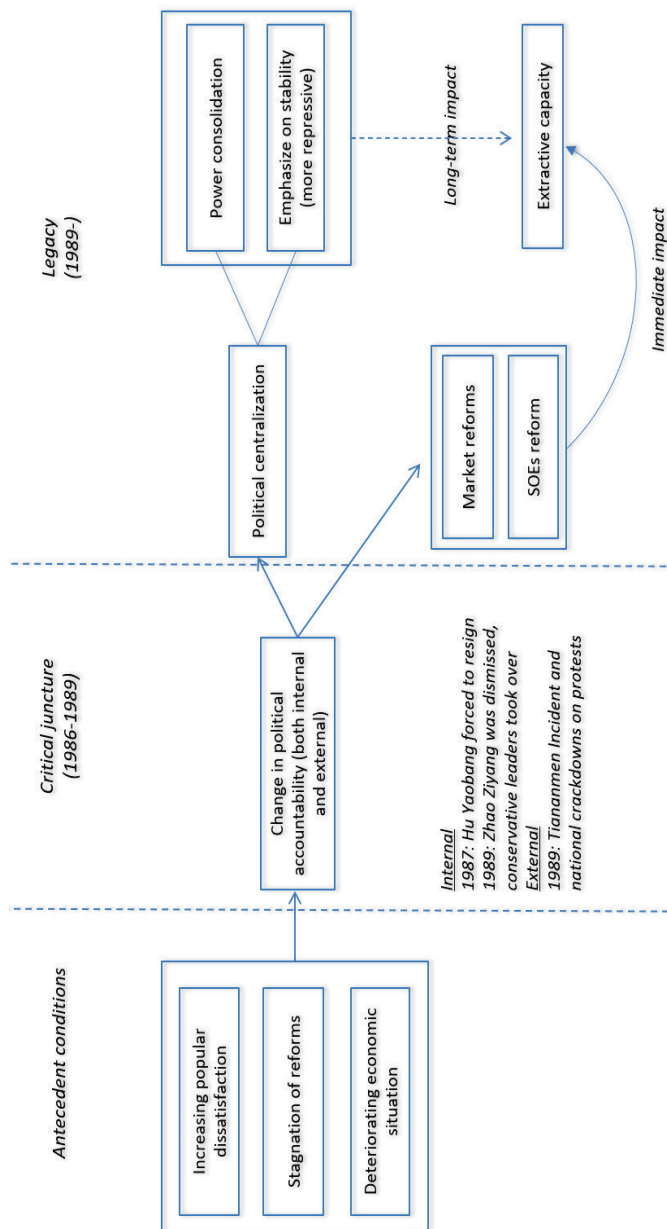


Figure 3: The sequence of political change and extractive capacity in China's critical juncture. Source: Author's design.

In sum, changes in political accountability during the critical juncture had a strong impact on the characteristics of extractive capacity in the two regimes. In the short term, the dominance of the reformists brought about a market reform policy that was more tolerant towards the non-state sector in Vietnam. In China, more centralised rule after the Tiananmen Incident allowed the regime to regain control of fiscal resources, scaling down the development of the private sector while greatly expanding the state sector, which saw the investment growth rate from 1990 to 1992 triple that of the 1980s (Huang 2008, 23). These distinctive attributes have been reproduced and reinforced since the critical juncture, setting path dependence for the evolution of extractive capacity in Vietnam and China. Although the political opening up in Vietnam was far from ‘democratisation’ and was soon scaled back after the collapse of global communism in the early 1990s, it did shape the regime’s more lenient approach to the population. This, in turn, allowed Hanoi to extract more from the non-state sector. The emergence of crude oil exports in 1989 unexpectedly alleviated Hanoi’s budget concerns for a while. However, drops in oil revenue in the mid-2000s again redirected Vietnam towards a traditional tax state model. In contrast, political centralisation gave Beijing the discretion to carry out its economic strategies with little objection, including the 1993–94 fiscal reforms and the decision to maintain a strong state presence in the economy. This helped stabilise China’s fiscal situation – particularly at the central level – and China gradually established a unique fiscal regime that is a mixture of a quasi-tax, quasi-rent and quasi-domain state.

Political accountability defined the characteristics of extractive capacity in Vietnam and China in the critical juncture of the late 1980s. The next key questions are whether, how and for how long these patterns were upheld when the two countries moved to the stage of authoritarian consolidation. To answer these questions, the next section examines the characteristics of extractive capacity in the two regimes from the early 1990s to the present.

Political Accountability and Extractive Capacity in Vietnam and China after the Critical Juncture

Political accountability affects extractive capacity in two main ways. First, it determines the sources of fiscal revenue. A less accountable regime is more dependent on either resource rents or the state sector. This was the case for Vietnam (rentier state) and China (domain state) before their market reforms. Second, political accountability determines the characteristics of taxation policies. A less accountable regime is more likely to focus on indirect taxation, such as VAT, that is less visible to the population, which helps rulers avoid the principle of ‘no taxation without representation’. Accordingly, the more politically accountable Vietnamese regime has an extractive capacity that is less dependent on the state sector and non-tax revenue and sees an increasing share of direct taxation in its budget. By contrast, the less politically accountable Chinese regime depends on the state sector and non-tax revenue for income generation, as well as having a substantial share of revenue coming from indirect taxation. The following section analyses the characteristics of fiscal revenue in the two countries to test this hypothesis.

The Diverging Role of SOEs

In China, the 1993–94 fiscal reforms marked the abandonment of the old socialist system that relied on state industrial enterprises but did not transform it into a tax state. Taxes from SOEs still contributed to at least 30 per cent of the state budget in the period from 2003 to 2018 (Chinese Ministry of Finance 2019). Furthermore, it should be noted that since 2013 the Chinese Communist Party (CCP) Central Committee has encouraged the ‘mixed ownership form’, which allows the fusion of SOEs and the private sector (Chinese Communist Party 2013). As official data does not break down the sources of tax revenue from mixed ownership, it is impossible to extract the precise amount of the tax contribution from state-owned shares in joint-stock companies and limited companies, which together contributed 49 per cent of the total tax revenue in 2018 (Chinese Ministry of Finance 2019). Accordingly, the tax contribution of the state sector could be much higher than the available data suggested.

More importantly, the growing investment of SOEs in the private sector allows the state to control private businesses without holding majority shares. Bai *et al.* (2020) show that the number of ‘connected’ private owners – those who have connections directly or indirectly with SOEs – has increased dramatically in the last two decades: while their registered capital accounted for 16 per cent of all registered capital in 2000, this rose to 35 per cent in 2019. Among the top 100,000 businesses in China, state-affiliated businesses account for 61.4 per cent. This figure includes only ‘visible’ equity ties and excludes the implicit ties of regulatory control, the state’s discretionary power to intervene and individual connection (Feng 2019; Reuters 2019; Yang *et al.* 2020).

By contrast, the contribution of SOEs in Vietnam’s state budget has declined substantially since the early 1990s. While they accounted for more than 65 per cent of budget revenue in 1991 (Vietnam Ministry of Finance 2021), SOEs only contributed 12 per cent in 2019. Over the past two decades as the two countries have taken concrete steps towards a market economy, Chinese SOEs have contributed a much greater amount to state revenue than their Vietnamese counterparts have done (Figure 4). Although the proportion might have declined slightly in number, the significance of Chinese SOEs did not change significantly as the decrease in tax contribution is compensated by non-tax revenue, the majority of which comes from SOEs.²

The fundamental difference between the reform of SOEs in China and Vietnam is that while China tends to empower SOEs, Vietnam reduces both their size and influence. Among the top 100 biggest enterprises in China in 2020, 63 are SOEs; three are directly connected to SOEs; and 31 are indirectly connected to SOEs (Bai *et al.* 2020, 15). In Vietnam, 52 of the 100 biggest enterprises in 2007 were SOEs (Vietnam Report 2007), but this number decreased to 38 in 2019 (Vietnam Report 2021). While the reform of SOEs in Vietnam prioritises the speed of state divestiture and equitization (or privatisation) (Vietnamese Government 2020), Beijing aims to enhance the power of SOEs in the economy (Chinese Communist Party 2013). From 2010 to 2020, the

2 The high non-tax revenue in Vietnam during the 2000s resulted from high dependence on oil exports; see Figure 5.

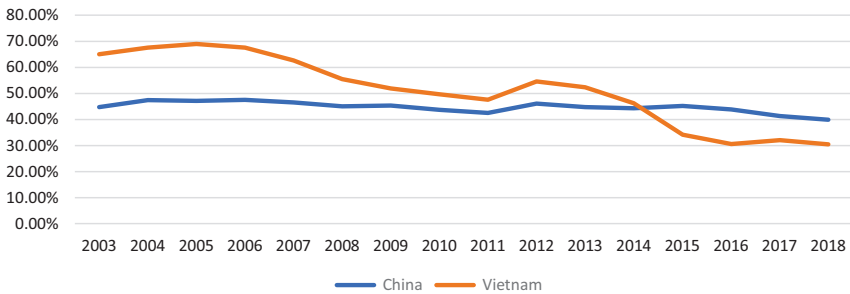


Figure 4: Non-tax revenue (including income from SOEs) in Vietnam and China, 2003–2018.
Source: Author's compilation from the Chinese Financial Yearbook database and Vietnam's Ministry of Finance's database.

Vietnamese government divested itself of 208 trillion VND (9.5 billion USD) of equity in SOEs (Pham Thi Van Anh 2020). By contrast, the long-term equity investment of Chinese SOEs increased three-fold from 3,045.07 trillion yuan (47 billion USD) to 10,668.49 trillion yuan (164 billion USD) during the period from 2009 to 2018 (Chinese Ministry of Finance 2019). In short, during the reform era, while Chinese SOEs have maintained their flagship role, Vietnamese SOEs have seen their influence sharply decrease.

This change, however, does not mean that the Vietnamese regime wants to have a smaller state presence in the economy. In various party documents, including the most important ones, such as the Congresses' political reports, the VCP remains adamant that the state sector is the nucleus of the 'socialist market economy' (Vietnamese Communist Party 1986, 2006b, 2021). Throughout the course of *Đổi mới*, Hanoi repeatedly tried to shore up the state sector in a strategy of 'grasping the large, letting go of the small' identical to China's (Sakata 2020). In the early 1990s, the state gathered the largest SOEs to create eighteen national state-owned general corporations in order to build the 'pillars of a market-oriented economy', in the hope that these SOEs would have 'advanced technology, efficient economic performance, and contribute significantly to the state budget' while 'taking up the flagship role in the economy, setting the foundation for economic growth as well as solving social issues' (Vietnamese Communist Party 2013, 377). In 2006, at the height of a successful spell of economic development, the Vietnamese Prime Minister, Nguyen Tan Dung, initiated an ambitious plan to regroup the largest SOEs into twelve state-owned conglomerates, which would become the 'iron fists' of the economy (Vu-Thanh 2017). These plans resembled the reform of SOEs agenda in China, which built 'dragon-head enterprises' to take control of key economic sectors (Chan 2009). However, the results were opposite. The 'iron fist' policy was heavily criticised after just two years of implementation. PM Dung was close to being disciplined for economic mismanagement, only managing to avoid punishment at the last minute (Vuving 2013).

While many factors contributed to the failure of these reforms in Vietnam, diverse elite interests and public pressure played a critical part. The National Assembly's representatives frequently used public dissatisfaction as a pretext for criticising the government's policies. On one occasion, representatives asked the PM to resign over his role in the mismanagement of SOEs (Malesky 2014, 92). Public challenges never arose in China. In addition, because major policies must be approved by the Central Committee (CC), in which provincial elites hold the majority, it is not easy to construct a Chinese-style SOEs policy in which most profits would be transferred to the centre. Empirical evidence shows that the private sector is better than SOEs in contributing to economic growth and alleviating poverty in Vietnamese provinces (Jaax 2020; Van Thang and Freeman 2009), making it even less tempting for provincial leaders to treat SOEs more favourably. This effect is enhanced by the practice of 'Vietnamese-style gerrymandering': the creation of new provinces that are less dependent on SOEs for revenue, thus establishing a winners' coalition in the CC (Malesky 2009).

In comparison, unified political control allowed the CCP to reform SOEs with almost no opposition (Yu 2019) and in a concerted bureaucratic effort (Chan 2009, 52). In fact, Chinese SOEs only became profitable in the late 1990s after a long period of struggle (Ma 2011; Sachs and Woo 2003). The Chinese state carefully protected the domestic market and privileges of SOEs, despite the country's integration with the global trade system (Wolfe 2017). In contrast, in exchange for major trade deals, Vietnam has to give concessions on SOEs reforms, particularly regarding the transparency of their businesses, state subsidies and market regulations (Hoang and Hoan 2019). In key indicators, Chinese SOEs do not perform significantly better than Vietnamese SOEs. The former had a return on assets (ROA) ratio of 2.9 per cent in 2018 (Chinese Ministry of Finance 2019), equal to just one-third of the private sector (Kennedy 2020). The latter had a ROA ratio of 2.2 per cent (the FDI sector had a ROA ratio of 7 per cent and the private sector, 1.8 per cent) in 2018 (Vietnamese Ministry of Planning and Investment 2019). The persistence of SOEs in China, in other words, reflects a political rather than an economic rationale.

'Hidden Taxation' and Direct Taxation

Some taxes are more easily felt by the population than others. Authoritarian regimes prefer indirect taxation, such as VAT, to personal income taxes (PIT) because it is not directly levied on the population (Ma 2011). The characteristics of the taxation systems in Vietnam and China vividly illustrate this tendency.

Since the market reforms, the two countries have adopted a taxation strategy that depends heavily on indirect taxes, particularly VAT. When first introduced in 1985, VAT only accounted for 7.2 per cent of China's total tax revenue. After the 1993–94 reforms, VAT accounted for 43 per cent of its total tax revenue in 1995 (National Bureau of Statistics of China 2010). The share of VAT has remained stable over the past three decades, with VAT accounting for 45.1 per cent of the total tax revenue in 2019 (China State Taxation Administration 2019). In Vietnam, VAT was introduced in 1997, it almost immediately became one of the most important sources of state income. However, the share of VAT in Vietnam's tax revenue is significantly smaller than in China. In the period from 2006 to 2019, VAT accounted for around 25 per cent of the

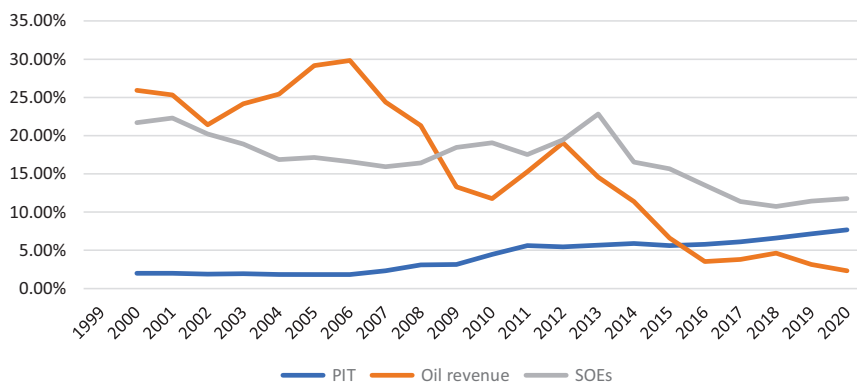


Figure 5: Revenue shares from SOEs, oil exports and PIT in Vietnam, 2000–20. Data from 2000–7 is tax on high-income earners; from 2007 onward it is PIT. Source: Author’s compilation from Vietnam General Statistics Office and Ministry of Finance.

country’s total tax revenue (Thu Hong 2020). Chinese VAT rates are higher than those in Vietnam and among the highest in the Asia–Pacific region, whether counted by the highest applied rate or by the averaged rate (Tan and Zhu 2013).

PIT was first adopted in China in 1980 (Zhan, Li and Xu 2019), while in Vietnam a formal personal income tax law was not issued until 2007. However, PIT has quickly increased its share in Vietnam’s total budget revenue. Interestingly, its increase coincided with decreases in the shares of oil revenue and SOEs (Figure 5). In China, although the number of nominal taxpayers is high, the share of PIT has remained modest throughout the Reform and Opening Up.

Comparing PIT in Vietnam and China with PIT in India, the world’s largest democracy, and Taiwan, a vibrant democracy with similar cultural characteristics, is revealing. PIT revenue in India was consistently higher than that in China and Vietnam during the period from 1999 to 2020 (Figure 6), although significantly fewer people are obliged to pay PIT (as percentage of the total population) in India. While 15 per cent of the population in China and 7.5 per cent of the population in Vietnam are subject to pay PIT, only 1 per cent of the Indian population are eligible (Financial Express 2020). In Taiwan, PIT accounted for just 5.6 per cent of government revenue in 1975 when political democratisation began. In 1996, when the first democratic election was held, the PIT share rose to 12 per cent and has since remained relatively stable above 15 per cent of the total government revenue (Taiwan Ministry of Finance 2021).

Piketty and Qian (2009) hypothetically projected that if China retained the current (2008) PIT threshold, then 50 per cent of the Chinese population would have to pay PIT by 2015., and PIT would account for 10 per cent of China’s GDP and thus have a huge impact on the country’s political prospects. This projection did not happen, however.

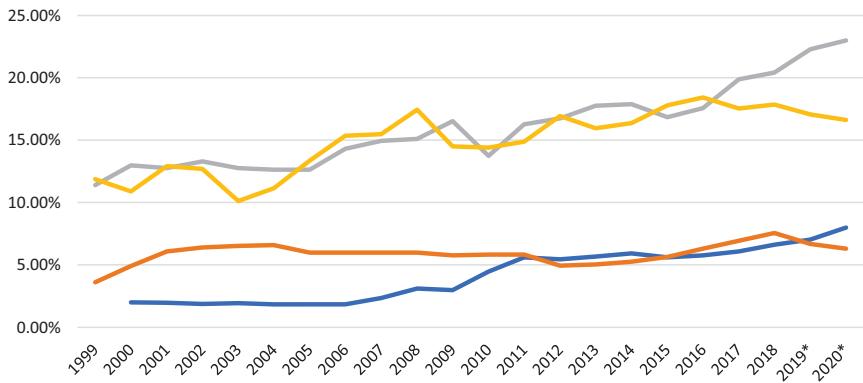


Figure 6: Personal income tax: Vietnam, China, India and Taiwan compared (percentage of government revenue), 1999–2020. Source: Author's compilation from Vietnam's Statistical Office, Vietnam's Ministry of Finance, China's National Bureau of Statistics, China's Ministry of Finance, India's Ministry of Finance, and Taiwan's Ministry of Finance. * Data for 2019 and 2020 are estimated.

By 2018, PIT revenue accounted for 7.6 per cent of the government's total revenue and was equivalent to less than 1.5 per cent of the GDP. In 2019, PIT's share in government revenue decreased to 5.4 per cent. It is difficult to speculate whether leaders in Beijing intended to keep PIT low in order to avoid the risk of popular pressure; however, this characteristic is noteworthy, as scholars have observed how states that raise significant revenue from income taxation face strong demands for accountability (Besley and Persson 2013; Fukuyama 2011; Ross 2018). Tax avoidance remains a big issue in China, as only 28 million of 187 million eligible people paid PIT in 2015 (Economist 2018).

In short, although both countries favour indirect taxation in their extraction practices, China tends to be more dependent on VAT, while PIT plays a minimal role in the state budget. In contrast, Vietnam's state revenue has transformed dramatically from a rent-based system into a more tax-based one, in which PIT plays an increasingly important role.

Vietnam as China's Path not Taken

Up to now, the paper has analysed how Vietnam's and China's extractive capacities have evolved and diverged in the past four decades. My main argument is that differences in political accountability can explain this divergence. A more collective leadership system and higher external accountability prevented Hanoi from having a consistent SOEs policy that could have provided the regime with a stable source of income as China has achieved. This political arrangement, however, allowed Vietnamese rulers to implement direct taxation when non-tax revenue – particularly from natural resources – could not

keep up with the growing need of public expenditure from the early 2000s. By contrast, centralised leadership gave Beijing the discretion to develop a state-led economy with SOEs dominating, while limiting its option to implement taxation. There are, however, alternative theories that account for this differentiation in extraction patterns.

First, tax collection capability matters. China's fiscal income may depend on revenue collected from SOEs and VAT because the Chinese state is unable to extract taxation from the non-state sector as efficiently as the Vietnamese state does. This line of argument leads to a conclusion that Vietnam's tax governance is better than China's. This sounds counter-intuitive, as higher-income countries tend to have greater tax capacity (Teera and Hudson 2004). China also has a much larger urban population and an economy that is less dependent on agriculture, two conditions that help strengthen the state's capability to collect taxes. The total tax and contribution rate (% of profit) of enterprises operating in China (surveyed in Beijing and Shanghai) stood at 62.6 per cent, doubling East Asia's average and 20 percentage points higher than OECD countries in 2020 (World Bank 2021a). The rate in Vietnam was 37 per cent (World Bank 2021b), half of China's, but enterprises had to spend nearly 400 hours per year to pay taxes, compared to just 128 hours in China. If anything, this suggests that China possesses a much more efficient tax governance system than Vietnam does, because it collects a larger portion of tax from enterprises' profits with a much smaller amount of time required. Since the 1993–94 reforms, the Chinese tax administration has been greatly strengthened and much more centralised. China's tax collection agency (under the direct management of the State Council) was divided into local and central bureaus in each province, and the central bureaus were tasked with collecting the shared taxes, including the biggest taxes, such as VAT, corporate income tax and PIT. In 2018, the local tax bureaus were merged into the central bureaus, further consolidating the central government's control over taxation (KPMG 2018). In Vietnam, there is only one local tax bureau in each province; the bureaus' operational costs – including salaries – are covered by the provincial governments, thus aligning them with local interests.

Another useful indicator for comparison is the amount of tax revenue collected per tax official. In 2019, the number of tax officials in China was 720,000, and they collected a total tax revenue of 15.6 trillion yuan (2,397 billion USD) (China State Taxation Administration 2019). Thus, the amount of tax revenue collected per official was 3.33 million USD. In the same year, the number of tax officials in Vietnam was 39,995 (Trung Kien 2020), and tax revenue was 1,276 trillion VND (55 billion USD) (Vietnamese Ministry of Finance 2020). The tax revenue collected per official in Vietnam was 1.37 million USD. The higher level of tax collection efficiency in China vis-à-vis Vietnam shows that geographical and size differences do not convincingly explain the divergence in extractive capacity.

Second, extraction patterns might depend on the historical legacy of each country's development model. Even if the Chinese political leadership had become more collective-based as happened in Vietnam, the regime would have maintained a fiscal system that depends on SOEs and indirect taxation. To put it bluntly, there is no critical link between political accountability and extractive capacity. To provide a counter-factual analysis of what might have happened is difficult and speculative in nature (Capoccia and Kelemen 2007); however, there are reasons to believe that this line of argument was not the case.

First, tax rebellions have historically been major threats for different Chinese regimes and dynasties throughout the country's long history (Bernhardt 1992; Bernstein and Lu 2002; Fukuyama 2011). Communist rule is not an exception. Concerns about tax resistance appeared frequently in the party's documents from the mid-1980s, when the second phase of market reform was implemented (China's State Council 1987). After the recentralisation of fiscal revenue, local governments imposed excessive taxes and fees on farmers to secure their budget, which led to an increase in tax riots in rural China during the 1990s and early 2000s (Bernstein and Lu 2002). The Chinese leadership certainly had political stability in mind when deciding to carry out rural tax reforms and ultimately abolished agricultural taxes (Liu *et al.* 2012; Yep 2004).

Second, if we consider Vietnam as 'China's path not taken' (Schuler 2020b), then we might be able to construct an alternative set-up of China's fiscal regime after the critical juncture of the late 1980s. A more collective-based leadership might have empowered different factions, such as provincial elites or reformists, with different – sometime opposing – economic and political interests. Indeed, before the Tiananmen Incident and the subsequent fall of the reformist faction, 'Reform and Opening Up' in China was a process of decentralisation (Naughton 1995; Shirk 1993). The recentralisation after 1989 – particularly the 1993–94 fiscal reforms – effectively ended this 'federalism with Chinese style' (Huang 2008, 111–12; Zheng 2007). At that time, the CCP's General Secretary, Zhao Ziyang, led political reform efforts that were characterised as a 'soft authoritarian alternative' with a much more open attitude to 'interest-group pluralism' (Baum 2008, 113; Zhao 2009). If these efforts had been successful, then a development strategy that required a long-term commitment with an enormous cost, such as the SOEs programme, would have been much more difficult to achieve.

Conclusion

We can be proud that the high revenue reflects the people's confidence in the government ... not because of the government's excessive extraction efforts. If the people do not trust the government, they will try to avoid taxes.

—Vietnamese PM Nguyen Xuan Phuc (Duc Tuan 2020)

The comment above, made by the Vietnamese PM, captures a dramatic turnaround in Hanoi's fiscal strategy from a total disregard of taxation as 'capitalistic' to full recognition of its importance to the one-party state's fiscal revenue. This paper shows that the PM's comment is not merely rhetorical. Adopting a historical institutionalist approach, this paper explained how extractive capacities in Vietnam and China diverged after the critical juncture of the late 1980s. While Vietnam moved towards a tax state with an increasing dependence on taxation from the non-state sector and direct taxation, China depends on the state sector and indirect taxation for its fiscal need.

The different characteristics of political accountability in the two countries is the main explanatory factor. Vietnam's diverse political leadership contributes to their inconsistent SOEs policy, which was dragged back by 'the contradictions and

conflicting objectives' (Kokko and Sjöholm 2000, 261). In contrast, despite concerns over corruption and inefficiency, Chinese SOEs have been guaranteed monopolistic power over the economy (Duan and Saich 2014). Given Vietnam's empowered National Assembly (Schuler 2020a; Malesky and Schuler 2010), genuine public interest in SOEs has fuelled public debates and queries about government performance, serving as an informal accountability mechanism. Foreign pressure is another mechanism of accountability in the case of Vietnam. As a middle-power and a trade-dependent economy, Vietnam is under enormous pressure to carry out reforms to SOEs in exchange for trade deals with Western partners. These agreements – particularly the granting of American Permanent Normal Trade Relations (PNTR) status in 2006, World Trade Organisation (WTO) membership in 2007, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) in 2018 and the EU–Vietnam Free-Trade Agreement (EVFTA) in 2020 – have further curbed the influence of Vietnamese SOEs in the past 20 years. These pressures rarely exist in the much more self-assured, centralised regime of China.

Leaders in Hanoi and Beijing are fully aware of the link between taxation and representation. Taxpayers' consciousness can easily evolve into political consciousness, which threatens a regime's survival. China's rural unrest in the 1990s and the regime's subsequent agricultural tax reforms served as a lively example (Bernstein and Lu 2002). Indirect taxation offers a viable solution, because it allows rulers to extract substantial revenue without creating bottom-up pressures from taxpayers. This explains why indirect taxation, such as VAT and environmental protection taxes, plays a critical role in the fiscal revenue of both regimes. Although tax rates in China are among the highest in Asia, a 2014 national survey found that less than 10 per cent of respondents thought their tax burden was too high (Zhang 2017, 48).

The characteristics of extraction affects the characteristics of rule and ultimately decide a regime's democratisation prospects (Tilly 2009). In this sense, the relationship between accountability and state capacity can be seen as an evolving, symbiotic process with the 'positive feedback' effect embraced by historical institutionalist scholars (Pierson 2004; Thelen 1999). This relationship is not unique to Vietnam and China. For example, in his study of post-communist state-building in Eastern Europe, Gerald Easter (2008) shows that tax compliance is high in Poland because the state manages to achieve a considerably high level of consent from the society, while non-compliance is common in Russia, even when the state employs a coercive strategy, because it lacks effective institutional and legal checks on state power and an empowered civil society. The Russian state's dependence on oil and gas revenue, thus, is linked to its low level of political accountability.

Making a comparative case study of two 'successful' autocracies, this study suffers from the limitations inherent in the case study approach (Gerring 2007, 244). The ability to generalise is lacking, and the ability to quantify the causal effects of political accountability on extractive capacity is limited. Future research might explore the link between political accountability and extractive capacity in other non-democratic states and carry out quantitative tests when appropriate data is available.

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Biographical Note

Nguyen Khac Giang is a PhD candidate at Victoria University of Wellington where he compares Vietnamese and Chinese political developments. Giang is also a research fellow at Vietnam Centre for Economic and Strategic Studies (VESS). Giang is a frequent commentator on Vietnamese affairs and writes extensively for major Vietnamese and English news outlets.

